
# Accounting Methodology Statement 2020/21

05 July 2021

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Section 1

# Introduction

1.1 The purpose of this methodology statement ("The Statement") is to explain the systems, processes and allocation methods used to report costs in the following financial tables in the Annual Performance Report ("APR") for the year ended 31 March 2021:

*Section 2: Price review and other segmental reporting:*

- 2A – Segmental income statement;
- 2B – Totex analysis – Wholesale;
- 2C – Cost analysis - Retail; and
- 2D – Historic cost analysis of tangible fixed assets – Wholesale Water, Wholesale Wastewater & Retail.

*Section 4: Additional regulatory reporting:*

- 4D – Totex analysis – Water resources and water network+; and
- 4E – Totex analysis – Wastewater network+ and bioresources.

1.2 These are referred to as the 'Section 2 tables' and 'Section 4 tables' throughout this document and are prepared in accordance with Regulatory Accounting Guidelines ("RAGs").

1.3 This methodology statement should be read in conjunction with the APR for the year ended 31 March 2021. This methodology explains the Wholesale upstream services and Price Control methodology approach as stated per RAG 3.12 and therefore does not cover the approach used for the more detailed splits in the cost assessment tables.

## A Scope

1.4 This document relates to Thames Water Utilities Limited appointed business only and focuses only on costs relating to that business. This statement should be read in conjunction with the following guidance:

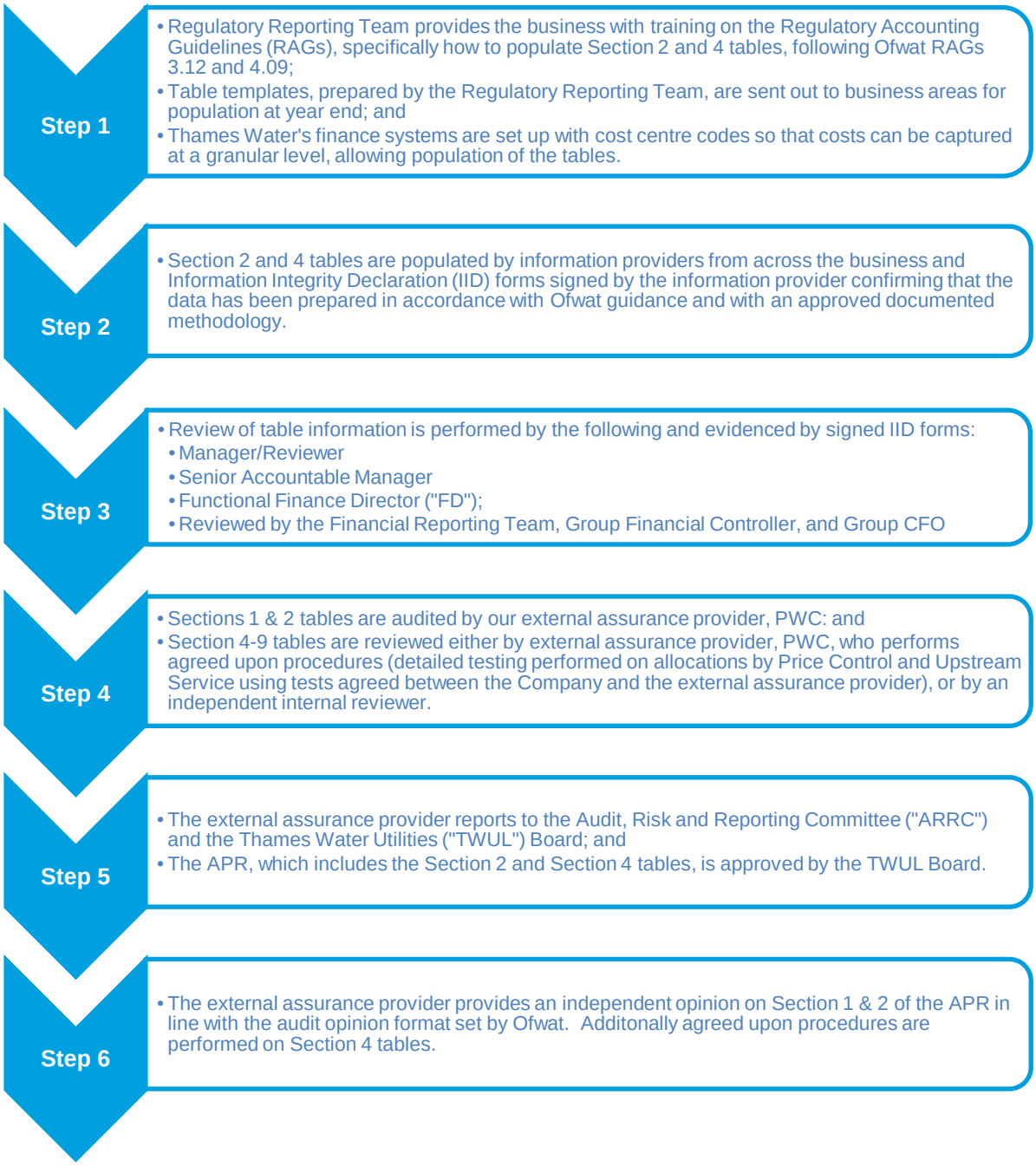
- IN 21/01 Expectations for monopoly company annual performance reporting 2020-21;
- RAG 2.08 'Guideline for the classification of costs across the price controls';
- RAG 3.12 'Guideline for the format and disclosures for the annual performance report;
- RAG 4.09 'Guideline for the table definitions for the annual performance report';
- RAG 5.07 'Guideline for transfer pricing in the water and sewerage sectors'; and
- 2020-21 Annual Performance Report (https://corporate.thameswater.co.uk/about-us/our-investors/annual-results).

## B Governance

1.5 We have a robust governance framework around the production of the APR, which includes the Section 2 and 4 tables. This framework supports our commitment to our customers and stakeholders to publish information that is complete, accurate, reliable, and transparent.

1.6 The specific governance processes that accompany the production of Section 2 and Section 4 tables are outlined below:

Figure 1 - Governance Process




*Source: Thames Water*

Section 2

# Operating Systems, Structure and Outsourced Contracts

## A Operating Systems

2.1 There are three key systems used for the population of Section 2 and Section 4 tables:

- SAP; the primary financial accounting and management tool used by the business and the source of the data used in Anaplan;
- HFM; used to consolidate financial information held with SAP on a cost centre and general ledger line basis;
- Anaplan; (implemented in 2015) is the system used for allocating operating expenditure ("Opex") to upstream service ("US") levels[1].

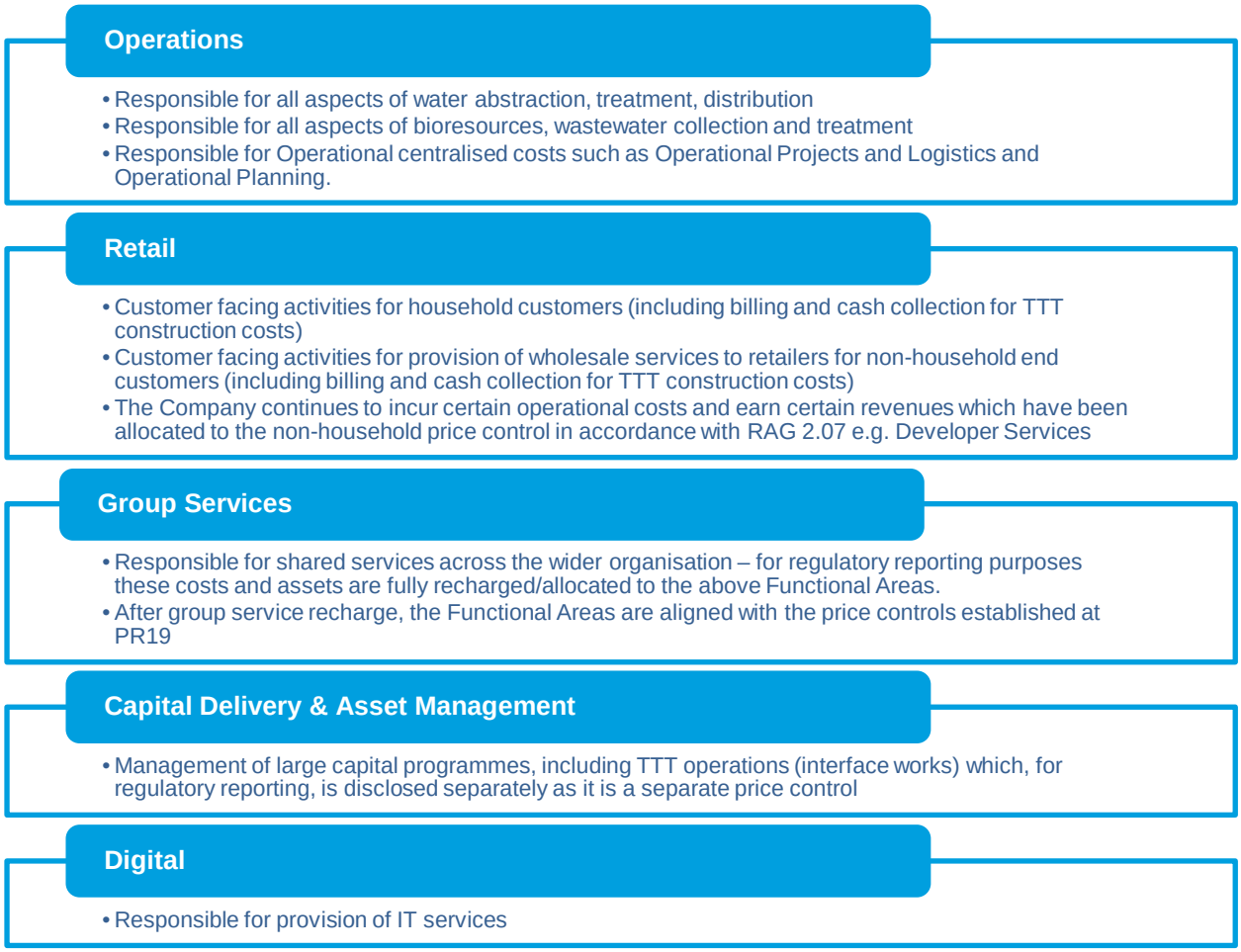
## B Operating Structure

2.2 Our business is structured into a customer journey led organisation. This means that our business is structured in a way that customers want to see us - as 'One Thames Water' - a single organisation with clear lines of accountability for delivering the end-to-end customer experience. This helps to make sure that all parts of the business are focused on delivering high quality water and wastewater services, 24 hours a day, 365 days a year and collaborating to proactively resolve customer issues - ensuring we are providing an overall service that is personal, affordable, valued and right first time.

