

Part B8 – Revenue Projections**Summary Report by REPORTER****Summary of Audit Findings & Reporter Opinion**

We traced historic data to June Returns (where applicable) on a sample basis. Where the Company has relied on information from its source data systems but presented working papers using extracts from those source systems we challenged the Company to provide an audit trail to those source systems.

At the draft stage the general approach adopted by the Company was to take the actual position at 2007-08, or forecast position at 2008-09, where specific information about the future was available, and assume future trends would remain unchanged. However for the final business plan the Company has undertaken an assessment of the impact of the economic downturn. This has included the consideration of advice from external consultants. (TEXT REDACTED) In general this has been applied on line by line basis based on judgement from Thames Water staff. Our audit report for Part B5 – Supply/Demand (water) gives further details on Thames demand forecasts with respect to the impact of the economic downturn. However the future impact of the recession is unclear with various governmental and non-governmental organisations often providing very different view of the length and impact of the recession.

Reporter Engagement & Scope of Audit

Our opinions are based on a review of the Company's compiled data between January 2009 and submission of the Company Final Business Plan. Our audits were undertaken at Clearwater Court, Reading. We have tracked the Company's work supporting its Part B8 submission.

We traced historic data to June Returns (where applicable) on a sample basis. Where the Company has relied on information from its source data systems but presented working papers using extracts from those source systems we challenged the Company to provide an audit trail to those source systems.

Summary of Thames Water's Proposals

At the draft stage the general approach adopted by the Company was to take the actual position at 2007-08, or forecast position at 2008-09, where specific information about the future was available, and assume future trends would remain unchanged. However for the final business plan the Company has undertaken an assessment of the impact of the economic downturn. This has

included the consideration of advice from external consultants. (TEXT REDACTED) In general this has been applied on line by line basis based on judgement from Thames Water staff. Our audit report for Part B5 – Supply/Demand (water) gives further details on Thames demand forecasts with respect to the impact of the economic downturn. However the future impact of the recession is unclear with various governmental and non-governmental organisations often providing very different view of the length and impact of the recession.

Where the Company has used judgement in relation to future impact we have sought to challenge the basis of this.

Summary of Audit Findings

Below we have provided commentary specific to this table.

A) Revenues – Water Services

Line 10 – Rechargeable Works

The Company advised that this relates largely to hydrant repairs. At the draft stage the Company position was to maintain the actual position at 2007-08 as an appropriate view of the future position.

For the final business plan the Company has projected an increase in expenditure related to fire hydrants to £x million in 2008-09 and £x million in 2009-10. The Company has then projected a stable position from 2010-11 onwards. We challenged the Company in relation to this projection. The Company advised that a backlog of work existed. The future projections account for this backlog and a subsequent stable position.

The actual position for 2007-08 is consistent with data reported in table 23 of the June Return. The value reported for rechargeable works in 2006-07 was £x million. As this is already audited data reasons for the variance between the two years would have been reviewed by the Company financial auditors.

Line 11 – Revenue from Bulk Supplies

The largest proportion of revenues here relate to Essex and Suffolk. The Company advised that Essex and Suffolk provide around 90% of the revenue related to bulk supplies.

The projection is broadly consistent with actual values in 2008-09. The Company advised that it has no basis to project a position of substantial variance from the 2007-08 position. However, the Company have advised us that there could be a reduction in (TEXT REDACTED) bulk supply revenues in

the final year of the AMP5 period. However Thames Water has not forecast a reduction in revenue as this position is uncertain.

Line 14 – Other Sources (Excluding Large Users, Third Parties and Special Agreements)

(TEXT REDACTED)

Other sources of income included by Thames Water are made up of:

- Building Supplies;
- Asset Development;
- Quotations;
- Mains Re-Quote
- Water Regulations;
- Customer Side Leakage;
- Relevant Deficit Income.

These categories (1 to 5) account for £x million of revenue in 08/09 as per the draft plan. The projected income then drops off to account for the impact of the recession, to £x million in 2009-10 before increasing to £x million in 2014-15 to account for the expected recovery in revenues. This profile is shown below:

Customer side leakage revenue is projected at £x million in 2008-09 and then is forecast to reduce to £x million after this period. We challenged the Company to provide supporting data in terms of cost codes for this activity to date. The Company advised that the actual value of income in 07/08 was £x million. However, this was prior to the introduction of the new Company policy related to customer side leakage.

In addition the Company has included £x million under an 'Other category' for the entire forecast period. We challenged the Company in relation to this. The Company advised that this related to various minor revenue impacts which individually are not material.

The Company has also included a relevant deficit income of £x million reducing to £x million by 2015. The position is slightly more conservative than the draft business plan projections, though the average assessed contribution levels is not inconsistent with what the Company has advised us are historic levels of contributions.

