

# Accounting Separation Methodology Statement

Published July 2023



YorkshireWater

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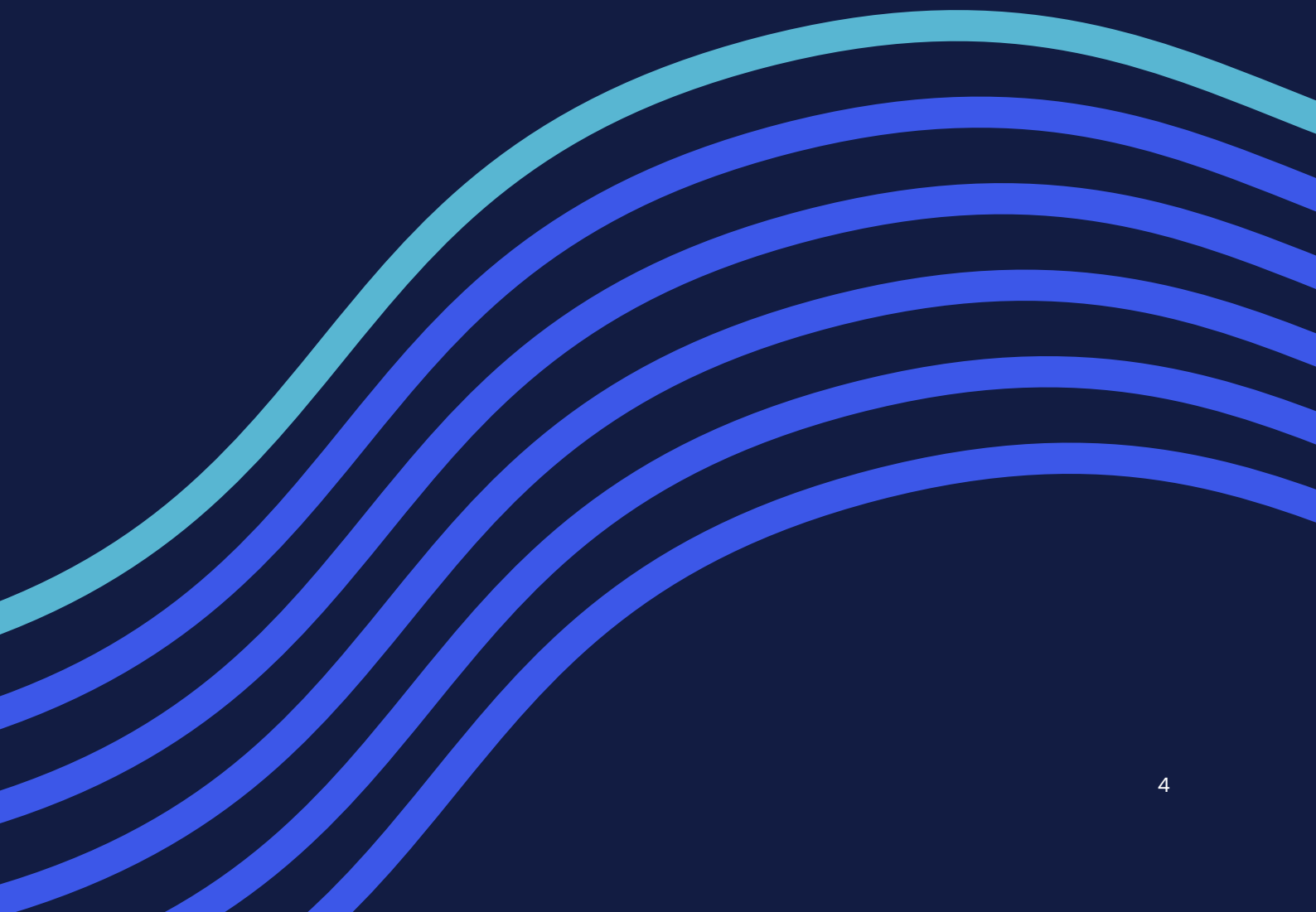
# Contents

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# 1. Introduction



# Introduction

## **The economic regulator of England and Wales (Ofwat) requires water companies to publish an Annual Performance Report (APR).**

The objective of the APR is to provide clear information regarding delivery of the performance commitments and financial performance. This methodology statement provides an overview of the processes, systems and assurance that Yorkshire Water uses to ensure the financial APR data is robust and meets all Ofwat's requirements. This document includes the enhancements made to processes this year and details the allocation methods to disaggregate totex costs between price controls and upstream services described in Section 4: Pro forma tables of the APR.

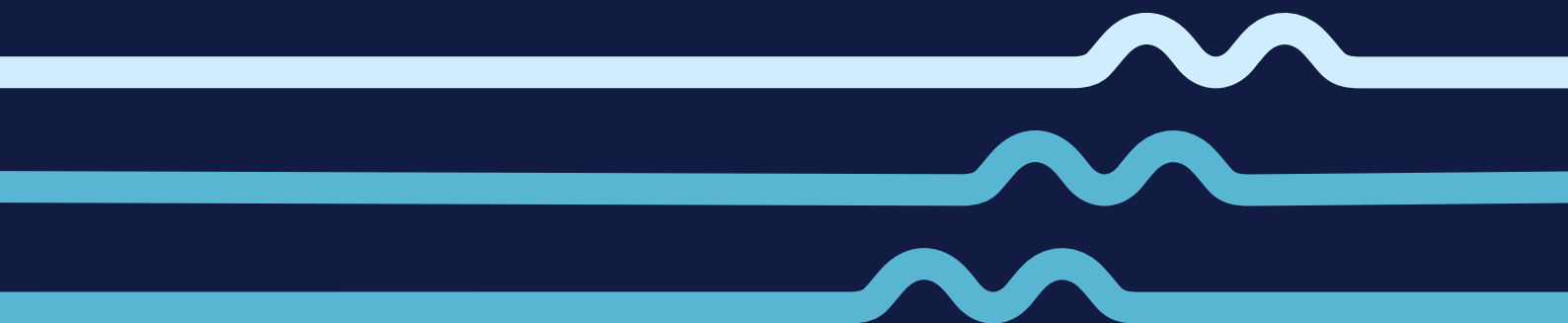
The contents of this document are intended to help stakeholders understand the robustness and method of producing our regulatory accounting statements, with particular focus on Price Control Units (Annual Performance Report Section 4: Pro forma tables) and wholesale upstream services (Annual Performance Report Section 4: Pro forma tables).

In accordance with RAG 3.14, the document is separated into the following three sections:

- High Level Overview
- Price Controls Units
- Wholesale Upstream Services.

Our Annual Performance Report can be downloaded from our reports webpage at: [yorkshirewater.com/about-us/reports/](https://yorkshirewater.com/about-us/reports/)

# 2. High level overview



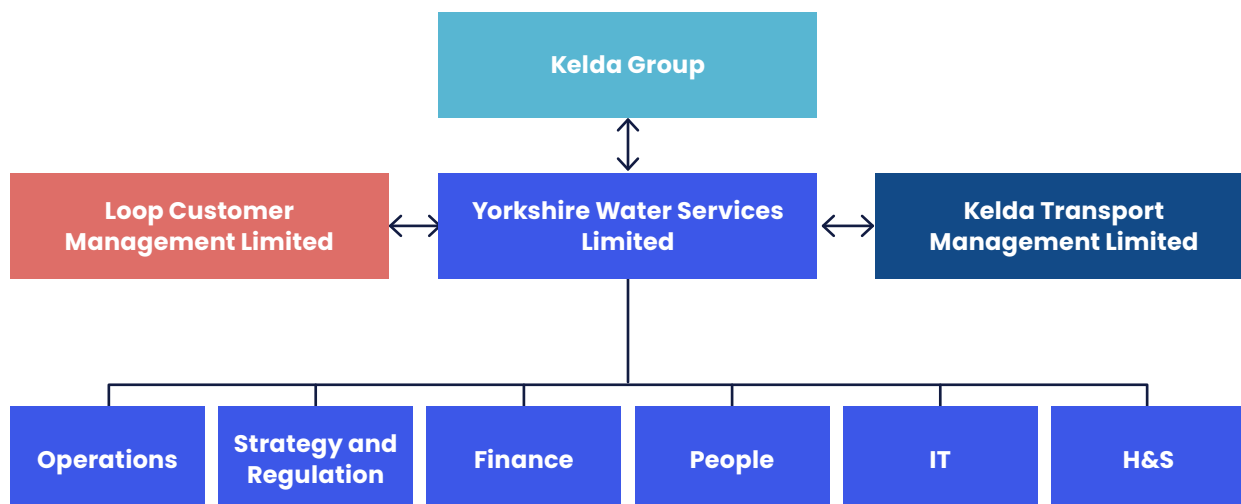
# High level overview

**To explain the process of producing the disaggregated financial cost and asset data, the company structure, financial systems and accounting standards need to be understood.**

This methodology statement includes information on:

- Business structure
- Outsourced function
- Regulatory requirements
- Governance
- Role and responsibilities
- Systems and processes.

