

Part B3 – Management & General (M&G)**Summary Report by REPORTER****Summary of Audit Findings & Reporter Opinion**

We consider the M&G business cases are based upon sound principles and robust methodologies and the levels of investment are supportable.

The M&G business cases included in this Part B3 Report are:

- IS (Information Services, aka IT);
- SCADA;
- Buildings including Fire Reform Order;
- CARE (Conservation, Access, Recreational and Educational);
- Furniture and Laboratory Equipment; and
- Vehicles

Reporter Engagement & Scope of Audit

(TEXT REDACTED) The Company published its final B3 Submission on 6th April 2009. Before that we reviewed the M&G supporting documents through undertaking a series of audits on the 4th, 13th, 24th and 25th February, and 10th and 24th March at the Company's offices in Reading.

The audits consisted of interviews with the Thames team responsible for the preparation of the M&G part of the Part B3 submission. This included a review of the data, assumptions and methodology that underpin the submission, and a review of the analyses.

We confirm that we have reviewed all of the Company's M&G submission, are satisfied that it is complete and consider that it generally conforms to the Company Reporting Requirements.

We have followed the Reporter Guidance and have addressed the points set out in our Audit Plan. (TEXT REDACTED)

We have seen evidence that the Company's submission has been subject to a rigorous level of internal checking and challenge and are satisfied that there has been appropriate input and oversight from the Company's Senior Managers and Directors. (TEXT REDACTED)

We found the Company teams responsible for the business cases documentation capable, responsive and co-operative and the response to our Audit was conducted in a professional and robust manner.

Summary of the Company's Proposals

We confirm that the Company's submission, tables and supporting documents are complete. The Company is supporting the Levels of Service in all M&G business cases. In the IS case by replacing obsolete hard and software, including supporting the planned adoption of SAP. We noted in our DBP Report that this was not supported by CBA, but this has now been satisfactorily provided for FBP.

The SCADA case improves the control and intervention timing of both the Water and Sewerage systems. We noted in our DBP Report that this too was not supported by CBA, but this has now been satisfactorily provided for FBP.

The Buildings case maintains operational and non-operational structures in adequate, and through AMP5, preventing deterioration and by so doing improving condition. (TEXT REDACTED) The Company has made reductions from other DBP M&G case values by reviewing scope and cost, which is off-set by the Fire Reform addition.

The CARE case is not directly related to Service but was supported by customer preference. This case has been reduced in the Company's final plan of 6th April 2009.

The Furniture case, and particularly Laboratory Equipment, maintains the Service.

The Vehicles case continues the provision of necessary transport but also captures the cost savings of moving to purchase rather than lease, as foreseeable in the autumn of 2008. The change criteria have not been revisited by the Company in the light of the continuing recession, although it will keep the emerging economic situation under review. The Company has also introduced further controls over vehicle use and expenditure.

Across the M&G investment the Company has made no allowance for price changes as a result of the current economic downturn. The Company considers this approach to be appropriate as it cannot robustly demonstrate what changes in price levels will apply across the AMP5 period.

The current recession may enable the Company to drive lower acquisition costs in all the M&G cases.

The implementation risks are all in the control of the Company, and there should be no barriers to implementation.

Summary of Audit & Review

TEXT REDACTED

We found that the Company disclosed all the information and support that we requested, and the Company teams were competent, capable and co-operative.

We found that the Company has complied with the Company Guidance. The Company is not proposing any new activities, but the continuation of existing policies, other than the step change in SCADA investment in AMP5. The Company's plans are in line with the general principles and practices of the industry.

We found that all the M&G business case plans are likely to deliver the expected outcomes and should prove fit for purpose.

The M&G business case for IS (IT) is supported by business need and we found the investment totals reasonable for the assets involved.

The M&G business case for SCADA is supported by business need and we found the investment totals reasonable for the assets involved

The M&G business case plans for IS will deliver Opex savings. (TEXT REDACTED) This includes reduced head count is planned from the introduction of SAP. As it happens the introduction of parts of SAP has been delayed (Customer Centre System) and this would otherwise have some delay to the head count reduction but the Company has retained its original forecast in the back-end of AMP4 in any case, taking any change as Company risk. The delay in part SAP implementation will alter the IS investment profile, but the overall investment in the AMP period is likely to remain the same.

The M&G business case plan for Buildings is supported by business needs and sweeps-up some under investment in AMP4. The overall investment estimate, which includes Listed Buildings, appears reasonable for the Buildings stock, but we found the sample of the maintenance cost model we reviewed erred on the high side. This is unlikely to have a material impact on the AMP5 estimate as investment needs are costed from detailed surveys, but it would have impact over a Building life-cycle maintenance cost. We recommended that the Company review its cost model, which it is doing.

The Company has introduced a Fire Reform business case separately from the Buildings case. This investment is driven by statutory requirements. The

Company has chosen the lesser standard of people protection rather than people and property, and this is understandable as there is separate provision already made for Buildings that are occupied; and insurance provisions are not compromised.

Furniture and Laboratory Equipment case is supported by business needs with a planned marginal increase in expenditure over AMP4 primarily in Laboratory Equipment to keep pace with technology development and retain the Company in-house capability.

The Vehicles case is supported by the business needs, and the Company has changed its procurement strategy from leasing to acquiring. There is a small cost benefit case for this change.

The M&G business case plan for CARE not supported by business needs, but is provided under environmental drivers for public access to certain sites. The Company opts for do minimum, which in these current times is understandable.

The Business Cases

IS

We carried out an in depth technical assessment and we audited the supporting cost spreadsheets. We found the IS investment totals reasonable for the purpose and assets involved.