2.3 In July 2016 we announced our decision to exit the non-household retail market from the date of market opening (1 April 2017). The Company entered an agreement to transfer ownership of its non-household customers to Castle Water at this time. We continue to provide wholesale services into the non-household market.

[1] Upstream services are a further disaggregation of the value chain and are used in Section 4 of the APR. These upstream services, when aggregated, form the price controls.

Figure 2 - Functional Areas




*Source: Thames Water*

2.4 For 2020/21 reporting RAG 4.09 Section 2 requires disaggregation for both Water and Wastewater into the below Price Controls. This structure is defined by Ofwat and is reflected in our Anaplan regulatory model.

Table 1 - Price Control unit and Upstream Service levels

| Price Control Unit | Upstream Service Unit |
|---|---|
| Water Resources | • Abstraction licence<br>• Raw water abstraction |
| Water Network Plus | • Raw water transport<br>• Raw water storage<br>• Water treatment<br>• Treated water distribution |
| Wastewater Network Plus Sewage collection | • Foul<br>• Surface drainage<br>• Highway drainage |
| Wastewater Network Plus Sewage treatment | • Sewage treatment and disposal<br>• Sludge liquor treatment |
| Bioresources | • Sludge transport<br>• Sludge treatment<br>• Sludge disposal |

*Source: Thames Water*

2.5 Our main systems, SAP and Anaplan, use cost centres ("CC") as a way to capture costs at the lowest possible level by service area. Management have aligned the SAP CC hierarchy to the regulatory structure down to upstream service level where possible. Where the activity of a CC is 100% attributable to one of the units listed above, and allocation of costs is not required, the cost centre is mapped, within SAP and Anaplan, directly to that unit.

2.6 Where the activity of a CC is not 100% attributable to an upstream service unit, the operating expenses of those cost centres are allocated based on the underlying activity of the cost centre. This requires using management judgement and cost drivers.

2.7 Typically, costs that are required to be allocated are either:

- costs that are held at a site or regional level (e.g. treatment works), where the activity straddles more than one of the upstream service activities; or
- costs where the nature of the operation does not lend itself to direct allocation e.g. in Wastewater Network Plus where we operate on a combined network (foul mixed with highway and surface); or
- Group Services costs, which are all general & support ("G&S"). Where possible, Group Services operating expenses are directly attributed to the individual functional areas (and hence Price Controls). All other operating expenses are allocated by expenditure type using suitable cost drivers following RAG 2.08 Section 2 guidance. The allocation process and cost drivers are detailed in Section 6.

## C Cost categories

2.8 Each CC is flagged in SAP and Anaplan as direct, indirect, overhead or non-appointed as defined below:

- Direct costs are defined as costs which can be clearly traced to a cost object. A cost object can be a product, contract, project or site. For example, the employment costs of a Site Manager associated with his/her site, chemicals, site maintenance and power;
- Indirect Costs are defined as costs which cannot be traced directly to one cost object or activity. For example, the employment costs of a Regional Manager who has several sites under his/her remit that relate to the Functional Areas;
- Overhead costs are defined as costs not directly related to the operational element of the Functional Areas. For example head office costs, senior managerial costs, and administration; and
- Non-appointed costs are those incurred in the delivery of our non-appointed services such as billing commissions, rental income from non-appointed assets, property searches and others as defined in RAG 4.09.

## D Expense line items

2.9 In Anaplan, general ledger account codes are further grouped into the operating expense line items in the Proforma tables 2B, 2C, 4D and 4E.

## E Outsourced contracts

2.10 We are required to disclose any outsourcing arrangements, including agreements with other water companies and local authorities. Table 2 below lists the outsourced contracts, which the Company had in place for the year ended 31 March 2021.

## Table 2 - Outsourced Contracts

| Outsourced contract | Nature of contract | Managing Functional Areas |
|---|---|---|
| Digital | Offshore and office-based support - IBM, Accenture and Bilfinger | Group Services |
| Legal services | Legal services - Eversheds Sutherland | Group Services |
| Facilities | Facilities and maintenance – EMCOR UK<br>Property services – Savills | Group Services |
| Property Searches | Property searches - HCL Great Britain Limited | Retail |
| Payroll and recruitment | Payroll, recruitment and contractor payment services - Pertemps | Group Services |
| Metering | Meter installation/management by MGJV[1], Arqiva<br>Meter reading - Morrison Data Services and Temetra | Retail / Digital |
| eight$_2$O | Support for major projects - Costain, Black and Veatch, Atkins, Skanska, Stantec UK Limited, MWH Treatment Ltd, Balfour Beatty | Delivery |
| Wastewater Networks | Reactive and planned network maintenance and sewerage services - Lanes | Operations |
| Infrastructure Alliance | Infrastructure maintenance - KCD[2] and Agility[3] | Operations |
| Local authorities and Housing Associations | Billing and cash collection | Retail |
| Other water companies | Billing and cash collection | Retail |
| Billing | Annual billing performed by WIPRO and Capita | Retail |
| Customer Assistance Funding ("CAF") | Administration of CAF performed by Auriga | Retail |
| Debt collection | *Collection of debt* - Moorcroft, Advantis, Avarto, 1st locate, Fair Isaac Services (FICO), GB Data, Experian, Language Line.<br>*Debt transformation* - TDX, Moriarty Law, Sagacity | Retail |
| Fire Hydrants Licence Fee Collection | Aquam | Retail |
| Credit Sharing | Equifax | Retail |
| Mailing and Postage | Communisis, Royal Mail and Paragon | Retail |
| Online & Other Channels | Content design provided by Hugo and Cat | Retail |
| Customer contacts | Non-network contacts - WIPRO, Capita Customer Management Ltd, WNS Global Services (UK) Ltd and Huntswood | Retail |
| Major Project Design & Consultancy | Arcadis, Stantec, AECOM, Motts McDonald, Geotechnical Consulting Group Limited | Delivery |
| Customer Insight | Rapide Communication Ltd | Retail |
| Developer Services | Building Water Site Surveys and Flow & Pressure Testing – RPS<br>Buildover CCTV surveys - A1, MTS & McAllisters | Retail |
| Wholesale Market Services | Engineering, technology and communication contracts supporting customer programmes:<br>**WMS:** MGJV, Arqiva, Tecurra, Metro Rod, Wipro, Greenredeem, Groundwork, Solo | Retail |
| Customer Programme | **CP**: PJ Keary, Engage, Data Real, Z-tech, MOSL | Retail |

*Source: Thames Water*

[1] MGJV - Morrisons Utility services and Galliford Try joint venture
[2] KCD – Kier Clancy Docwra
[3] Agility – J. Murphy & sons and Morrison Utility Services

Section 3

# Guidance

## A Regulatory Accounting Guidelines ("RAGs")

3.1 Ofwat issued the latest RAGs in February 2021, of which RAG 4.09 'Guideline for the table definitions in the annual performance report' and RAG 2.08 'Guideline for the classification of costs across the price controls' are the primary guidance used in producing the regulatory tables. There has been no change to the RAGs since this date however clarification has been provided through the query process.

3.2 The following cost allocation principles have been applied when allocating costs to the relevant price controls, Price Control units and upstream services (RAG 2.08).

### Transparency:

3.3 The cost attribution and allocation methods applied to allocate costs within the APR need to be transparent. This requires that the costs and revenues apportioned to each service and business unit should be clearly identifiable. The cost and revenue drivers used within the accounting separation system should be clearly explained to enable a review of their appropriateness.

3.4 Costs apportioned to each business unit are identifiable by CC and can be traced back to our SAP ledger. This methodology statement, including our cost allocation tables, provide further transparency.

### Causality:

3.5 Cost causality requires that costs (and revenues) are attributed or allocated to those activities and services that cause the cost (or revenue) to be incurred. This requires that the attribution of costs and revenues to activities and services should be performed at as granular a level as possible. Allocating costs in relation to the way resources are consumed provides a means of building up service and product costs.

3.6 Wherever possible, costs are directly attributed to a price control. Some costs are less easily attributed (for example the costs of regulation). Where possible we have taken an activity-based costing approach. The method applied to allocating indirect costs is described in this methodology statement, Section 6.

3.7 All operating and capital costs must ultimately be attributed or allocated.

### Non-discrimination:

3.8 The attribution of costs and revenues should ensure that no undue preference or discrimination is shown to any business unit within the regulated company and it should be possible to demonstrate that internal transfer charges are consistent with the prices charged to external third parties.