# Business structure



**Yorkshire Water Services Limited (YWSL) is the legal entity in which all appointed regulated costs are included. The company is managed by a Board of Directors and a senior executive leadership team which manage the largest business areas. This is supported by two sister companies.**

#### These are our two sister companies:

- **Loop Customer Management Limited (Loop)**  
Manages most retail elements of customer service (excluding meter reading) and some wholesale customer service activities. Loop provides services to Yorkshire Water (YW) for domestic retail services and wholesale customer services.
- **Kelda Transport Management Limited (KTML)**  
Manages the heavy goods vehicles for the wholesale business, which is mainly the liquid sludge transport vehicles. KTML provides this service to Yorkshire Water at cost in the form of a management fee charged throughout the year.

#### These are our six major business areas:

- **Operations** includes the Water, Waste and Customer Experience areas of the business. As well as our Capital Delivery, Programme Delivery and Transformation function.
- **Strategy and Regulation** incorporates the regulatory team that undertakes price review submissions, along with both asset and company strategy teams.
- **Finance** includes procurement, with other areas of finance such as tariff setting and tax and treasury. These functions sit within Kelda Group and costs are recharged across to Yorkshire Water.
- **People** includes Human Resources.
- **IT** includes technology, data and business change.
- **H&S** includes health, safety and wellbeing across the group as well as public safety, physical security and governance of environmental protection.



# Outsourced functions

A significant proportion of retail activities have been performed by Loop, which is a UK based company. All the costs associated with this contract are charged to Yorkshire Water via an annual contract fee.

Yorkshire Water and Loop are wholly owned subsidiaries of Kelda Group Limited.

For some customers, billing and cash collection is performed by other UK water companies, typically on the boundary of the Yorkshire Water region where one company provides water services and another provides sewage services. Yorkshire Water also has arrangements with a number of local authorities for them to collect water charges on behalf of Yorkshire Water.

The table below shows the major activities that were outsourced to third parties by Yorkshire Water and Loop for the year ended 31 March 2023.

Outsourcing company	Function outsourced	Outsourced to
Loop	Cross water boundary billing, payment handling and debt management	Other UK water companies
Loop	Some billing, payment handling, and debt management	UK based local authorities and housing associations
Yorkshire Water	Customer service, billing, payment handling and debt management – domestic customers only	Loop
Yorkshire Water	Below ground network repair	UK based contract partners
Yorkshire Water	Capital delivery	UK based contract partners
Yorkshire Water	Sludge transport and sludge disposal	UK based contract partners
Yorkshire Water	Operator License and the servicing costs for the Heavy Goods Vehicles and plant	Kelda Transport
Yorkshire Water	Finance – statutory and management accounts, tax and treasury, Internal audit	Kelda Group

Yorkshire Water receives services from associates within the Kelda Group. These charges are for corporate functions including areas such as Group Finance and Internal Audit. Yorkshire Water also charges Kelda Group/associates for any support service activity. The cost and revenues associated with this are allocated to non-appointed activities and follow RAG 5 guidelines. All transactions that have occurred in the year between the appointed business (Yorkshire Water) and associated companies are disclosed in Section 7: Transactions with associates and the non-appointed business of the APR.

# Regulatory requirements

The data collated and represented in the tables within the APR follow Ofwat's Regulatory Accounting Guidelines (RAG's). The tables show the costs, revenues, assets and liabilities in a variety of formats and levels of granularity, for the different activities to deliver the appointed services provided by Yorkshire Water. Ofwat uses separate binding controls, these are: water resources, water network+, waste network+, bioresources and retail household. Detailed below is Yorkshire Water's approach to applying these guidelines.

The information presented in this document is limited to Yorkshire Water and, where appropriate, the ultimate parent company Kelda Holdings Limited.

This report has been prepared in accordance with the following documents published by Ofwat:

- IN 21/03 Regulatory accounting guidelines 2021/2022 and IN 2201 Expectations for monopoly company annual performance reporting 2021/2022.
- RAG 1.09 – Principles and guidelines for regulatory reporting under the new 'UK GAAP' regime.
- RAG 2.08 – Guideline for the classification of costs across the price controls.
- RAG 3.14 – Guideline for the format and disclosures for the annual performance report.
- RAG 4.11 – Guideline for the table definitions for the annual performance report (inclusive of appendices).
- RAG 5.07 – Guideline for transfer pricing in the water sewerage sectors.

Within RAG 2.08, Ofwat has set out cost allocation principles that should underpin the attribution and allocation of costs within the APR. Detailed below are the principles applied, together with Yorkshire Water's response on the approach. The Ofwat principles are shown in blue on the following pages.

## Ofwat principle

**Transparency:** The cost attribution and allocation methods applied to allocate costs within the APR need to be transparent. This means that the costs and revenues apportioned to each service or segment should be clearly identifiable. The cost and revenue drivers used within the system should be clearly explained to enable robust assurance against this guidance.

## Yorkshire Water response

- Costs are allocated in a clearly transparent way via cost centres which map to the regulatory definitions within the APR. The cost centres are clearly identified within the company's accounting system (SAP) allocating them directly to the activity of work carried out.
- We seek to minimise manual adjustments to information in SAP. Where overhead costs cannot be attributed to regulatory specific cost centres at source, the allocations are made using Ofwat guidance and reviewed in detail and agreed by the relevant finance and operational experts. However, once the draft regulatory accounts are prepared, some manual adjustments are inevitable to ensure that any required adjustments captured during the assurance process are included in the final regulatory financial accounts. These adjustments are then captured in a lesson learnt process to ensure that they can be incorporated in the accounting system in future years.
- Cost drivers used are consistent with Ofwat guidance and are set out in the price control and upstream services sections.

## Ofwat principle

**Causality:** 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 or allocation 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. This approach views a business as a series of activities, each of which consumes resources and, therefore, generates costs. An activity based approach should result in the majority of the total costs being attributed or allocated on a meaningful basis. All operating and capital costs must ultimately be attributed or allocated.

## Yorkshire Water response

- Cost centres are aligned to the relevant regulatory service allowing reports to be run in the required format for the tables in accordance with Ofwat's Regulatory Accounting Guidelines. Checks are undertaken to ensure all cost centres are included, and that the balances reconcile to the regulatory financial statements.
- Where possible, costs are directly allocated to service (e.g. Water Treatment). Costs are attributed and allocated to price controls in relation to the way in which resources are consumed. If allocation of costs is required, because the cost relates to more than one service, the allocation methods used are chosen from the suggested methods in the Ofwat guidance. Further details are provided in the price control and upstream sections.
- The documented procedures and resulting reported costs attributed to price controls and upstream services are then reviewed by the appropriate finance expert and approved by the senior manager in that area.

## Ofwat principle

**Non-discrimination:** Companies should ensure that no undue preference or discrimination is shown by water undertakers and sewerage undertakers in relation to the provision of services by themselves or other service providers (this is consistent with the new duty in section 2 of the Water Industry Act 1991 that has been (or, in relation to Welsh water companies, will be) inserted by section 23 of the Water Act 2014). 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.

## Yorkshire Water response

- The attribution of costs and revenues are allocated consistently across all business units and price controls, in compliance with RAG 5.07 transfer pricing guidance.