(TEXT REDACTED) The Company has for FBP carried out a cost benefit analysis (CBA). (TEXT REDACTED) In response to our challenges the Company satisfactorily demonstrated that:

- IS supports the current business and due to current levels of IS efficiency the obsolete assets may not support future needs;
- The IS plan is the key driver to generate efficiency within AMP5; (TEXT REDACTED)
- A large proportion of the existing systems are obsolete and out of manufacturer support; (TEXT REDACTED)
- During 2006 there were 628 separate systems attached to the Customers Services system with the result that this carried an increasing risk to TWUL and its customers. These together reduce the possibility of bandage fixing, and a new system investment is appropriate; In any case maintaining the current system is unsustainable;

- The forecast investment involves replacement of work management, SCADA historian and customers information service systems;
- The majority of the AMP5 investment will be in 2010-2012;

Also in response to our challenges the Company satisfactorily demonstrated that a new system would:

- Improve response time to incidents due to work management process automation and improvements, and enabling the benefits of the enhanced SCADA case;
- Assist DG3 reduction, pollution, incident and traffic management;
- Improve assets performance and understand better failure in the supply and sewerage networks through SCADA data analysis (facilitated by the IS investment);
- Improve response time to customer calls and callouts; and
- Improve billing accuracy.

In conclusion we consider that the Company has presented a well supported and robust case for investment in IS to keep pace with technological advance and provide operational improvements and consequent cost savings. We find the case supportable.

SCADA

We carried out an in depth technical assessment and we audited the supporting cost spreadsheets. We found the SCADA investment totals reasonable for the purpose and assets involved.

(TEXT REDACTED)

The Company considers that by industry standards its use of, and investment in SCADA is required to maintain current service and prevent it falling behind. Not only that but it further considers that there are efficiencies to be gained by improving and enhancing its real time remote monitoring of the water systems and sewerage collection. (TEXT REDACTED)

The SCADA investment falls into the base and enhanced categories of Ofwat investment tables resulting in:

- Quantifiable efficiencies through operational improvement;

- Indirect unquantifiable improvements to customer service; and
- A benefit that other regulatory indicators would not detect.

(TEXT REDACTED)

In response to our challenges the Company satisfactorily demonstrated that the SCADA investment, whilst serving many assets, will bring particular improvements in the two key areas:

- In the Water Service the real time monitoring of primary mains and the resulting improvement in response times to major bursts; and
- In the Sewerage Service the real time monitoring of major pumping stations and the improvement in response times to major flooding incidents.

The benefits that these improvements should bring are:

- Resource efficiency through earlier intervention and clean-up cost reduction (including amelioration of third party and legal costs); and
- Lessening of impact on customers thereby improving customer service.

The CBA, which runs over the Ofwat prescribed duration, is much longer than the SCADA lifecycle but reflects costs and benefits for the period. However we consider that the tangible efficiencies and intangible benefits of greater customer service have a suitably mitigating affect.

We consider that the Company has presented a well supported and robust case for investment in SCADA to keep pace with technological advance and provide operational improvements and consequent actual and potential cost savings. The Company has stated the benefit linked with it's enhancement investment and we find the case supportable.

Buildings including Fire Reform

We carried out an in depth technical assessment and we audited the supporting cost spreadsheets. We found the Building and Fire Reform investment totals reasonable for the purpose and assets involved.

The Buildings case is based upon maintaining the Building stock against failure and to prevent deterioration to avoid increased cost of failure in the long term, both to catch-up with under investment in AMP4 and maintain and thereby enhance the working environment. It also includes compliance with statutory obligations of fire safety (the Fire Reform Order 2005).

Under the Fire Reform Order 2005 the Company has elected to follow the protection of life standard (including the public) and not the protection of Building asset standard. The Company considers the cost involved in complying with the latter is not warranted for the majority of its Buildings stock. Buildings in which people are permanently employed are separate matters covered under other statutory obligations.

In constructing the Buildings case the Company has had regard to the protection of the Service and included fitting out vehicles in accordance with the Fire Reform Order. In response to our challenge the Company satisfactorily demonstrated that there was no double counting with the Vehicle case.

(TEXT REDACTED)

We consider that the Company has presented a well supported and robust case for investment in Buildings maintenance and Fire Reform Order compliance. We find the case supportable.

CARE

The CARE business case is driven partly by the Water Industry Act; general access and the Disabilities Act, and the results of customer preference surveys.

The Company provides public access facilities at 111 sites as part of its obligation to protect and enhance wildlife on its sites as well as providing recreational facilities for its customers. At DBP the option of developing visitor centres was still in debate; the Company was to include it in FBP, but in its final submission elected not to do so. The Company had benchmarked its CARE provisions (Visitor Centres) with other major water companies. The Company had not been the biggest investor in the past.

The proposed investment plan is to maintain facilities for public access at the existing sites where facilities are provided. The Company may consider funding additional facilities but this is not included in the investment case.

We audited the supporting cost spreadsheets and found the investment totals reasonable for the assets involved.

Furniture and Laboratory Equipment

The business case is based upon replacing time expired furniture and keeping the Laboratory Equipment up to the standard necessary for the activity.

We audited the supporting cost spreadsheets and found the investment totals reasonable for the assets involved.

Vehicles

The Vehicles case is based upon a combination of replacement of lease vehicles when leases fall-in with purchased vehicles. This strategy applies to cars, vans and larger commercial vehicles. The larger specialist vehicles have always been purchased.

We examined the business case for the change from lease to purchase and found that there are savings to be made and that the strategy is supportable.

The Company has standardised its future acquisitions from a market tested sole source to maximise economies of scale. It has also tightened its user policy and standard of vehicle.

We audited the supporting cost spreadsheets and found the investment totals reasonable for the assets involved.

Date: 12 April 2009
Prepared By: HMS
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