3.9 Therefore, the attribution or allocation of costs and revenues should not favour any price control unit or appointed/non-appointed business and it should be possible to demonstrate that internal transfer charges are consistent with the prices charged to external third parties.

### No cross subsidy between price controls:

3.10 Companies cannot transfer costs between the price control units in setting prices and preparing the APR. In accordance with RAG 5, transfer prices for transactions between price control units should be based on market price unless no market exists, in which case transfer prices should be based on cost.

3.11 In line with the separate binding price controls introduced from April 2015, costs are not transferred between price control units and are compliant with RAG 5.07.

### Objectivity:

3.12 The cost and revenue attribution criteria need to be objective and should not intend to benefit any price control unit or appointed/non-appointed business. Cost allocation must be fair, reasonable and consistent.

3.13 Costs are allocated objectively and do not favour any reporting area. Where possible direct allocations are used, otherwise externally and internally reported measures are used that are in line with Ofwat's principles to allocate costs.

### Consistency:

3.14 Costs should be allocated consistently by each company from year to year to ensure meaningful comparison of information across the sector and over time, that regulatory incentives from comparative analysis apply fairly across companies and to enable monitoring of companies' performance against price control assumptions.

3.15 Cost allocation methods are kept as consistent as possible. Where changes are required, these are documented in Section 4.

### Principal use:

3.16 Capital expenditure and associated depreciation should be directly attributed to one of the price control units. Where this is not possible as the asset is used by more than one service, it should be reported in the service of principal use with recharges made to the other services that use the asset reflecting the proportion of the asset used by the other services.

3.17 Where possible we have directly attributed capital expenditure and the corresponding depreciation to the price control units and applied the principle use guidance for shared assets, see Section 7 (details the allocation assumptions outlining how the above principles have been applied).

Section 4

# Changes to methodology from 2019/20

4.1 During 2020/21, as part of the new AMP we have revised our approach to a number of tables following the issue of the new RAG guidance. We have otherwise not materially changed the methodology we have applied to make allocations between price controls.

Section 5

# Operating expenses - allocation assumptions

5.1 The following sections describe the allocation assumptions used in the production of the operating expense line items of table 2A, 2B, 2C, 4D and 4E reported in the APR.

5.2 Recharges between Functional Areas are allocated using the cost drivers described in the tables.

5.3 For the purposes of cost allocation, FTEs (or "full-time equivalents") should include all full-time staff, and contractors/temporary staff directly employed. Where there is an existing contractual arrangement in place with an associate or third party for example a third party billing arrangement, FTEs will include all full-time staff, and contractors / temporary staff directly employed by the associate or third party involved in providing that service to the appointee.

## A Wholesale

5.4 The following are the cost drivers used for all expenditure lines listed in tables 4D, 4E, 4J & 4K. For general and support expenditure, the appropriate allocation basis is provided in Section 6.

Cost Driver A: costs can be attributed directly to the relevant US process by reference to cost centre function and GL purpose.

Cost Driver B: costs can be directly attributed to a price control (water, wastewater) but a specific cost driver is required to allocate the cost to the appropriate Price Control unit and US process within the price control.

Cost Driver C: allocations are worked out using appropriate estimates and judgements based on available data and management understanding of the business.

### Wholesale water

5.5 Most costs can be directly attributed at source to a Price Control unit and Upstream Service process within water services or to water treatment sites and allocated to the relevant process. Table 3 below details the allocation basis and assumption for each expenditure line.

### Table 3 - Water service allocation basis

| Expenditure line | Cost driver | Cost driver for allocation to price controls, Price Control units and US level |
|---|---|---|
| Power | A/B | Direct allocation by use of specific expenditure codes and cost centres to site, else allocated based on assessment of activities and sub-metering where available |
| Income treated as negative expenditure | B | Direct allocation by use of specific expenditure codes and cost centres to site else allocated based on assessment of activities and sub-metering where available |
| Service charges/discharge consents | A | Actual charge from the Environment Agency directly coded to process through cost centres and expenditure codes |
| Bulk supply/Bulk discharge | A | Directly coded to process through cost centres and expenditure codes |
| Other operating expenditure | | |
| Employment costs | A/C | Directly coded to process where possible, else allocated based on assessment of time spent |
| Hired and contracted | A/C | Directly coded to process where possible, else allocation based on assessment of site activity by site management |
| Materials and consumables | A/C | Directly coded to process where possible, else allocation based on assessment of site activity by site management |
| Other direct costs | A/C | Direct cost to site else management judgement |
| General and support | See Section 6 | |
| Cumulo rates | B | Gross Modern Equivalent Asset Value ("GMEAV") based on US values |
| Third party services | B/C | Allocated to US unit based on activity analysis, else management judgement |

*Source: Thames Water*

### Wholesale wastewater

5.6 Most costs can be directly attributed at source to a Price Control unit and Upstream Service process within waste services or to sewage treatment sites and allocated to the relevant process. Table 4 below details the allocation basis and assumption for each expenditure line.

### Table 4 - Wastewater service allocation basis

| Expenditure line | Cost driver | Cost driver for allocation to price controls, Price Control units and US level |
|---|---|---|
| Power | A/B | Direct cost to process by sub metering where it exists, else allocated based on assessment of site activity by site management and Energy Management Department. Oil and gas allocated based on assessment by Energy Management Department. All savings from self-generation of power in the sludge process are allocated to Sludge Treatment. |
| Income treated as negative expenditure * | A | All ROC income reported in Sludge treatment, and all sludge cake sales reported in Sludge Disposals. |
| Service charges/discharge consents | A | Actual charge from the Environment Agency for discharge consents directly coded to process |
| Bulk supply/Bulk discharge | A | N/A |
| Other operating expenditure | | |
| Employment costs | A/C | Directly coded to process where possible, else allocated based on assessment of time spent |
| Hired and contracted | A/C | Directly coded to process where possible, else allocation based on assessment of site activity by site management. Sludge disposal costs fully allocated with exception of ash disposal which is directly coded |
| Materials and consumables | A/C | Directly coded to process, else coded to site and allocated between sewage and sludge treatment based on site activity by site management |
| Other direct costs | A/C | Direct cost to site, else allocated based on management judgement depending on the type of cost reported in this category |
| General and support | See Section 6 | |
| Local authority rates | B | Gross Modern Equivalent Asset Value ("GMEAV") based on US values for non-infrastructure assets. Sewer networks and pumping stations are not rateable |
| Third party services | B/C | Allocated to US unit based on activity analysis, else management judgement. |

*Source: Thames Water*

* Income treated as negative expenditure; includes income from sludge cake sales and Renewable Obligation Certificates ("ROC"), levy exemption certificates and the national grid reserve, in line with guidance provided in RAG 4.09.

## B Retail

5.7 The Retail Functional Area reports the customer facing costs of water and waste services. These are reported in APR table 2C.

### Allocation of CCs to retail activities

5.8 The allocation of operating expenditure between Retail household ("HH") and Retail Non-household ("NHH") is an automated process through Anaplan.