## Ofwat principle

**No cross subsidy between price controls:** Price reviews have separate binding price controls. Companies cannot transfer costs between the price control units in setting prices and preparing the APR. The revenue allowance for each price control is determined by the costs specific to that particular price control. Rules on transfer pricing are detailed in RAG 5.

## Yorkshire Water response

- Costs are allocated based on the activity and services that cause that cost (or revenue) to be incurred.
- Costs are allocated consistently across all business units and price controls in compliance with RAG5 transfer pricing guidance.
- Within the internal governance of preparing these statements, there is a high degree of segregation of duties.

## Ofwat principle

**Objectivity:** 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.

## Yorkshire Water response

- To ensure no favour is given to any business unit, costs are directly allocated where possible and where this is not possible an objective measure (in line with Ofwat's principles) is used to allocate costs.
- Objective cost allocation measures used are measures which are reported internally or externally, e.g. number of customer contacts, number of (Full Time Equivalent) FTEs and are in some cases subject to external assurance.
- The attribution of costs and revenues are allocated consistently across all business units, price controls and non-appointed business in compliance with RAG 5 transfer pricing guidance.

## Ofwat principle

**Consistency:** 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, to enable monitoring of companies' performance against price control assumptions; and any changes to the attribution and allocation methodology from year-to-year should be clearly justified and documented in the Accounting Separation Methodology Statement.

## Yorkshire Water response

- The tables are prepared in a consistent manner each year to enable meaningful comparison of information over time. The underlying company structure and SAP financial systems have remained the same for many years. However, regulatory guidance is refined annually and improvement opportunities identified and implemented. Where these changes are necessary to improve accuracy and compliance, changes are made and detailed within this statement in the changes to methodology section.
- Any changes as detailed in Information Notices or company specific letters issued by Ofwat are implemented.

## Ofwat principle

**Principal use:** Where possible, capital expenditures 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.

## Yorkshire Water response

- Assets, where possible, are allocated to the service in which they are required for use and any associated operating costs and depreciation will be charged to that service.
- Assets which are used by more than one service area are allocated to a single business unit of principal use and then recharged to the relevant business unit. Included in this category are a number of general and support assets that do not have a single principal use service, for example the financial system and the IT infrastructure. These assets have been allocated to Wastewater Network+ and then recharged to other business units using an appropriate cost driver. The recharges are included in Section 4: Pro forma tables of the APR, Table 2A and are detailed on the next page in the capital recharge table.

Asset category	Recharge basis	Total £m	Water resources £m	Water Network+ £m	Waste Network+ £m	Bioresources £m	Retail HH £m
IT	FTE	23.980	0.589	9.555	10.599	1.201	2.037
Offices	FTE	9.699	0.233	3.787	4.200	0.476	1.002
Operational	FTE	4.133	0.111	1.800	1.996	0.226	0.000
R&D	FTE	0.384	0.010	0.166	0.184	0.021	0.003
Regulation	FTE	0.141	0.003	0.055	0.061	0.007	0.015
Stores/ Depots	FTE	0.042	0.001	0.018	0.020	0.002	0.000
Telemetry	FTE	0.803	0.022	0.350	0.388	0.044	0.000
Vehicles	FTE	0.005	0.000	0.002	0.002	0.000	0.000
<b>Total</b>		<b>39.186</b>	<b>0.970</b>	<b>15.733</b>	<b>17.450</b>	<b>1.977</b>	<b>3.057</b>

The overall recharge of assets held in wastewater network+ under principal use has reduced from £42.3m to £39.2m. This is due to a review of the assets held within wastewater network+ for the principal use recharge, transferring some assets to their appropriate price control so they are directly depreciated rather than being recharged from wastewater network+.

As in prior years these assets are allocated to wastewater network+ in Section 4: Pro forma tables of the APR, Table 2D and 2O and then recharged across price controls using Full Time Equivalent (FTE).

Whilst the assets follow principal use set out in RAG 2, with depreciation recharged to other price controls. In 2021/2022 the principal use recharge impact for wholesale was presented within depreciation and amortisation in Table 2A. After clarification of the RAGs from Ofwat we have changed this approach for 2022/2023 and the principal use recharge impact for wholesale is reported within the PU opex recharge on Table 2A and is included within the relevant lines in Table 4D, 4E, 4J and 4K.

Our Management and General support capital programme expenditure programme continues to be proportionately allocated to the Water and Wastewater programmes in line with the price control units section. This seems practical as the alternative would be to capitalise each asset separately and hence, we apportion expenditure using the same approach to ensure consistency.

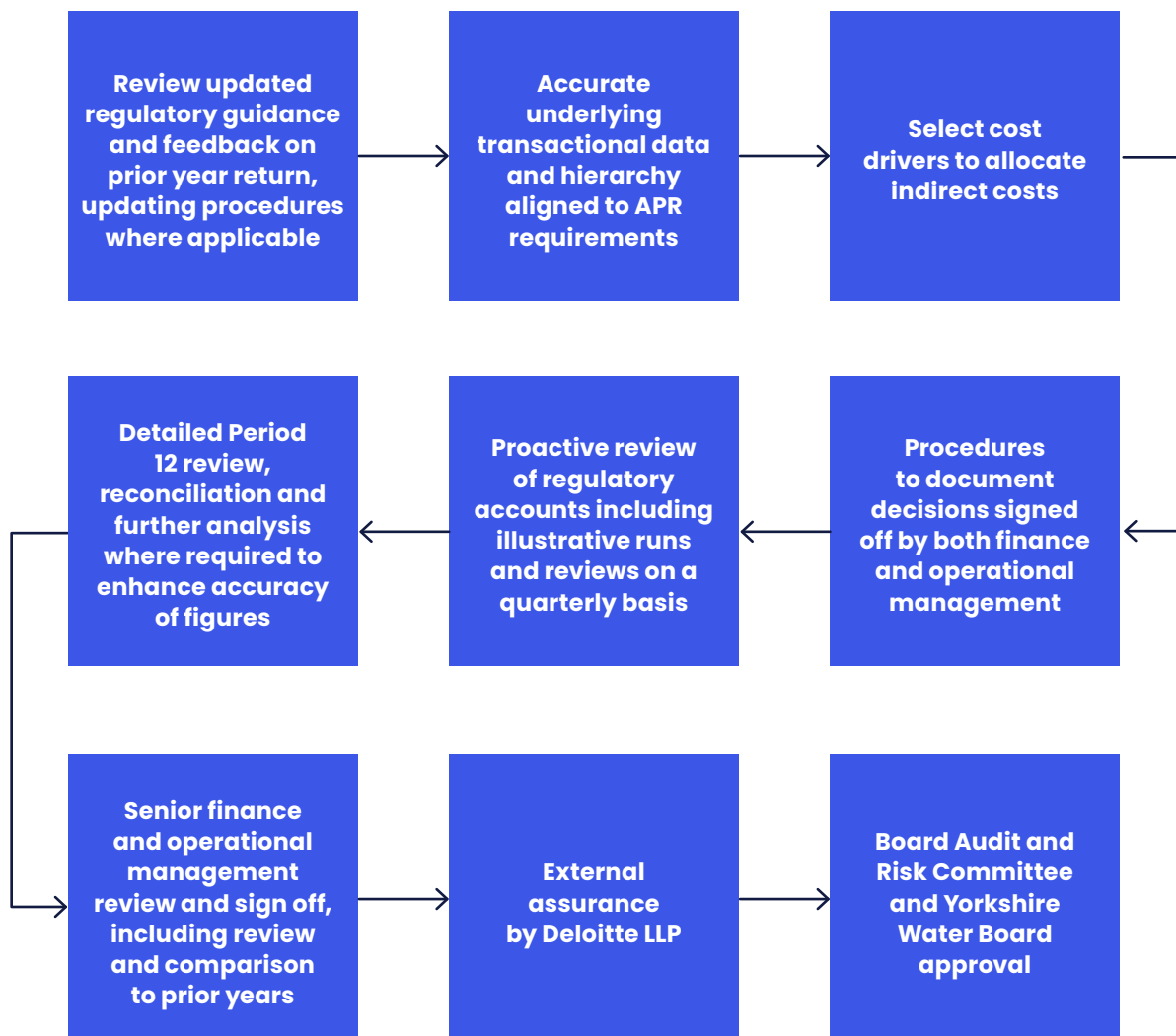
# Governance

**The APR involves experts from across the business to pull together the required financial and regulatory information.**

The key teams involved are as follows:

- Finance and Regulation
- Operational management at both senior and local level
- Board Audit and Risk Committee
- Yorkshire Water Board.