The categories are discussed in more detail below:

Building Supplies

This involves Thames Water identifying building supplies that are currently unmetered. Once identified Thames Water charges a fixed percentage fee for use of water. The process involves Thames Water driving around its operating area in a pro-active manner until it finds illegal use of its water supply. The Company has projected a general increase in this revenue based on professional judgement. We received details related to the cost centre for building supplies. We note an internal budget of £x of the calendar year 2008. The Company has included £x million for 2008-09. The projection then drops off in line with the projected average impact of categories 1-5 as described above with the overall assessment of reduced income due to the impact of the recession.

Asset Development

The Company advises that this covers ad-hoc tests for customers. The number is less than £x for 08/09 thus largely immaterial. For projections the Company has made an adjustment for recession which is in line with the overall revenue profile impact of the recession for categories 1-5 as described above. We received details related to the cost centre for asset development. We noted that for the budget for the calendar 2008 was broadly consistent with the projected outturn for financial year 2008-09.

Quotation

In order to reduce the number of quotations that do not progress into actual work undertaken and reduce the cost impact to the Company the Company now operates a system where all quotes are charged. This is a fixed fee on water services. In the event that the quote is taken up, revenue is capitalised, else the charge is shown on the income statement. The number is relatively small, projected at £x for 2008-09. The figure is then projected to remain stable at £x per annum.

Water Regulations

This relates to Thames Water checking compliance with water regulations. The Company advised that the charge for Water Regulation compliance goes through the revenue line. The value here is relatively small, only £x million projected for 2008-09. The Company has then made an assessment based on judgement that future revenues will fall and remain at £x million. The Company advised that it has no reason to believe that the future will be different from the past. The figure is largely immaterial. The Company advised that this is a new charge which commenced in April 2007.

Customer Side Leakage

The Company has assigned £x million to customer leakage for 2008/09. The Company advised that the actual revenue for 2007-08 was £x million. The budgeted revenues for 2008/09 were £x million. However, due to a change in Company policy the Company believes that the revenue related to this category will reduce to £x m million in future. The Company advised that all customers will now be responsible for arranging their own leaks to be fixed. The Company will provide a subsidy as follows:

- £215 if a supply pipe requires replacement;
- £95 for a repair of the supply pipe.

The subsidy is applicable for only the first leak. Thames will no longer quote for the work in house. This is a new policy and hence the actual impact will not be clear until the policy has been operational for a period of time. The Company has advised that in 2007/08 the total value of such income was £x million. However, this was prior to the change in approach to customer side leakage during 2008/09.

Relevant Deficit Income

(TEXT REDACTED)

As the Company advises in its commentary the Water requisition income from developers is released to the profit and loss account to reflect the profile by which the single payment mirrors the annual deficit calculation. The Company has assumed that all payments from 2008 onwards will be released over a period of 12 years. The cumulative release of income for any year represents the charge for the relevant year. For water, at the Draft Business Plan stage the Company assumed that the lump sum contribution received in the 12 months till March 2008 will remain as the future forecast annual lump sum. However, for the final the Company has assessed a reduction in contribution levels in 2009-10 which will gradually recover to 90% of the 2007-08 position. The projection however is still broadly consistent with historic contributions.

B) Revenues – Sewerage Services

Line 25 – Rechargeable Works

[TEXT REDACTED] We note that at the draft stage the Company had made an allowance for COPI on Build Overs and Consents. This has now been removed.

We challenged the Company in relation to why its approach was more optimistic than the draft business plan submission. The Company advised that although this is the case though the overall assessment is only marginally different.

The overall £x million and £x million are from table 23 of the June Return 2008. We challenged the Company in relation to the variation between historic data and projections after 2008-09 and specifically reasons for this variation. The Company advised at the Draft Stage that the reason for this variation is primarily a contractual disagreement which is commercially confidential information.

Whilst the income was excluded from the draft Business Plan it has now been included in the final Business Plan as Thames advises that they believe that they now have a greater degree of certainty that this income will be recoverable.

The drop in revenue in 09/10 is attributed, by Thames, to the impact of the recession.

Line 29 – Other Sources

As the Company advises in its commentary the requisition income from developers is released to the profit and loss account to reflect the profile by which the single payment mirrors the annual deficit calculation. The Company has assumed that all payments from 2008 onwards will be released over a period of 12 years. The cumulative release of income for any year represents the charge for the relevant year. For Sewerage the Company has applied an internal projection based on the expected capital expenditure where income is a factor. (TEXT REDACTED)

We challenged the Company to advise us of why it had assessed a dip in projections in 2010-11. We further challenged the Company in relation to why it had a different profile for water and wastewater. The Company advised that the requisition income assessment was based on a sub-line analysis related to capital expenditure projections for AMP5. The percentages used to calculate the amount of income recovered per annum on the various projects was based on historic AMP4 analysis related to recovery (TEXT REDACTED) rates.

In addition to this the Company has included £x million per annum based on actual income from various sources for 2007/08.

The Company provided working papers that it advised described actual revenues for various categories in 2007-08. The largest of these categories is income from trade effluent sampling which accounted for £x million of income in 2007-08. Future projections for trade effluent increase to £x million in 2009-10 and then maintain at this level.

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