5.9 The following sections provide the basis for the production of APR table 2C.

## Table 5 - Retail activities by expense

| Retail activities by cost centre | Basis of allocation | Customer services | | | | | | | | Debt management | Doubtful debts | Meter reading | Services to developers | Disconnections and reconnections | Demand-side water efficiency initiatives | Customer side leaks | Other direct costs |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Billing | Payment, remittance and cash handling | Charitable Trust donations | Vulnerable customer schemes | Non-network customer enquiries & complaints | Network customer enquiries and investigatory/first time visits to customers | Other customer services | | | | | | | | | |
| First Contact Resolution Support | Based on call volumes and , FTEs by teams, and TW propositions | • | • | | | • | | | | | | | | | | | |
| RSC Resource Planning | Based on analysis of calls allocated by Rev/Ops and then Thames propositon | • | • | | | • | | | | | | | | | | | |
| Operations Support centre Management | Based on analysis of calls allocated by Rev/Ops and then Thames propositon | • | • | | | • | | | | | | | | | | | |
| Business Intelligence Team | Based on analysis of calls allocated by Rev/Ops and then Thames propositon | • | • | | | • | | | | | | | | | | | |
| Exec Regulatory & Financial Insight & Analysis | Based on analysis of calls allocated by Rev/Ops and then Thames propositon | • | • | | | • | | | | | | | | | | | |
| Customer Service Continuous Improvement | Allocation based on cost centres benefitting from improvement projects | • | • | | | • | • | | | • | | • | | | | | • |
| Document Handling Centre | Analysis of queries/complaints recorded | | | | | • | • | | | | | | | | | | |
| High level complaints team | Volumetric data on network / non network complaints | | | | | • | • | | | | | | | | | | |
| Head of Customer Contact (Management cost centre for Operations RSC) | Weighted average calculated for cost of managers in this cost centre based on cost centres served | • | • | | | • | • | | | • | | • | | | | | • |
| Head of Collections | Weighted average calculated for cost of managers in this cost centre based on cost centres served | • | • | | • | • | | | | • | | | | | | | |
| LAHA Transition Project | Based on Managers Activity Summary | • | • | | • | • | | | | | | | | | | | |
| WNS Performance | Management of WNS outsourcing allocated per analysis of WNS activity | • | • | | | • | | | | • | | • | | | | | • |
| Mail house & Post room | Based on volumes of type of bills/mail | • | • | | | | | | | • | | | | | | | |
| Customer Communication & Design | Specific to other direct costs (service improvement, intelligence, monitoring, marketing) | | | | | | | | | | | | | | | | • |
| Customer Research & Insight | Specific to other direct costs (service improvement, intelligence, monitoring, marketing) | | | | | | | | | | | | | | | | • |
| Collection Process & Strategy | Specific to Debt Management | | | | | | | | | • | | | | | | | |
| Collection Service Delivery | Specific to Debt Management | | | | | | | | | • | | | | | | | |
| Billing - Outsource & Performance Management | Management Review of FTE resource | • | | | | | | | | | | | | | | | |
| Billing Process Management Staff Costs | Management Review of FTE resource | • | • | | | • | | | | | | • | | | | | |
| Billing and Collections - LA/HA Commissions (all HH) | Management judgement based on TW relative costs for the activities covered, and historical discussions with LA/HA's. | • | • | | | • | | | | • | | • | | | | | |
| Billing Service Delivery | Based on Managers assessment of FTE's | • | | | | | | | | | | | | | | | |
| Meter reading | Specific to meter reading | | | | | | | | | | | • | | | | | |
| WOC Bad Debt | Specific to Doubtful Debts | | | | | | | | | | • | | | | | | |
| WOC Commissions | Allocation across activities covered by WOCs pro-rata to their Retail Costs submissions | • | • | | | • | | | | • | | • | | | | | |
| Bad Debt Provision & Excess Credits | Specific to Doubtful Debts | | | | | | | | | | • | | | | | | |
| Customer Resolution - RSC | Based on manager's assessment of FTE | | | | | • | | | | | | | | | | | |
| Digital Communications | Specific to other direct costs (General and support cost) | | | | | | | | | | | | | | | | • |
| Affordability & Vulnerability | Specific to Vulnerable Grps | | | | • | | | | | | | | | | | | |
| Customer Experience & Design | Weighted average based on cost centre allocations the managers in this cost centre are responsible for | | | | • | | | | | | | | | | | | • |
| Senior Management Team | Based on overall % allocation of all activites in Retail | • | • | | • | • | • | | | • | | • | | | | | • |
| Recharged from Wholesale | Calls found not to be a network issue | • | • | | • | • | • | | | • | | • | • | | | | • |
| Recharged from Digital, Group | Specific to retail, based on FTEs | • | • | | • | • | • | | | • | | • | • | | | | • |
| Case management | Specific to other direct costs (General and support cost) by Capita | | | | | | | | | | | | | | | | • |
| Wipro | Management of Wipro outsourcing allocated per analysis of Wipro activity | • | • | | | • | | | | | | | | | | | • |
| Capita | Management of Capita outsourcing allocated per analysis of Capita activity | • | • | | | • | | | | | | | | | | | • |
| Transactional | Management of Wipro & WNS outsourcing allocated per analysis of activities | • | • | | | • | | | | • | | • | | | | | • |
| Channel Performance team | Based on Managers assessment of work activity | | | | | | | | | | | | | | | | • |
| Quality team | Allocation based on cost centres benefitting from quality team | • | • | | | • | • | | | • | | • | | | | | • |
| Collectives | Based on FTEs by teams, and activity | • | • | | | • | • | | | | | | | | | | |

*Source: Thames Water*

5.10 The majority of costs reported within table 2C are directly attributable and reported within the Retail OpCo.

5.11 Retail Opex includes recharges from Digital, Group functions (covered in section 6), recharges from Non-appointed business, Wholesale business which include services to Developers administration, Investigatory visits, where it is found that it is not a network issue and allocation from estates.

### Retail Household and Retail Non-Household

5.12 The Company's allocation of costs into Household and Non-Household is compliant with the definitions below as stated in RAG 2.08.

5.13 **Household:** These are properties used as single domestic dwellings (normally occupied), receiving water for domestic purposes which are not factories, offices or commercial premises. These include cases where a single aggregate bill is issued to cover separate dwellings having individual standing charges (In some instances, the standing charge may be zero). The number of dwellings attracting an individual standing charge and not the number of bills should be counted. Mixed/commercial properties and multiple household properties – for example, blocks of flats having only one standing charge – should be excluded.

5.14 **Non-household**: These are properties receiving water for domestic purposes, but which are not occupied as domestic premises, or where domestic dwellings are combined with other properties, or where properties are in multiple occupation but only have one standing charge. In this case, it is the number of bills that should be counted.

### Allocation of costs to Household and Non-Household

5.15 Thames Water exited the Non-Household market in April 2017 hence there is limited Non-Household activity by 2020/21.

### Allocation of Household costs by customer type

5.16 Following the changes to APR table 2C, Household costs are no longer required to be further manually allocated by customer type.

## C Billing and collection

### Percentage of income

5.17 The percentage of income that the Company outsourced for billing and collection is based on the revenue billed on behalf of the company by Local Authority and Housing Associations (LAHA), who bear the risk of any non-collection of any outstanding debt. The billed value is taken from year-end LAHA Commissions Report. During the year ended 31 March 2021, LAHA billing percentage of turnover billed was 1.08%, a reduction from 2019/20 as Thames continues to proactively transfer customers to direct billing and customer service.

### Bills to occupier policy

5.18 The Company only raises bills in the name of the "occupier" when it has evidence that the property is occupied but cannot confirm the name of the occupier. When the occupant is identified the bill is cancelled and rebilled in the customer's name. If the Company has not identified an occupant within 6 months the bill is cancelled, and the property is classified as empty. The value of bills issued in the name of the occupier included in turnover is obtained from the 'Occupier Billing report' run by our Billing Analysts. No specific doubtful debt provision is made for bills issued in the name of the occupier at the year-end. A bad debt provision is applied to all outstanding debt, at the year-end a provision of 18.1% is applied to all debt less than one year old, which would include any debt in the name of the occupier.

### Doubtful debt policy where the customer has vacated a property

5.19 Where a customer has vacated a property leaving unpaid debt, this is handled within our debt management process, credit notes are not issued to cancel any such uncollectable debt, when uncollected it is written-off as bad debt.

### Bad debt provision policy

5.20 The bad debt provision is charged to operating costs to reflect the company's assessment of the risk of non-recoverability of debtors. It is calculated by applying expected erosion rates to debts outstanding at the end of the accounting period. These collection rates take into account the age of the debt and type of debt. Higher provisioning percentages are applied to older categories of debt. Bad debt provisioning rates are updated annually to reflect the latest collection performance data from the company's billing system. All debt greater than five years old is fully provided for. Further overlays are made as required; please see the Annual Performance Report for details of specific annual adjustments.

5.21 The bad debt provision also takes into account the recoverability of debts which will ultimately be cancelled and may or may not be rebilled, and of debts which have not yet been billed, but are part of the metered sales accrual.

5.22 Future expected performance (taking into account historic trends) is also used to validate our bad debt provisions to ensure that use of historic performance will not result in a material misstatement.

5.23 A provision is also made against debts held by Water Only Companies (WOCs) who bill their customers for sewerage services on behalf of the Group. Since detailed information about the debt held on our behalf by the WOCs is limited, we provide for the debt with a rate calculated using the bad debt provision applied by the WOCs in their most recent statutory accounts, as a percentage of their billed and unbilled debts. We consider current performance and any information available to us to create the provision we then make a management judgement in respect of future credit losses, in accordance with the requirements of IFRS 9.

### Contact centre and outsourced costs

5.24 Contact centre agents' costs and outsourced costs are allocated to activities on the basis of the FTE requirement planning and the work packs and work streams issued to outsource partners.

5.25 WOC commissions costs from industry data share of the APRs are allocated across the activities they undertake, i.e. billing, payment handling, debt management and customer (non-network) queries based on the relevant weighting of those activities within the Retail operating expenses.

5.26 LAHA commissions are allocated across the activities they undertake, i.e. billing, payment handling, debt management and customer (non-network) queries based on the relevant weighting of those activities within the Retail operating expenses, factored for the relative costs for the LA/HAs based on management analysis and judgement.

### Further assumptions

5.27 The following assumptions have been applied consistently with the prior period, unless a change has been identified.

5.28 Local authority rates are allocated to Retail based on office occupancy of the Retail business in Walnut Court in Swindon.

5.29 Third party costs – there are no costs incurred within Retail that are classed as third-party costs, therefore no costs have been reported within this line.

Section 6

# Group Services expenditure

6.1 These costs reflect the support services functions within the company, which are detailed below in Table 6 with an explanation of cost driver used. All of these costs are classified as General and Support overheads ("G&S").The costs allocated to the price controls are net of any recharges of costs that the Group Services functions provide to associate companies of the group and recharges to the non-appointed business of the Company. Most Group Services costs are shown within the 'Other operating expenditure' line in APR tables 2B/4D&E.

6.2 Management considers that the allocation assumptions and cost drivers used are appropriate and are compliant with the cost allocation principles contained in RAG 2.08.