An overview of the process is set out below:



# Roles and responsibilities

## Regulation

- Understand Ofwat guidance.
- Agree levels of assurance and process.
- Set assurance timetable in line with Board dates.
- Co-ordinate the collation of the APR document and supplementary documents.
- Publish and submit all regulatory documents.

## Finance

- Understand Ofwat guidance and ensure procedures align with the requirements and that those procedures are approved by operational experts.
- Review of quarterly position to assist operational teams to make decisions for investment and/or efficiency. As well as identifying and rectifying any issues ahead of year end.
- Management of underlying financial transactions, cost centres and cost drivers ensuring all values reconcile and all costs are included within the regulatory accounts.
- A dedicated virtual finance team to form APR finance working group which communicates regularly to ensure compliance with Regulatory Accounting Guidelines (RAGs) and how to generate these changes through the corporate system.
- Review and sign off cost drivers with Operational Managers as part of the annual business planning process, but also as required if there are relevant operational changes.
- Consolidate and report annual performance tables including methodology statement.

## Senior and operational managers

- Review and approve procedure notes.
- Review and confirm the data has been produced in a manner consistent with the procedures.
- Review and confirm the data meets the relevant reporting requirements.
- Review and confirm the data has been sense checked by the Data Manager.
- Understand and explain any significant changes or trends in the data.
- There is an APR Steering Group to ensure process and timetable adherence in the months prior to publication.

## Audit and assurance

Once completed, the Annual Performance Report with its data is subject to an external financial audit and external assurance. The outcomes of these are stated in Section 4: Pro forma tables of the APR.

## Board review

Board Audit Committee and Yorkshire Water Board review and sign-off the audited report before publication.

# Systems and processes

**Yorkshire Water uses SAP as the corporate financial system, and is the only system used for producing the regulatory accounts. A new version of SAP was introduced in 2019/2020 and a consistent approach for cost assessments and allocations has been used.**

Cost centres have been set up for all sites and network locations and, where possible, costs are coded directly to sites as purchase orders are raised. Instead of using an external reporting tool to disaggregate the data, the indirect cost assessment facilities in SAP are used to allocate costs that cannot be directly coded to an upstream service or price control.

An example of indirect costs would be the operating costs of our IT infrastructure which need to be apportioned across the price controls. By using the cost assessment process in SAP to allocate costs directly to site and regulatory cost centres, it gives the advantage of providing operational and financial users differing views of the same data set. The management, statutory and regulatory accounts are extracted from the same source data giving 'one version of the truth'.

The APR financial tables have been produced within SAP from cost capture information that has been set to include price control data wherever possible. The current operating structure and management accounting hierarchy within Yorkshire Water have been deliberately structured along similar lines to the price controls. This minimises further data processing and disaggregation into Ofwat's price controls, with operational managers managing direct costs and budgets that are closely aligned to Ofwat's price controls.



# 3. Price control units



# Price control units

## The principles and guidance set out in RAG 2.08 have been applied in the preparation and completion of the regulatory accounting tables.

The price controls which Ofwat have specified are: water resources, water network+, wastewater network+, bioresources, retail household. These are the price controls over which all costs in Yorkshire Water appointed business must be allocated and presented for the purposes of Ofwat regulatory reporting.

The methodology for allocation of total operating expenditure (totex) across price controls is summarised below.

### Capital expenditure

Capital expenditure data is managed and maintained on the corporate financial system (SAP). Separate projects are raised for each discrete work instruction, and each project is allocated investment categories which are attributes that describe the regulatory reason, asset type and the price control and wholesale upstream service.

Where a project is given more than one regulatory driver for the investment, two or more investment categories with appropriate percentages are used to calculate the allocation to each price control and upstream service. All project investment category allocations are reviewed by the regulatory programme assurance team (within the Finance department), and system controls prevent any project going live until these positions have been assured.

Monthly capital expenditure is reported to our Business Investment Committee (BIC), which actively manages the capital programme and the associated regulatory and customer performance commitments. This includes individual approvals of projects greater than £1m.

At the start of this AMP we re-designed and expanded the hierarchy of investment categories used to record capital expenditure data. This has created a structure which can be expanded as our reporting needs continue to develop in line with regulatory guidance.

All live projects have been mapped to this new structure and projects managers have received training and documentation in the use of the new investment categories.

An analysis and explanation of capital expenditure by price control and variance from the Final Determination are detailed in Section 4: Pro forma tables of the APR, Table 4D and Table 4E.

### Operating expenditure

Operating expenditure data is managed and maintained on the corporate financial system (SAP). On a monthly basis appointed operating costs are reported to the Yorkshire Water Board.

For annual statutory reporting purposes, all information is prepared in SAP in accordance with FRS 102. Once these values have been reviewed and approved by senior managers, the cost assessment functionality within SAP is used quarterly; to allocate overheads into the site and regulatory price control cost centre hierarchy, including any adjustments required by RAG 1.09. Further details of the methodology for the allocation of costs over price controls is detailed in tables 1 to 7 in this methodology statement.

An analysis and explanation of operating expenditure by price control and variance from the previous year are detailed in Section 4: Pro forma tables of the APR, Table 2B.

The RAG 4.11 principles and guidance have been reviewed and applied when completing the tables within the APR.

Yorkshire Water do not have any sites that cover more than one price control. However, power costs are disaggregated by upstream service.

Any other power costs that are not electricity, such as heating oil and gas, are directly allocated to the correct service cost centre in SAP in accordance with RAG 3.14.

# Methods and cost drivers used to calculate allocations between price control units

The following tables provide details how costs are allocated across price controls:

**Table 1 – Wholesale/retail allocations**

Activity Wholesale/ retail	Company	2022/2023 Cost Driver	2022/2023 Why considered appropriate	2021/2022 Cost Driver
Customer Services – Billing	Loop	Wholly in retail	Per Ofwat RAG 2.08	Wholly in retail
Customer Services – Payment handling, remittance, and cash handling	Loop	Wholly in retail	Per Ofwat RAG 2.08	Wholly in retail
Customer Services – Charitable trust donations	YW	Wholly in retail	Per Ofwat RAG 2.08	Wholly in retail
Customer Services – Vulnerable customer schemes	Loop	Wholly in retail	Per Ofwat RAG 2.08	Wholly in retail
Customer Services – Non-network customer enquiries and complaints	Loop/YW	Wholly in retail	Per Ofwat RAG 2.08	Wholly in retail
Customer Services – Network customer enquiries and complaints	YW	Wholly in retail	Per Ofwat RAG 2.08	Wholly in retail
Customer Services – Investigatory visits/first visit to customer	YW	Where the cause of investigation is not a network issue it is charged to retail. Where the cause of the investigation is a network issue it is charged to wholesale	Per Ofwat RAG 2.08	Where the cause of investigation is not a network issue it is charged to retail. Where the cause of the investigation is a network issue it is charged to wholesale
Customer Services – Other customer services	YW	Wholly in retail	Per Ofwat RAG 2.08	Wholly in retail

**Table 1 – Wholesale/retail allocations (continued)**

<b>Activity Wholesale/ retail</b>	<b>Company</b>	<b>2022/2023 Cost Driver</b>	<b>2022/2023 Why considered appropriate</b>	<b>2021/2022 Cost Driver</b>
Debt management	Loop	Wholly in retail	Per Ofwat RAG 2.08	Wholly in retail
Doubtful debts	YW	Wholly in retail	Per Ofwat RAG 2.08	Wholly in retail
Meter reading	YW	Wholly in retail	Per Ofwat RAG 2.08	Wholly in retail
Services to developers	YW	Providing developer information and administration for new connections in retail, all other services within wholesale	Per Ofwat RAG 2.08	Providing information and administration for new connections in retail, all other services within wholesale
Disconnections and reconnections	YW	Administration and decision retail, physical activity is within wholesale	Per Ofwat RAG 2.08	Administration and decision retail, physical activity is within wholesale
Demand side water initiatives	YW	All expenditure is retail except where expenditure is to meet wholesale outcomes	Per Ofwat RAG 2.08	All expenditure is retail except where expenditure is to meet wholesale outcomes
Customer side leaks	YW	All expenditure and income is retail except where expenditure is to meet wholesale outcomes	Per Ofwat RAG 2.08	All expenditure and income is retail except where expenditure is to meet wholesale outcomes
Other operating expenditure (OOE)	YW	Other direct costs which are retail in nature are allocated direct to retail (i.e. those not covered under the other headings)	Per Ofwat RAG 2.08	Other direct costs which are retail in nature are allocated direct to retail (i.e. those not covered under the other headings)
OOE – General and Support – IT costs	YW	Split based on headcount – proxy to number of computers	Per Ofwat RAG 2.08 allows the choice of an appropriate cost driver	Split based on headcount – proxy to number of computers
OOE – General and Support – Finance, HR, payroll, general management	YW	HR on headcount, everything else FTEs	HR on headcount, everything else FTEs. Timesheets are not available so Ofwat’s second preference has been used	HR on headcount, everything else FTEs

**Table 1 – Wholesale/retail allocations (continued)**

<b>Activity</b>	<b>Company</b>	<b>2022/2023</b>	<b>2022/2023</b>	<b>2021/2022</b>
<b>Wholesale/ retail</b>		<b>Cost Driver</b>	<b>Why considered appropriate</b>	<b>Cost Driver</b>
OOE – Executive Directors remuneration	YW	FTEs	Timesheets are not available so Ofwat’s second preference has been used	FTEs
OOE – Non-Executive Director’s remuneration	YW	FTEs	Timesheets are not available so Ofwat’s second preference has been used	FTEs
OOE – General and support – Facilities, building/grounds maintenance	YW	FTE (Inc. office based contractors) and grounds maintenance is directly allocated to the associated site	Per Ofwat RAG 2.08	FTE (Inc. office based contractors) and grounds maintenance is directly allocated to the associated site
OOE – General and support – insurance	YW	FTEs for staff related insurance, Gross Modern Equivalent Asset Value (GMEAV) for asset insurance	Per Ofwat RAG 2.08	FTEs for staff related insurance, GMEAV values for asset insurance
OOE – Other general and support costs	YW	FTEs	Timesheets are not available so Ofwat’s second preference has been used	FTEs
OOE – Regulation Licence costs	YW	One ninth of Regulation staff and license costs are allocated to Retail and the remainder to Wholesale. The direct costs are then used to apportion amongst upstream services	Per Ofwat RAG 2.08	One ninth of Regulation staff and license costs are allocated to Retail and the remainder to Wholesale. The direct costs are then used to apportion amongst upstream services
OOE – Local Authority Rates	YW	Rateable Asset Value	Per Ofwat RAG 2.08	Rateable Asset Value
Third party services, e.g. rechargeable works	YW	All Wholesale	Per Ofwat RAG 2.08	All Wholesale
Depreciation	YW	Assets allocated per principal use, partly in retail	Per Ofwat RAG 2.08	Assets allocated per principal use, partly in retail

**Table 2 – Retail household/non-household allocations**

Yorkshire Water exited the retail non-household market in October 2019 and in 2021/2022 we just included developer services cost as specified in RAG 2.08. For 2022/2023 no developer services activities were carried out via a retailer intermediary and all costs are, therefore, classified as wholesale as per RAG 2.08.

Activity	Company	2022/2023	2022/2023	2021/2022
Retail household/ Non-household		Cost Driver	Why considered appropriate	Cost Driver
Services to developers	YW	No retail non-household	Per Ofwat RAG 2.08	100% Non-household

**Table 3 – Wholesale Water cost allocations**

Expenditure line	Method of allocation	Why considered appropriate	How satisfied
Power	The Energy system (Optima) collects costs at meter level and this costed directly to the activity where possible. Where site meters supply more than one service the account is split based upon estimated power usage of equipment on site	When metered data is available it is used, otherwise management estimate is applied per RAG 4.11	Management estimates are reviewed by the finance team with operational colleagues
Income treated as negative expenditure	Renewable Obligation Certificates income associated with each service type allocated appropriately	Directly allocated	Reviewed with operational colleagues
Bulk Supply	Directly allocated	Directly allocated	Directly allocated – bulk supply solely related to raw water
Renewals expensed in year – infrastructure/ non-infrastructure	N/A	Nil operating expenditure	Nil operating expenditure

**Table 3 – Wholesale Water cost allocations (continued)**

Expenditure line	Method of allocation	Why considered appropriate	How satisfied
Other operating expenditure – Employment costs	These costs are allocated based on a management assessment. For overhead costs these are allocated based on number of FTEs	All employment costs charged to capital are recorded using timesheets as well as standard capitalisation for key teams. For remaining operating costs, management assessments are based, where possible, on operational data. Where this is not possible estimates have been made	Finance business partners are trained in accounting separation guidelines and meet with all operational budget managers. A peer review is also undertaken
Other operating expenditure – Hired and contracted services	These costs are allocated direct to service through our procurement system (Ariba) and work management system (WMS). For elements which cross price controls an assessment is completed to allocate these costs based on an appropriate driver	Directly allocated	A review is under-taken monthly and at the end of the year to ensure all costs have been allocated correctly
Other operating expenditure – Other direct costs – Telephone	Landline costs are directly allocated. Mobile phone costs are allocated in the same way as employment costs	Directly allocated, where possible, and the rest in line with cost of employment	In line with employment allocation process
Other operating expenditure – Other direct costs – Insurance	Insurance payments are directly allocated to service and are allocated using an appropriate cost driver based on the type of insurance e.g. Gross Modern Equivalent Asset Value (GMEAV) for property insurance	Directly allocated where possible and the balance is based on appropriate cost driver	Insurance database categorises insurance claims and the allocations for the premium are based on the type of cover
Other operating expenditure – Other direct costs – Rents	Rents are allocated directly to service	Directly allocated	Monthly costs review to ensure directly allocated costs are correct
Other operating expenditure – Other direct costs – Contract cars	Allocated in the same way as employment costs	Directly allocated, where possible and the rest in line with cost of employment	In line with employment allocation process

**Table 3 – Wholesale Water cost allocations (continued)**

<b>Expenditure line</b>	<b>Method of allocation</b>	<b>Why considered appropriate</b>	<b>How satisfied</b>
Other operating expenditure - Other direct costs - Professional subscriptions	Directly allocated	Directly allocated	Directly allocated
Other operating expenditure - Other direct costs - GSS and Ex gratia	Directly allocated	Directly allocated	Monthly Guarantee Standards Scheme and ex gratia reviewed to ensure directly allocated costs are correct
Other business activities (Licence fee)	One ninth of Regulation staff and license costs are allocated to Retail, with the remainder equally allocated to Wholesale services. The direct costs are then used to apportion amongst upstream services	All of this cost is regulation costs. The cost allocation used is per the Ofwat guidance	Complies with RAG 2.08
Other business activities (Wholesale Market Costs)	50% water and 50% waste. The direct costs are then used to apportion amongst upstream services	Consistent approach to industry	Complies with guidelines
Other business activities – Innovation fund	As per Ofwat guidance innovation fund costs are not included in operating expenditure	As per information notice	Complies with guidelines
Exceptional items	Directly allocated	Analysis of operational costs identified as exceptional for statutory financial reporting has been separately undertaken	Complies with guidelines
Scientific services	Allocation on costs of sampling	Costs are driven by complexity of sampling, for which cost is a proxy	Monitor sampling for Drinking Water Inspectorate (DWI) purposes