## Table 5 - Group Services (spend allocated across appointed price controls)

| Group Services function | Activity and type of expenditure incurred | Cost driver for allocation to price controls, Price Control units and US level | Household | Non-household | Water Resources | Water Network | Wastewater Network | Sludge (Bioresources) |
|---|---|---|---|---|---|---|---|---|
| Executive remuneration | Total remuneration including bonuses, pensions and other benefits of Executive Directors | Direct for executives of price controls; for other executives including CEO and CFO allocated based on full time equivalent ("FTE") number of employees | 13% | 1% | 4% | 39% | 33% | 10% |
| Non-executive remuneration | Total remuneration of Non-Executive Directors | Price control allocation is split/charged to Upstream Service by FTE | 13% | 1% | 4% | 39% | 33% | 10% |
| General Management | Consultancy costs managed within the Chairman, CEO and CFO's offices | Allocated directly to Price control where possible and to Upstream Service by FTE | 13% | 1% | 4% | 39% | 33% | 10% |
| Finance | Internal Audit, Tax, Treasury, Corporate Finance, Financial Control, Operations and Retail & Digital finance teams | Allocated directly to Price Controls where possible and then to Upstream Service by FTE; For other areas allocated to Upstream Service by FTE | 21% | 2% | 3% | 34% | 31% | 9% |

| Group Services function | Activity and type of expenditure incurred | Cost driver for allocation to price controls, Price Control units and US level | Household | Non-household | Water Resources | Water Network | Waste-water Network | Sludge (Bioresources) |
|---|---|---|---|---|---|---|---|---|
| Legal & secretariat | Management of outsourced Legal service provider, management of Board and related committees and GDPR compliance | Legal fees directly allocated to price control and Upstream Service by case where possible and by FTE where not possible.<br>Secretariat & Data Protection allocated to Upstream Service by FTE | 16% | 2% | 3% | 38% | 31% | 9% |
| Human Resources | Employment, Training, Payroll and other HR business support costs | Allocated directly to Price control where possible and to Upstream Service by FTE | 15% | 1% | 3% | 38% | 33% | 10% |
| Digital | Employment and telephony costs<br>All other costs including management of outsourced IT support costs | Allocated directly to Price control where possible and to Upstream Service by FTE | 13% | 1% | 4% | 39% | 33% | 9.9% |
| Corporate Affairs | Corporate Affairs (excluding Fisheries, Fountains, Conservation, and Charitable Donations) | Allocated directly to Price control where possible and to Upstream Service by FTE | 18% | 2% | 3% | 38% | 29% | 9% |
| Facilities and Maintenance | This function includes office supplies, security, facilities and building maintenance costs. | Allocated to price control based on building and desk usage then allocated to Price Control unit and Upstream Service based on FTE | 3% | 0% | 2% | 29% | 50% | 16% |
| Health and safety | Occupational Health, H&S policy setters, systems costs, and other business support | Allocated to Upstream Service by FTE | 8% | 1% | 4% | 42% | 35% | 11% |
| Fleet | Fleet management costs and fuel costs | Allocated to price control based on the allocation of the cost centre in which the vehicle is used. | 0% | 0% | 5% | 37% | 42% | 15% |
| Commercial | Purchase to pay, Sourcing, Contract management and other supply chain and procurement support costs | Allocated to price controls based on estimated number of POs raised, then to Upstream Service based on FTE | 1% | 0% | 6% | 64% | 22% | 7% |

| Group Services function | Activity and type of expenditure incurred | Cost driver for allocation to price controls, Price Control units and US level | Household | Non-household | Water Resources | Water Network | Waste-water Network | Sludge (Bioresources) |
|---|---|---|---|---|---|---|---|---|
| Insurance | Policies include Public Liability, Property, Motor & Employers' Liability | Directly allocated to price control based on usage of each Policy, and then to Upstream Service based on FTE | 0% | 0% | 6% | 71% | 18% | 5% |
| Property - Local Authority Rates (Offices) | Office rates | Allocated to price controls based on sites, then to Price Control unit and US based on FTE for retail and Upstream Service based on MEAV for water and waste. | 13% | 1% | 2% | 56% | 27% | 0% |
| Property - Site Rates (non-head office) | Water & waste rates | Allocated to price controls based on sites, then to Price Control unit and US based on FTE for retail and Upstream Service based on MEAV for water and waste. | 0% | 0% | 3% | 66% | 32% | 0% |
| Regulation | Engagement with OFWAT, management of CCG and business support on regulation matters | Allocated to price controls 1/9 retail, 4/9 water & 4/9 waste in accordance with RAG guidance, then to Upstream Service based on FTE | 10% | 1% | 4% | 41% | 34% | 10% |
| Property – Rent and Management Costs | Savills fee and property team staff costs. | Allocated to price controls based on desk occupancy, then to Price Control unit and US based on FTE. Any non-specific costs are allocated 50/50 to water and waste, then to Upstream Service based on FTE. | 26% | 3% | 3% | 33% | 28% | 8% |
| Asset Management - Other | General Asset Management costs | Allocated to Price Control then to specific US where possible using management judgement, otherwise to US based on FTE | 2% | 0% | 5% | 55% | 30% | 7% |
| Asset Management - Water/Wastewater Quality | Managing the delivery of clean, safe drinking water, working closely with Drinking Water Inspectorate; Testing of Wastewater | Sampling costs are allocated based on the no. of samples taken mapped to each US; Other Water Quality costs allocated to specific US (WTW & Treated Water) using management judgement; Other Wastewater Quality cost allocated to specific US (Sewage Treatment & Disposal) using management judgement; Management team has been allocated 50/50 between Water/Waste Price Controls and then to US by sampling effort. | 0% | 0% | 10% | 53% | 35% | 2% |

| Group Services function | Activity and type of expenditure incurred | Cost driver for allocation to price controls, Price Control units and US level | Household | Non-household | Water Resources | Water Network | Waste-water Network | Sludge (Bioresources) |
|---|---|---|---|---|---|---|---|---|
| Asset Management - Labs | Labs staff, courier for samples, chemicals, and other materials | Allocated to Waste & Water based on number of samples in each service area, then to US based on FTE | 0% | 0% | 7% | 74% | 15% | 5% |
| Asset Management - Leakage | Maintenance and improvement of the distribution network for treated water | Allocated to specific US (Treated water) as it is assumed all pipes in the network contain treated water only | 0% | 0% | 0% | 100% | 0% | 0% |
| Asset Management - Carbon Management | Staff costs for Energy team | Allocated using management judgement | 0% | 0% | 6% | 32% | 46% | 16% |
| Asset Management - Strategy & Planning | Modelling studies and system costs, Water Resources Management Plan | Specific cost centres are allocated to US using Hydraulic model results from representative sample of catchments;<br>remaining cost centres are allocated to Price Control and then US using management judgement | 0% | 0% | 12% | 32% | 55% | 0% |
| Asset Management - Projects | Opex Study costs for Projects within Water and Waste | Allocated using purpose codes to split projects costs into US | 0% | 0% | 13% | 30% | 58% | 0% |

*Source: Thames Water*

Section 7

# Capex

## A Allocation to Price Control and segment

7.1 The following section describes the methodology used in the production of the Fixed Assets (capital expenditure) lines in APR tables 2D and 2O, including attributing spend across the price controls in table 2D and table 2O. This follows the guidance in RAG 2.08 Section 2.

7.2 Table 2D excludes intangible assets (which is separately disclosed in table 2O from 20/21 moving forward), non-appointed assets, and borrowing costs. It also excludes assets held for sale. However, 2D does include assets held at fair value.

7.3 In tables 2D and 2O gross cost, depreciation/amortisation and net book value are shown in the price control of principal use only. Likewise, in accordance with RAG 4.09 line item definitions, Retail/TTT is shown recorded in the price control of principal use.

7.4 Historic cost fixed asset data is maintained in SAP. Every capital project is assigned a purpose code and every asset is assigned to an asset class and is also assigned an Accounting Separation key code. The Thames Water purpose code, asset class and Accounting Separation key code structures have been rebuilt in AMP7 to reflect the regulatory 'Upstream Services' structure, so the data can be assigned to upstream services (or non-appointed) based on these codes in SAP.

7.5 The SAP Accounting Separation Key code on each asset in the SAP Fixed Asset Register maps the assets directly to the Tables 2D and 2O Category using the mapping below.

### Table 7- SAP Accounting Separation Key Mapping Table

| SAP Accounting Separation Key Mapping Table (Asset Master Data) to Tables 2D and 2O: | | |
|---|---|---|
| **Code** | **Code Description** | **2D Category** |
| RET1 | Retail | Retail Household |
| SEW1 | Sewage Collection | Wastewater Network+ |
| SEW2 | Sewage Treatment | Wastewater Network+ |
| SEW3 | Sewage Site Services* | Waste* |
| SLU1 | Sludge Treatment | Sludge |
| SLU2 | Sludge Disposal | Sludge |
| SLU3 | Sludge Transport | Sludge |
| WAT1 | Water Resource | Water Resource |
| WAT2 | Raw Water Distribution | Water Network+ |
| WAT3 | Water Treatment | Water Network+ |
| WAT4 | Treated Water Distribution | Water Network+ |
| WAT5 | Water Site Services* | Water* |
| TTT | Thames Tideway Tunnel | TTT |
| CEN1 | Central Support** | Central** |
| NON1 | Non-Appointed | *Excluded from 2D/2O* |

*Source: Thames Water*

7.6 This Accounting Separation Key Code is always assigned when the asset is created and corresponds directly to the approved funding paper documents and project asset classes/purpose codes authorised. This ensures the vast majority of assets are directly attributed to the price control unit that has principal use, by the relevant business specialist.

7.7 As per RAG 2.08, where possible, capital expenditures and associated depreciation / amortisation should be directly attributed to one of the price control units. Where this is not possible as the asset is used by more than one service, it should be reported in the service of principal use with recharges made to the others services that use the asset reflecting the proportion of the asset used by the other services.