**Table 3 – Wholesale Water cost allocations (continued)**

<b>Expenditure line</b>	<b>How costs are allocated</b>	<b>Why considered appropriate</b>	<b>How satisfied</b>
General and Support - HR	Allocated using headcount	Each colleague drives an HR cost even if part time	Proxy to how HR costs are driven
General and Support – IT	Headcount (Inc. office based contractors and 50% of non office as they share IT equipment)	Each colleague has a PC or hand-held device even if part time	Proxy for number of PCs and hand-held devices
General and Support – Management services and finance	FTE (Inc. Contractors)	Based on Ofwat guidelines	Complies with guidelines
General and Support – Facilities	FTE (Inc. office based contractors)	Based on Ofwat guidelines	Complies with guidelines
General and Support – Other	FTE	Based on Ofwat guidelines	Complies with guidelines
Local authority rates – Cumulo rates (water)	Use GMEAV to allocate costs (rateable assets only)	Based on value of assets assigned to the business units which are reported in supplementary fixed assets tables	Complies with guidelines
Service charges – Abstraction	Directly allocated	Directly allocated	Directly allocated
Service charges – Discharge	Directly allocated	Directly allocated	Directly allocated
Service charges – Other	Directly allocated	Directly allocated	Directly allocated
Cost associated with Traffic Management Act	Directly allocated based on number of permits	Directly allocated to treated water distribution	Complies with guidelines
Costs associated with lane rental scheme	N/A	Nil operating expenditure	Nil operating expenditure
Statutory water softening	N/A	Nil operating expenditure	Nil operating expenditure

**Table 4 – Wholesale wastewater cost allocations**

<b>Expenditure line</b>	<b>How costs are allocated</b>	<b>Why considered appropriate</b>	<b>How satisfied</b>
Power	The Energy system (Optima) collects costs at meter level and this costed directly to the activity where possible. Where site meters supply more than one service the account is split based upon estimated power usage of equipment on site	Where metered data is available it is used, otherwise a management estimate is applied per RAG 4.10	Management estimates are reviewed by finance business partners with operational colleagues
Income treated as negative expenditure	Renewable Obligation Certificates income associated with each service type allocated appropriately	Directly allocated	Reviewed with operational colleagues
Bulk Supply	N/A	Nil operating expenditure	Nil operating expenditure
Renewals expensed in year – infrastructure/ non-infrastructure	N/A	Nil operating expenditure	Nil operating expenditure
Other operating expenditure – Employment costs	These costs are allocated based on a management assessment. For overhead costs these are allocated based on number of FTEs	All employment costs charged to capital are allocated based on timesheets as well as standard capitalisation for key teams. For remaining operating costs, management assessments are based, where possible, on operational data. Where this is not possible estimates have been made	Finance business partners are trained in accounting separation guidelines and meet with all operational budget managers. A peer review is also undertaken
Other operating expenditure – Hired and contracted services	These costs are allocated direct to service through our procurement system (Ariba) and work management system (WMS). For elements which cross price controls, an assessment is done to allocate these costs based on an appropriate driver	Directly allocated	A review is undertaken monthly and at the end of the year to ensure all costs have been allocated correctly

**Table 4 – Wholesale wastewater cost allocations (continued)**

<b>Expenditure line</b>	<b>How costs are allocated</b>	<b>Why considered appropriate</b>	<b>How satisfied</b>
Other operating expenditure – Other direct costs – Telephone	Landline costs are directly allocated. Mobile phone costs are allocated in the same way as employment costs	Directly allocated, where possible, and the rest in line with cost of employment	In line with employment allocation process
Other operating expenditure – Other direct costs – Insurance	Insurance payments are directly allocated to service, and premiums are allocated using an appropriate cost driver based on the type of insurance e.g. Gross Modern Equivalent Asset Value (GMEAV) for property insurance	Directly allocated where possible, and the balance is based on appropriate cost driver	Insurance database categorises insurance claims and the allocations for the premium are based on the type of cover
Other operating expenditure – Other direct costs – Rents	Rents are directly allocated to service	Directly allocated	Monthly costs review to ensure directly allocated costs are correct
Other operating expenditure – Other direct costs – Contract cars	Allocated in the same way as employment costs	Directly allocated, where possible and the rest in line with cost of employment costs	In line with employment allocation process
Other operating expenditure – Other direct costs – Professional subscriptions	Directly allocated	Directly allocated	Directly allocated
Other operating expenditure – Other direct costs – GSS and ex gratia	Directly allocated	Directly allocated	Monthly Guarantee Standards Scheme and ex gratia review to ensure directly allocated costs are correct
Other business activities (Licence fee)	One ninth of Regulation staff and license costs are allocated to Retail, with the remainder equally allocated to Wholesale services. The direct costs are then used to apportion amongst upstream services	All of this cost is regulation costs. The cost allocation used is per the Ofwat guidance	Complies with RAG 2.08

**Table 4 – Wholesale wastewater cost allocations (continued)**

<b>Expenditure line</b>	<b>How costs are allocated</b>	<b>Why considered appropriate</b>	<b>How satisfied</b>
Other business activities (Wholesale Market Costs)	50% water and 50% waste. The direct costs are then used to apportion amongst upstream services	Consistent approach to industry	Complies with guidelines
Other business activities – Innovation fund	As per Ofwat guidance innovation fund costs are not included in operating expenditure	As per information notice	Complies with guidelines
Exceptional items	Directly allocated	Analysis of operational costs identified as exceptional for statutory financial reporting has been separately undertaken	Complies with guidelines
Scientific services	Allocated on costs of sampling	Costs are driven by complexity of sampling, for which cost is a proxy	Complies with guidelines
General and Support – HR	Allocated using headcount	Each colleague drives an HR cost, even if colleague is part time	Proxy to how HR costs are incurred
General and Support – IT	Headcount (Inc. office based contractors and 50% of non office as they share IT equipment)	Each colleague has a PC or hand-held device, even if part time	Proxy for number of PCs and hand-held devices
General and support – Management services and finance	FTE (Inc. Contractors)	Based on Ofwat guidelines	Complies with guidelines
General and Support – Facilities	FTE (Inc. office based contractors)	Based on Ofwat guidelines	Complies with guidelines
General and Support – Other	FTE	Based on Ofwat guidelines	Complies with guidelines
Local authority rates – Wastewater	Use GMEAV to allocate costs (rateable assets only)	Based on value of assets assigned to the business unit which are reported in supplementary fixed assets tables	Complies with guidelines
Service charges – Abstraction	Directly allocated	Directly allocated	Directly allocated
Service charges – Discharge	Directly allocated	Directly allocated	Directly allocated

**Table 4 – Wholesale wastewater cost allocations (continued)**

<b>Expenditure line</b>	<b>How costs are allocated</b>	<b>Why considered appropriate</b>	<b>How satisfied</b>
Service charges – Other	Directly allocated	Directly allocated	Directly allocated
Cost associated with Traffic Management Act	Directly allocated based on number of permits	Directly allocated to sewage collection	Compiles with guidelines
Costs associated with lane rental scheme	N/A	Nil operating expenditure	Nil operating expenditure
Costs associated with industrial emissions directive	Directly allocated	Directly allocated	Directly allocated

**Table 5 – Retail cost allocations**

<b>Expenditure line</b>	<b>How costs are allocated</b>	<b>Why considered appropriate</b>	<b>How satisfied</b>
Customer services – Billing	Where separately costed teams work solely on billing activity they are coded directly to billing. Where teams work for a proportion of their time on billing an appropriate cost driver is used. Where teams work solely on household or non-household their costs are allocated accordingly	Where costs are separately identified in SAP these are directly charged. For costs which are allocated, e.g. postage, an appropriate cost driver is used, e.g. number of bills issued as a proportion of total items of mail dispatched	Cost allocation methods are reviewed with a finance business partner and an operational colleague to ensure appropriate
Customer services – Payment handling	Payment commissions and the cost of the Payments team are held separately in SAP. Other costs allocated to payment handling are small and based on an appropriate cost driver	The majority of costs are separately identifiable	The majority of costs are separately identifiable
Customer services – Charitable trust donations	N/A	Nil operating costs	Nil operating costs
Customer services – Vulnerable customer schemes	Directly allocated	Directly allocated	Cost allocation methods are reviewed with a finance business partner and an operational colleague to ensure appropriate
Customer services – Non-network enquiries and complaints	Contact centre costs are allocated between network and non-network using the number of customer contacts as a cost driver. The number of customer contacts agrees to numbers reported within the APR and also for C-MEX. Other team costs are allocated based on management estimate	Costs are apportioned based on the number of calls	The number of contacts used to apportion costs are assured by the operational team

**Table 5 – Retail cost allocations (continued)**

<b>Expenditure line</b>	<b>How costs are allocated</b>	<b>Why considered appropriate</b>	<b>How satisfied</b>
Customer services – Network enquiries and complaints	Contact centre costs are allocated between network and non-network using the number of customer contacts as a cost driver. The number of customer contacts agrees to numbers reported for the APR and C-MEX. Other team costs are allocated based on management estimate	Costs are apportioned based on the number of calls	The number of contacts used to apportion costs are assured by the operational team
Customer services – First time investigatory visits – Retail	An analysis is prepared of customer visits which are not due to a network failure	This is compliant with Ofwat’s guidance that first time investigatory visits that are not due to a network failure are classed as retail activities	Cost allocation methods are reviewed with a finance business partner and an operational colleague to ensure appropriate
Customer services – Other customer services	N/A	Nil operating expenditure	Nil operating expenditure
Debt management	Most is done by separate household and non-household teams whose costs are directly allocated. Some other teams are allocated to this activity by management estimate, but the costs are smaller in value	The majority of costs are separately identifiable	The majority of costs are separately identifiable
Doubtful debts	Directly allocated	Directly allocated	Directly allocated
Meter reading	Directly allocated	Directly allocated	Directly allocated
Services to developers	N/A	Nil operating expenditure	Nil operating expenditure
General and support – IT	Loop costs are directly allocated. For Yorkshire Water costs are allocated based on headcount	Assumed each person employed has a PC, Laptop or hand-held device	Headcount data from payroll by section
General and support – HR	Loop costs are directly allocated. For Yorkshire Water, costs are allocated based on headcount	Assumed each person employed has called upon HR services	Headcount data from payroll by section

**Table 5 – Retail cost allocations (continued)**

Expenditure line	How costs are allocated	Why considered appropriate	How satisfied
General and support – Facilities	Loop costs are directly allocated. For Yorkshire Water, costs are allocated based on floor space and FTE	Floor space alone is not valid as some staff carry out both wholesale and retail activities	Done on a facilities site-specific basis
General and support – Other	Loop costs are directly allocated. For Yorkshire Water, costs are one ninth of regulation staff and license costs	YWSL is regulation costs. The cost allocation used is per the Ofwat guidance	Complies with guidelines

**Table 6 – Non-appointed cost allocations**

RAG 4.09 Appendix 1 has been followed to ensure operating costs associated with non appointed revenue has been appropriately allocated.

Expenditure line	How costs are allocated	Why considered appropriate
Revenue	Non-water/wastewater services e.g. tankered waste, third party use of appointed assets and rechargeable work where the appointee is not a statutory supplier	RAG 4.09 Appendix 1
Operating costs	Operating costs associated with revenue stated above. This includes depreciation where appropriate	RAG 4.11

**Table 7 – Sewage collection split by function, as recorded in Yorkshire Water mapping system**

Function	Length, Kilometres	Split by function, %
Foul	21,072	68%
Surface Water	7,569	25%
Highways	2,230	7%
<b>Total</b>	<b>30,871</b>	<b>100%</b>



Table 8 below shows the percentages in management and general allocation which are materially consistent with previous year's allocations.

**Table 8 – Management & General (M&G) percentage cost split allocations across the price controls as below:**

<b>FTE % allocations</b>	<b>Water resources</b>	<b>Water Network+</b>	<b>Wastewater Network+ sewage collection</b>	<b>Wastewater Network+ sewage treatment</b>	<b>Bioresources</b>	<b>Retail HH</b>	<b>Retail NHH</b>	<b>Total</b>
Total overhead 2021/2022	2%	38%	24%	18%	6%	11%	1%	<b>100%</b>
Total overhead 2022/2023	3%	39%	25%	18%	5%	10%	–	<b>100%</b>
Management services and finance 2021/2022	1%	40%	34%	12%	5%	8%	–	<b>100%</b>
Management services and finance 2022/2023	2%	48%	24%	13%	5%	8%	–	<b>100%</b>
Data processing 2021/2022	1%	40%	31%	14%	4%	9%	1%	<b>100%</b>
Data processing 2022/2023	2%	46%	24%	15%	4%	9%	–	<b>100%</b>
Facilities 2021/2022	1%	40%	28%	16%	5%	10%	–	<b>100%</b>
Facilities 2022/2023	2%	43%	24%	16%	5%	10%	–	<b>100%</b>

The above table shows how the Management and General costs have been allocated using internal FTE and contractors (where they use the overhead services).

For most management and general allocations internal Yorkshire Water FTE has been used. However, we have incorporated total contractors FTE's for management and finance as the in-year costs benefit the whole contract. In terms of data processing costs which are mainly information technology costs, only the actual number of contractors using these services have been included and similarly where contractors use Yorkshire Water facilities, they have appropriate FTE allocations. We have been continually reviewing and improving the process each year to ensure that each price control receives a fair share of their Management and General costs.

**Table 9 – General and support variance**

Variance	Water resources	Water Network+	Waste Network+ sewage collection	Waste Network+ sewage treatment	Bioresources	Retail HH	Retail NHH	Total
	£m	£m	£m	£m	£m	£m	£m	£m
General and support variance	1.2	1.3	(1.3)	0.7	(0.6)	0.4	(0.3)	<b>1.4</b>

General and support (G&S) expenditure has increased from 2021/2022 by £1.4m. The variance from 2021/2022 can be seen in Table 9.

In 2022/2023 PR24 related expenditure has commenced, this will continue in to 2023/2024.

Offsetting the PR24 impact this year is a reduction in our strategic procurement tendering and resourcing support.

As per the guidance in the information notice (IN22/01) we haven't included the innovation fund provision in 2022/2023.

We continue to incur costs in relation to the transformation project we commenced in 2020/2021 to identify efficiencies and provide a step change in operational performance.

Where possible, we have allocated G&S expenditure using appropriate costs drivers that truly represent the benefits each price control will see from the transformation programme.

**Table 10 – Recharges between water resources, water network+, wastewater network+ and bioresources**

	Water Resources £m	Water Network+ £m	Waste Network+ £m	Bioresources £m
Water usage	0	(2.0)	0.8	1.2
Wastewater disposal	0	4.9	0	(4.9)

Inter-price control charges are included for the consumption of water by wastewater network+ and bioresources, and there is also a charge for the disposal of water sludges produced through water treatment. These charges are consistent with prior-year and are listed and quantified in the Table 10 above.

Based on current methodologies we have reported liquor treatment recharge between wastewater network+ and bioresources in Section 4: Pro forma tables of the APR, Table 4E and this is consistent with our PR19 assumptions and submissions.

For Table 8C of the APR we have reported the indicative shadow cost for liquor treatment recharge using the Jacobs methodology and this ensures consistency with the industry.

For 2022/2023 we have reported costs to wastewater network+ of purchasing energy from Bioresources within Section 4: Pro forma tables of the APR, Table 4K.19 as per the guidance published in October 2021. The income received by bioresources in relation to this is reported in Section 4: Pro forma tables of the APR, Table 4K.20 and Table 8C.20.

## Power

Electricity allocations amongst price controls and upstream services continues to be a focus for this year’s annual performance report, with involvement of operational managers and energy experts across the business reviewing each site by asset and electricity rating of the assets.

This has further refined the process to ensure the electricity costs for co-located sites are allocated more accurately. A summary in Table 11 shows which costs are directly costed and which are allocated. In summary, electricity costs are allocated to services in three different ways:

- Sites that have been determined to be more than 95% related to a single service have been directly posted to a cost centre for that process, with the remaining percentages for those sites established to be immaterial and not cost beneficial to allocate further (per accordance with RAG 2).
- Sites with generation from sludge processes are complex, so are allocated to services on a monthly basis as part of the financial month end process. For these sites, all generation is deemed to be sludge related and overall site consumption, not purchased units, are allocated by percentage before the generation is deducted.
- Other sites relating to more than one service are coded to Whole Site Costs cost centres. These costs are then allocated by SAP cost assessment process.