7.8 The large bulk of tangible assets are operational assets that are assigned directly to the appropriate 2D/2O category in the table line items as follows:

Table 8 - 2D/2O Categories

| Table 2D/2O Line items: | Table 2D/2O Categories: | | | | | | |
|---|---|---|---|---|---|---|---|
| | Wholesale | | | | | Retail | |
| AMP7 Price Controls (price limits have been set for 2020-25) | Wholesale Water | | Wholesale Waste | | TTT | Retail Household | Retail Non-Household |
| Table 2D Categories: | Water Resource | Water Network+ | Wastewater Network+ | Bioresources | TTT | Retail Household | Retail Non-Household |
| Year-end Closing Balances (Gross Cost & Accum. Depreciation) | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | n/a |
| Disposals | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | n/a |
| Additions, Disposals and Adoptions at Nil Cost (Fair Value) | As per Tables 4D & 4E methodology (Asset Class & Purpose Code basis) | As per Tables 4D & 4E methodology (Asset Class & Purpose Code basis) | As per Tables 4D & 4E methodology (Asset Class & Purpose Code basis) | As per Tables 4D & 4E methodology (Asset Class & Purpose Code basis) | As per Tables 4D & 4E methodology (although TTT not included in 4D/4E) | As per Tables 4D & 4E methodology (although Retail not included in 4D/4E) | n/a |
| Depreciation/ Amortisation Charge in the Year | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | Mapped asset by asset from the SAP Fixed Asset Register using Accounting Separation Key codes. | n/a |

*Source: Thames Water*

**Note 1:** As shown in the earlier mapping table (coded "SEW3" and "WAT5"), there are a small minority of assets which are Water or Waste site assets (for example vehicles or generators, or site admin buildings) which are specific to the Waste or Water price control but are then allocated further between the Water or Waste 2D/2O Categories proportionally.

Note 2: Also shown in the mapping table, there are a remaining number of mainly "Management & General" assets which are coded as "CEN1" Central Support (e.g. computer hardware or fleet vehicles). Where the principal user still cannot be ascertained, and in the absence of further information, these are assigned to either the wholesale waste or wholesale water base in proportion to the asset base.

7.9 Specifically, where an asset is used by the whole of the business, for example headquarters buildings, the Accounting Separation code assigned is based on the principal user according to the purpose codes/asset classes approved in the funding paper. Where there is no clear principal user, the "CEN1" Central Support code can be used.

7.10 Where a new asset is related to an existing asset (for example an upgrade), the new asset may be assigned a different Accounting Separation code to the original asset. The code will be based on the principal user information from the purpose codes/asset classes on the new asset. The original asset will remain unaffected.

7.11 Assets commissioned each year are reviewed individually to provide assurance that the appropriate Accounting Separation Code has been assigned to the asset. The review is carried out by the relevant price control asset specialists (for example Sludge assets are reviewed by the Bio-Resources Ops Asset Manager). Central assets are reviewed by the Capital and Investment team in order to assign them where possible to the most appropriate price control on a principal user basis. The whole asset base Accounting Separation data will be reviewed at key points in time, for example where there is a change in methodology, or where a change in table category definitions/ requirements occurs. This ensures the appropriate mapping is maintained.

7.12 Table 2D balances also include the uplift in fair value as a result of adopting IFRS Accounting Standards in April 2015. These are split across the wholesale business (mainly Water Network+ assets) according to the specific instruction at that time.

7.13 A handful of assets included in the table have been acquired at nil cost. This includes assets adopted, (for example Self-Lay Sewers typically installed by property developers, or Private Sewer Pumping Stations which Thames Water are now responsible for). These are directly attributed to the relevant price controls.

7.14 Further, as per RAG 1.09, OFWAT's requirement is that all companies should account for leases in accordance with IFRS 16 in the regulatory accounting statements. Therefore, Table 2D has been adjusted to reflect opening balances, additions (modifications), disposals and depreciation of leases subjected to IFRS 16. The calculation of lease adjustments were obtained from the group team and each lease was determined whether these are "shared leases" or specifically attributable to a price control (ie Walnut Court to Retail, TTT). The balances of shared leases were then allocated using FTE %, which is in line with the distribution of rent expense on the opex side.

7.15 The Adjustments line shows the movements in the opening/closing balances not driven by standard additions, disposals, adoptions or depreciation activities. This would include any asset reclasses, revaluations, or accounting (e.g. IFRS) adjustments.

7.16 Under RAG 4.09, it is a requirement to split the depreciation charge for the year between principle assets and assets dedicated to third party service activities. This is defined as assets that enable the fulfilment of bulk supplies and other services to other monopoly suppliers and inset appointees. Depreciation on assets used for both principal and third-party activities do not need to be allocated and should be recorded as principle services.

Based on the list of projects obtained from capex additions in the year (3rd party line), this will be used in reference to reporting in the next regulatory reporting period and check for related assets commissioned in these projects to recognise depreciation as per requirement above.

7.17 Where assets are used by more than one price control, a recharge is made from the principal user to the other price controls to reflect the usage of the asset. The recharge is calculated as an allocation of the depreciation charge since this represents the charge for using the underlying assets. The cost driver and basis for the allocations follow the same basis as operating expenses allocations per Table 8 above. These recharges are reported in APR table 2A/2C.

## B Allocation to Upstream Service (US) level

7.18 The following documents the process adopted by the Company to comply with Ofwat's guidance for allocation of capital expenditure across Upstream Service units. The methodology detailed in this section covers the assumptions, adjustments and method of analysis applied to populate the capital expenditure sections of tables 4D and 4E.

7.19 As the relevant sections of these two tables require the allocation of capital expenditure to Upstream Service units, the primary driver for allocation is the asset class in use on the capital project. Our asset class structure has been rebuilt for AMP7 to reflect the Upstream Service structure so the data can be assigned to Upstream Service immediately from the Asset Class entered into SAP. The asset class also identifies whether the asset is infrastructure or non-infrastructure and is used to split the capex line items in tables 4D/4E.

7.20 Assets are classed as "Base" or "Enhancement" in SAP. Base capex is reported in the "Maintaining the long-term capability of assets" lines and enhancement capex is reported in the "Other capital expenditure" lines previously in Tables 4D/E but is now disclosed as such in Tables 4J/K and Tables 4L/M, respectively.

7.21 A number of asset classes however do not map directly to the Upstream Service units. An example of such an asset class would be 'Treatment works plant & machinery – 20 year life'. Depending on the specific asset in question, this could sit within any one of the following Upstream Service units: Water Treatment, Sewage Treatment & Disposal or Sludge Treatment. In these cases we assign an Upstream Service unit based on the purpose code(s) allocated to the project. Our purpose codes for AMP7 have similarly been rebuilt to reflect the Upstream Service structure, so the vast majority of the data left unallocated from the asset class review can be assigned through the purpose codes recorded on the capital projects.

7.22 The data that then remains unallocated comprises largely management & general ("M&G") assets. Examples include Fleet and IT assets as well as office buildings on non-operational sites. Assets produced from these projects are reviewed manually in order to assign them to the most appropriate Upstream Service unit. In some cases such assets are used by multiple Upstream Service units and so are deemed 'shared use assets'.

## C Allocation of shared use assets

7.23 As mentioned above, a number of these M&G assets are used by more than one Upstream Service unit and indeed in a number of cases are used for the activities of more than one price control unit. In accordance with RAG 4.09, such assets have been wholly allocated in tables 4D and 4E to the price control of primary use, which in almost all cases for the Company is the wholesale wastewater price control (based on the total cost incurred by the Functional Area).

7.24 Once allocated to the price control unit of primary use, these assets are allocated across the Upstream Service units according to a suitable driver. In most cases the driver used is headcount of the directly attributable employees within each of the Upstream Service units, as the M&G activities are supporting the rest of the business as carried out by the staff within each operational business unit. In some cases a more bespoke allocation is possible, e.g. our main laboratory building is primarily carrying out sample testing of effluent from the sewage treatment process, and hence asset expenditure is allocated wholly to the 'Sewage Treatment & Disposal' Upstream Service.

## D Data adjustments

7.25 A number of adjustments are made to the raw data as extracted from the SAP system to ensure correct allocations are made to the US units as well as to the categories of infrastructure and non-infrastructure assets and between capital maintenance and enhancement expenditure. These adjustments were made to comply with Ofwat's guidance on allocation. The key adjustments are explained below:

- Sludge centres adjustment: a manual review of all capital expenditure allocated to sludge-related US units is undertaken to ensure that only assets at our dedicated sludge centres (or assets involved in transporting sludge to our dedicated sludge centres) are allocated to these categories. Similarly, a review of allocations within the sludge-related Upstream Service units is carried out to ensure correct assignment, for example, between sludge treatment and sludge disposal;
- Sludge transport and disposal: the sludge transport and sludge disposal Upstream Service units have a very small list of assets that should be allocated to them so this adjustment is moving Capex to sludge treatment where spend has been miscoded to disposal or transport;
- Infrastructure at treatment works sites: a manual review is undertaken to ensure no infrastructure assets are coded to the Water Treatment or Sewage Treatment & Disposal Upstream Service units as any underground pipework within treatment work sites should be classed as a civil structure;
- Shared use assets: an adjustment is made in line with method discussed in Section 7.1 above;
- Water assets on waste purpose codes (and vice versa): undoing the proportional allocation that puts Sewerage assets on Water purpose codes and vice versa;
- Land adjustment: land purchases must not be paired with a base purpose code, so the purpose code on any such lines is changed to enhancement. Where the land asset class is used for other purposes such as landscaping or SUDS or SEBA then a base purpose code is permitted;

- **Manual allocations:** as tables 4D and 4E do not have an ASUS unit for assets delivered by the M&G functions (that are not shared assets), any projects coded as M&G have to be assessed manually on an individual basis to assign them to the correct ASUS unit. Any that can't be allocated directly to one ASUS unit will need a suitable allocation across multiple ASUS units such as the allocation used in the FTE headcount splits by upstream service; and
- **Raw water assets review:** the distinction between raw water abstraction, transport and storage requires very specific allocations under RAG 4.06. As all of Thames Water's storage reservoirs have associated abstraction licenses they are to be classed as raw water abstraction along with the pipes and pumps that transport the water to them from the abstraction point. Only pipes and pumps on the raw water network beyond the storage reservoir on the way to the treatment works are coded to raw water transport while no allocation is made to raw water storage as Ofwat confirmed that TW have no Raw Water Storage.

7.26 Following completion of the manual data checks, a bulk adjustment is made to include unallocated capital overheads ("OHAP") that cannot be allocated through the steps mentioned above. As in previous years this is allocated proportionately across the relevant Upstream Service.

7.27 As per RAG 1.09, OFWAT's requirement is that all companies should account for leases in accordance with IFRS 16 in the regulatory accounting statements. Therefore, Table 4D and 4E have been adjusted to reflect additions (modifications) of leases subjected to IFRS 16 in the year. The calculation of lease adjustments was obtained from the group team and each lease was determined whether these are "shared leases" or specifically attributable to a price control. The balances of shared leases were then allocated using FTE %, which is in line with the distribution of rent expense being recognized within the P&L.

## E Population of tables 4D and 4E

7.28 Now that the data set has been fully allocated to Upstream Service units it can be mapped into the capital expenditure sections of tables 4D and 4E by way of specific data columns. These data columns distinguish between the following criteria in order to populate tables 4D and 4E:

- base capital expenditure;
- enhancement capital expenditure;
- developer services capital expenditure;
- third party; and
- upstream service units.

7.29 Developer Services capital expenditure relates to connections to our clean water and wastewater networks, from small residential developments to large-scale commercial developments, which enables us to supply our customers. Developer services expenditure is that required by developers to provide the same current level of service to newly connected customers. It also includes expenditure to divert water and sewer mains in connection with property developments, road improvements etc (RAG 4.09).

7.30 The additional lines for third party services relate to capital expenditure that enable the fulfilment of bulk supplies and other services to other monopoly suppliers and inset appointees, i.e. on-going supply of water and sewerage services. Further, OFWAT

provided guidance on what services should be considered as 3rd party and which ones fall under principal services. This is in reference to Appendix 1 of RAG4.09 which we have assessed and interpreted based on the summary below.

1) Projects included within Table 4P (expenditures on non-price control diversions) have been included and considered as 3rd party, in line with Developer Services method statements and assumptions;

2) Projects that are with another monopoly suppliers/inset appointees that provide bulk supplies have been considered as 3rd party; and

3) Rechargeable costs such as non-primary, fire hydrants and installation of meters to non-household are considered as 3rd party services however are recognized as opex (not as capex).

7.31 Consultation and confirmation from relevant business specialists have been made to confirm whether RAG's requirement as per above is appropriate and consistent with our reporting.

## F Reconciliation

7.32 Once all of the data has been reviewed and the necessary adjustments made, a final reconciliation is carried out to ensure no capital expenditure has been omitted or included when it should not have been. Tables 4D and 4E are reconciled to management accounts (HFM) and to statutory financial statements (i.e. PP&E note).

7.33 There are a number of capital expenditure categories that are removed during the allocation process that form reconciling items between our initial data set from SAP and tables 4D and 4E. These are listed below:

- Thames Tideway Tunnel capital expenditure – this is excluded from table 4E as it is included as a separate column of data in table 2B/2D (additions);
- Non-regulatory capital expenditure;
- Retail capital expenditure – this is excluded from tables 4D/E and reported separately in table 2C; and
- Developer Services fair value adjustments on grossed-up schemes - These assets are being built by the Developers which Thames will adopt at nil cost upon completion. Under IFRS, we need to value these assets in our Balance Sheet although no real spend to Thames. This requires an adjustment to recognise the assets in our Balance Sheet at fair value and the related income. However, the fair value is posted to the projects/SAP as normal 'Value of Work Done' ("VoWD") journal rather than a manual GL journal. Hence, this is being removed from the Gross capex.

## G Population of tables 4F and 4G (Major Projects)

7.34 OFWAT has released guidance within RAG 4.09 in terms of major projects definition. Further, in reference to PR19's project list as Direct procurement for customers (DPC) and also those that are listed as potentially suitable for DPC per FD, the below have been considered by the business as major projects.

| Project Name |
|---|
| Water Supply – System Resilience Programme |
| SRO - Effluent Reuse in London |
| SRO - Transfer TW-Affinity Water |
| SRO - Transfer TW-Southern |
| SRO - Abingdon Reservoir (SESRO) |
| SRO - Severn Thames Transfer |
| London Water Network Improvement Project |

7.35 In line with the guideline that only directly attributable costs should be disclosed as part of Tables 4F/G, we ensured that we have captured those costs that are directly attributable to major projects identified, which has been capitalized (both primary and secondary costs such as D&PG – overheads). This is also in line with the accounting treatment applied which is based on the provision of the accounting standards.

7.36 In reference to the projects identified above, we then assessed the split of these costs relating to operating or capital expenditures. The Accounting treatment has been considered and documented within Accounting papers, and further review of these projects were performed to ensure that only directly attributable costs are recognized and classified appropriately.

7.37 With the understanding of these projects obtained from the business and in compliance with RAGs (also in line with IFRS accounting standards), all costs spent in Year 1 of AMP7 were capitalized. This meant that there will be £nil cost that will be presented as operating expenditures for 20/21 reporting in tables 4F and 4G.

7.38 Having considered OFWAT guidance "RAG 4.09 (Appendix 4) below, we should only be reporting as cumulative capex to those projects that have been completed in the reporting year" - it is clear that there are no major projects for AMP7 that were completed in year 1, therefore there are no amounts shown in the right-hand side of the table "Cumulative spend on completed projects". In future years where there are completed projects then these will be calculated and included in the tables.

Section 8

# Year on year capex

## Table 9 - Capex Analysis- Wholesale Water [2]

| Capex analysis - wholesale water | Water resources | | Raw water distribution | | | | |
|---|---|---|---|---|---|---|---|
| | Abstraction licences | Raw water abstraction | Raw water transport | Raw water storage | Water treatment | Treated water distribution | Total |
| FY20/21 | 34.3 | | 6.9 | 0.0 | 95.0 | 408.3 | 544.6 |
| FY19/20 | 0.0 | 26.6 | 6.7 | 0.0 | 106.7 | 498.8 | 638.8 |
| YoY Movement | | 7.6 | 0.2 | 0.0 | ( 11.6) | ( 90.5) | ( 94.3) |
| YoY Movement % | | 29% | 3% | 0% | -11% | -18% | -15% |

*Source: Thames Water*

8.1 Gross Wholesale Water capital expenditure has reduced by 15% to £544.6m. The main reasons are explained below:

**Treated Water Distribution has decreased primarily due to:**

- FY19/20 reflects the conclusion of the well-established AMP6 programme (including the trunk main strategic review initiated in 2016);
- FY20/21 reflects the commencement of a reduced AMP7 programme with a new delivery model -c.£90.5m; and
- The main reductions are in work on Distribution Mains -c.£63.9m; Trunk Mains -c.£19.7m and Developer Services -c.£6.4m.

**Water Treatment has reduced primarily due to:**

- FY19/20 included significant investment for SEMD security improvements, in comparison FY20/21 has a reduced programme -c.18.0m; and
- FY20/21 includes the development of strategic regional water resource solutions which are new to AMP7 +c.£2.2m.

**Water Resources has increased primarily due to:**

- FY19/20 included significant spend on the close out of the NEP eel screen programme, which does not feature in the AMP7 FD -c.£4.4m;
- FY20/21 now includes the development of strategic regional water resource solutions which are new to AMP7 +c.£2.4m;
- There are a couple of significant Storage Reservoir projects which contribute to the increase +c.£4.1m; and
- An increase in the general maintenance of abstraction assets +c.£3.9m.

[2] Percentages calculated using absolute numbers

Table 10 - Capex Analysis – Wholesale Wastewater[3]

| Capex analysis - wholesale wastewater | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Sewage collection | | | Sewage treatment | | Sludge treatment | | | |
| | Foul | Surface water drainage | Highway drainage | Sewage treatment and disposal | Imported sludge liquor treatment | Sludge transport | Sludge treatment | Sludge disposal | Total |
| FY20/21 | 165.4 | 4.3 | 0.9 | 154.4 | 0.1 | 1.1 | 61.0 | 1.4 | **388.6** |
| FY19/20 | 203.7 | 10.4 | 1.7 | 150.1 | 0.0 | 1.3 | 45.3 | 4.8 | **417.4** |
| YoY Movement | **( 38.3)** | **( 6.1)** | **( 0.8)** | **4.3** | **0.1** | **( 0.2)** | **15.7** | **( 3.5)** | **( 28.9)** |
| YoY Movement % | **-19%** | **-58%** | **-48%** | **3%** | **17009%** | **-15%** | **35%** | **-72%** | **-7%** |

*Source: Thames Water*

8.2 Gross Wholesale Wastewater capital expenditure has decreased by c£29m (-7%). The key variances are explained below:

**Foul collection investment has decreased by £38m (-19%):**

- Due to closure of our AMP6 Eight2O Alliance contracts (-£62m) and ramp-up our AMP7 delivery model (+£22m). The hydraulic enhancement flooding programme is a key year on year driver of this change (-£30m).

**Surface Water Drainage investment has decreased by £6m (-58%). This is driven by:**

- Key programmes of hydraulic flooding (incl. Counters Creek) and Suds drive this year on year movement.

**Sludge treatment investment has increased by £16m (35%) due to:**

- c.£12m more directly managed investment at our treatment centres as part of our focus to get the basics right.

**Sludge Disposal investment has decreased by £3.5m (-72%)**

- This is mainly due to lower investment in Advanced Energy Recovery plant at Crossness.

[3] Percentages calculated using absolute numbers

Section 9

# Year on year comparison of operating expenditure

## A Wholesale Water

### Table 6 - Wholesale Water Opex year on year movements in operating expenses by Upstream Service level

| | | | | Water Network+ | | | |
|---|---|---|---|---|---|---|---|
| | | Total | Water resources | Raw water transport | Raw water storage | Water treatment | Treated water distribution |
| | | £m | £m | £m | £m | £m | £m |
| **2019/20** | | **473.3** | **65.2** | **4.2** | **-** | **94.3** | **309.6** |
| Power | The increase is driven primarily by Covid-19 demand changes resulting in a switch of production to less efficient sites, in addition to increased cost of power. | **1.2** | - | - | - | 1.1 | 0.1 |
| Income treated as negative expenditure | Consistent with previous period | **-** | - | - | - | - | - |
| Bulk supply | Consistent with previous period | **(0.4)** | (0.4) | - | - | - | - |
| Other operating expenditure | Decrease largely as a result of significant cost incurred in the year 5 of the previous AMP (2019/2020) which did not reoccur to the same level in current year. These related to additional efforts of cost in meeting the targets of the FD, particularly that of the leakage targets. In the current year we have also had an in-house efficiency drive to ensure we are delivering leakage fixes at a lower cost rate, whilst still ensuring a delivering the improvements required. These cost reductions partially offset by an increase in traffic management charges due to the direct charges levied in this activity from the relevant councils. | **(23.3)** | (10.1) | (0.7) | - | 3.7 | (16.2) |
| Local authority and cumulo rates | The increase reflects a rates rebate received in prior year of £23m which did not occur in the current period. | **24.8** | (1.2) | 5.9 | - | (8.7) | 28.8 |
| Abstraction charges/ discharge consents | Increase in discharge costs driven by poor weather, and as such additional abstraction charges. | **4.0** | 3.9 | - | - | - | 0.1 |
| Enhancement (Nil in PY) | This is a new cost category for current year as required by the RAG guidance, and reflects the operating cost impact of enhancement activities that occurred in the year, which given is the first year of the AMP have had a significant focus. Further detail on the breakdown of these are included in table 4L. | **6.9** | 1.0 | 0.1 | 0.1 | 0.5 | 5.2 |
| Third party services | The COVID-19 pandemic led to a reduction in level of developer services activities, and therefore our third-party service costs. | **(1.6)** | (0.7) | 0.4 | - | (0.3) | (1.0) |
| **Total movement** | | **11.6** | **(7.5)** | **5.7** | **0.1** | **(3.7)** | **17.0** |
| **2020/21** | | **484.9** | **57.7** | **9.9** | **0.1** | **90.6** | **326.6** |

*Source: Thames Water*

# B Wholesale Wastewater

## Table 7 - Wholesale Wastewater year on year movements in operating expenses by Upstream Service level

| | | | Network+ Sewage collection | | | Network+ Sewage treatment | | Sludge | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Total | Foul | Surface water drainage | Highway drainage | Sewage treatment and disposal | Imported sludge liquor treatment | Sludge transport | Sludge treatment | Sludge disposal |
| | | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| 2019/20 | | 414.1 | 102.1 | 30.5 | 17.8 | 204.9 | 1.3 | 10.4 | 27.3 | 19.8 |
| Power | This movement is driven by an increase in overall power prices, in addition to lower generation of own electricity, primarily through a change in London footfall as a result of Covid-19. This is offset partially by lower consumption due to respective flow decreases and other site efficiencies. | 2.1 | 2.7 | (0.8) | (1.3) | (13.6) | 0.4 | - | 14.6 | 0.1 |
| Income treated as negative expenditure | Consistent with previous period | 1.0 | - | - | - | 3.4 | - | 0.2 | (2.6) | - |
| Bulk Discharge | Consistent with previous period | - | - | - | - | - | - | - | - | - |
| Other operating expenditure | Increases driven by a multitude of factors. This includes general wage inflation, pollution provisioning costs and increases in the number of wet weather incidents driving up tankering costs. As a result, maintenance and other costs also increased. Also included and driving the increase is traffic management costs, which have risen because of growing council charges. Finally, the foul increase is mainly derived from a significant uptick in the amount of sewer cleaning activities undertook, from 900km in prior year to 1,500km in current year. | 14.4 | 29.7 | (6.9) | (11.5) | 8.2 | (1.1) | 0.5 | (3.9) | (0.6) |
| Local authority and Cumulo rates | Broadly consistent, with rebates received in current year reducing costs slightly. | (1.7) | - | - | - | 12.0 | (0.1) | - | (12.5) | (1.1) |
| Discharge consents | Consistent with previous period | 0.7 | 0.1 | 0.1 | (0.1) | 0.4 | - | - | - | 0.2 |
| Enhancement opex | This is a new cost category for current year as required by the RAG guidance, and reflects the operating cost impact of enhancement activities that occurred in the year, which given is the first year of the AMP have had a significant focus. Further detail on the breakdown of these are included in table 4M. | 7.6 | 5.1 | 0.8 | 0.1 | 1.6 | - | - | - | - |
| Third party services | Consistent with previous period | - | (0.8) | - | - | 0.6 | - | - | 0.1 | 0.1 |
| Total movement | | 24.1 | 36.8 | (6.8) | (12.8) | 12.6 | (0.8) | 0.7 | (4.3) | (1.3) |
| 2020/21 | | 438.2 | 138.9 | 23.7 | 5.0 | 217.5 | 0.5 | 11.1 | 23.0 | 18.5 |

*Source: Thames Water*

# C Retail – Household

## Table 8 - Retail Opex – Household Commentary

| | £m | Operating Expenditure | Customer services | Debt management | Doubtful debts | Meter reading | Services to developers | Other operating expenditure | Local authority and Cumulo rates |
|---|---|---|---|---|---|---|---|---|---|
| | **19/20 published** | **204.2** | 67.1 | 10.4 | 72.9 | 9.1 | 0.0 | 44.7 | 0.0 |
| | Methodology change to restate group recharges across all categories and abortive visit | - | 15.3 | 1.0 | - | 1.0 | - | (17.3) | |
| | **19/20 restated** | **204.2** | 82.5 | 11.5 | 72.9 | 10.1 | 0.0 | 27.3 | 0.0 |
| direct | Commission upside driven by repatriation of LAHA accounts to Self billing and banking charges | **(7.7)** | (7.1) | (0.6) | | | | | |
| direct | Contact centre resource increase driven by contact volumes | **4.8** | 4.8 | | | | | | |
| direct | Transformation and stabilisation spend to address contact volume increase | **6.4** | 0.9 | 1.2 | | (0.0) | | 4.3 | |
| direct | Impact on doubtful debt of Covid-19 and system changes and inflation partially offset by transformation initiatives | **4.1** | | | 4.1 | | | | |
| direct | Lower Meter read volumes | **(2.3)** | | | | (2.3) | | | |
| direct | Decreased project costs, predominantly billing and CRM system implementation costs as customer migrations and training completed in Q1 20/21 | **(7.1)** | | | | | | (7.1) | |
| allocated | Decreased Project costs , Central Transformation launch (includes impact of 19/20 write off) and PR19 | **(8.4)** | | 2.4 | | | | (10.9) | |
| allocated | Group recharge (IFRS 16 adjustment credit offset against legal fees and salary costs) | **(10.7)** | (4.1) | (0.4) | | (0.1) | | (6.3) | 0.3 |
| allocated | Decreased field visit volume, lower legal aid and allocation methodology refinement, partially offset by increased digital spend | **(1.1)** | (0.7) | 0.6 | - | (0.4) | - | (0.6) | |
| | **20/21** | **182.1** | 76.2 | 14.7 | 77.0 | 7.3 | 0.0 | 6.7 | 0.3 |

*Source: Thames Water*

## Commentary

9.1 The underlying performance in 2020/21 (direct costs excluding Other operating expenditure) demonstrated the focus on transformation efficiency projects, the impact of Covid-19 and increased customer contact volumes in year. The YoY increase in underlying spend of £1m primarily reflects the adverse impact on doubtful debt of Covid-19 and system changes as well as increased investment in Customer Service. This was partially offset by transformation driven gains, savings in commissions driven by the LAHA repatriation project and reduced Meter reading volumes.

9.2 The year on year £22.1m favourable movement in Operating costs were inflated by £23.1m of non-recurring items and group allocation cost movements:

- £2.9m decrease in project costs primarily related to Spring (Billing and CRM system) with customer migration completed in Q1 2020/21, partially offset by stabilisation consultancy spend;
- £8.4m decrease in Central transformation PR19 and transformation write off cost taken in 19/20; and
- £11.8m decrease in net group function allocated costs.

## D Retail – Non-Household

9.3 Non-Household performance demonstrated a year on year upside of £5.8m predominantly in Doubtful debts with the recognition of uncashed checks across all non-residential business units.


Thames
Water