## Direct and Indirect Costs

Direct costs are costs which relate directly to that activity and are costed in SAP directly; indirect costs are costs that are allocated on an assessment basis. Table 11 shows the proportions which are direct and indirect for total other operating costs. Most of our costs are directly allocated with the remaining allocated through assessments. This is consistent for both water and wastewater.

**Table 11 – Split between Directly Coded and Allocated Costs**

	Wholesale			
	Water		Waste	
	Direct	Allocated	Direct	Allocated
Power	69%	31%	61%	39%
Other operating expenditure	85%	15%	81%	19%

## Revenue allocation for each price control

A new requirement for AMP7, RAG 4.11 requires companies to split wholesale revenues by the four wholesale price controls. Our allowed revenue for each price control is set out in our final determination. We set wholesale tariffs each year with the intention to recover our allowed revenue for each price control. Our tariffs are set based on our latest view of forecast customer numbers and consumption. Every year, if each tariff therefore was to be multiplied by the forecast number of customers and consumption on that tariff, we would expect to recover our allowed revenue for each price control. The tariff split between price controls varies depending upon the characteristics of each individual tariff; the split is predominantly based on the underlying costs forecast to be incurred in providing that particular service to customers.

## Base, enhancement and developer service operating expenditure

We follow the same allocation methods for enhancement operating expenditure as we do for base. Enhancement expenditure is minimal for 2022/2023. This will continue to increase as we go through AMP7. We do not report any operating costs for developer services as the majority of costs are capital in nature.

## Changes to methodology, reasons and quantification

A thorough review of operating cost allocations and SAP processes is undertaken each year to ensure compliance with Regulatory Accounting Standards. Refinements are made only to achieve more accurate categorisation, but these are minor and the allocations have been applied materially consistently since (2017/2018).

### The areas of changes in 2022/2023 are:

- We have followed the same principles as in 2021/2022 in relation to principal use recharge. However, in 2021/2022 the principal use recharge impact for wholesale was presented within depreciation and amortisation in Section 4: Pro forma tables of the APR, Table 2A. In accordance with RAG 4.11, the principal use recharges are now included in base operating expenditure within the detailed cost tables (4D, 4E, 4J & 4K) and disclosed on table 2A.
- In 2017/2018, we completed a bottom up appraisal of staff and contractor time, which forms the basis on which overheads are allocated to price controls and upstream services. We continue to enhance the process and set out the allocation of costs to reflect appropriate consumption by price control to reflect the nature of and consumption by specific contractual arrangements. This seems more consistent with the causality principle set out in RAG 2.08. We review all cost drivers as business changes take place.

# 4. Wholesale upstream services



# Wholesale upstream services

The disaggregation of operating costs into price controls (within Tables 2B of the APR) follows the same process as the disaggregation into upstream services (within Tables 4D-4E of the APR). The allocation methods and processes described in this Accounting Separation Methodology statement apply to both upstream services and price controls. A description of the basis of upstream costs has been included in the commentary below. Capital cost allocations are also the same for capital expenditure. All capital projects are coded directly to the relevant upstream service by using Investment categories on SAP for each project, which are then amalgamated into price control.

**Table showing Water upstream cost methodology & assumptions**

Price control	Upstream service	Yorkshire Water methodology & assumptions
	Abstraction licences	Abstraction licence costs payable to the Environment Agency are held on a separate general ledger code and on specific cost centres within the accounting system SAP.
<b>Water resource</b>	Raw water abstraction	The Yorkshire Water costing structure is set up in such a way that the cost centres within the accounting system SAP reflect the definition, which includes any pumping associated between two reservoirs. It is assumed that impounding reservoirs (including compensating reservoirs) are under raw water abstraction. All YW impounding reservoirs have abstraction licences either individually, or as a group e.g. those in the Washburn Valley. YW has only one bulk supply import that is allocated to water resources.

**Table showing Water upstream cost methodology & assumptions (continued)**

Price control	Upstream service	Yorkshire Water methodology & assumptions
<b>Water Network+</b>	Raw water transport	The YW costing structure is set up in such a way that the cost centres within the SAP system reflect the definition of raw water transport.
	Raw water storage	The YW costing structure is set up in such a way that the cost centres within the SAP system reflect the definition of raw water storage.
	Water treatment	Not all costs are posted to individual treatments works, for example salary costs are posted at service level.
	Treated Water Distribution	<p>The YW costing structure is set up on a catchment basis, each area contains both above and below ground assets with no split between trunk treated water transport and local treated water distribution. Some larger assets, e.g. Grid Pumps, do have their own cost centre. In order to complete the upstream services table, the above and below ground assets within each Treated Water Transmission (TWT) were assigned to either trunk or local with the following assumptions being made.</p> <p><b>Above Ground Assets</b></p> <p>The following types of assets were split between trunk and local:</p> <ul style="list-style-type: none"> <li>• Water Pumping Stations (WPS)</li> <li>• Water Towers (WTR)</li> <li>• Service Reservoirs (SRE)</li> <li>• Critical Supply Reservoirs (CRE)</li> </ul> <p>The treated water storage assets (towers, services reservoirs and critical supply reservoirs) could be either trunk or local, but only a small number are deemed by operational colleagues to be local. Therefore, all treated water storage costs have been dealt with as trunk mains costs.</p> <p>Water pumping stations could be deemed to be either trunk or local, so an exercise has been carried out to determine which category the operational Water Pumping Stations belong. Power costs by metered supply have been assigned based on this data. Other costs such as maintenance have been split pro rata.</p> <p>There is no specific field in the asset database to identify whether treated water distribution assets relate to trunk or local mains. However, current cost depreciation (CCD) is only found on above ground assets within this business unit, and the CCD value has been allocated in a consistent manner to operating costs.</p> <p><b>Below Ground Assets</b></p> <p>Below ground assets within the YW Asset Inventory System have a flag attached to them, indicating whether they are 'Main Treated' or 'Distribution Management Area'. Functional locations within SAP direct all repair and maintenance activity to the relevant network cost centre, apart from proactive leakage repairs which are settled to codes that separately identify them.</p> <p>An analysis of borehole pumping costs using the formulas within RAG 2.08 has been performed to calculate the proportion of costs that relate to the separate upstream services for water resources and water network+ upstream services.</p>

**Table showing Water upstream cost methodology & assumptions (continued)**

Price control	Upstream service	Yorkshire Water methodology & assumptions
<b>Wastewater Network+ sewage collection</b>	Foul	<p>YW splits its sewage collection assets into the three upstream services being foul, surface water and combined. However, from a costing perspective, sewage collection costs are held on cost centres at drainage area zone (DAZ) level for both above and below ground assets with no split between foul, surface, highways or combined. To do the apportionment, an analysis of sewer lengths in each of the three 'Sewage Collection' categories has been undertaken from our Asset Inventory (AI) system, due to improved mapping of our below ground infrastructure the proportion of costs has drastically changed this year. Please refer to Table 7 for the revised splits.</p>
	Surface water drainage	<p>YW's operational (non-terminal) stations are categorised as foul, surface or combined. No pumping stations have been identified specifically under the highways drainage category. Power costs are allocated direct to appropriate service (i.e. foul, surface) with the costs attributed to combine being allocated as described.</p>
	Highway drainage	<p>Repair and maintenance work (cyclical or reactive) on infrastructure assets are carried out by contractors on jobs raised via SAP which is coded to the drainage area zone. Costs are collected at drainage area zone level only.</p>
<b>Wastewater Network+ sewage treatment</b>	Sewage treatment and disposal	<p>A significant proportion of costs are coded directly (e.g. maintenance work is coded directly to assets), with some costs such as salary costs posted at service level.</p>
	Imported liquor treatment	<p>A small proportion of direct costs are allocated to this activity as most of the liquor is gravity returned to the front inlet of a sewage treatment works and therefore incurs very little cost. Salary costs are posted at service level based upon management assessment, and power costs are a split of whole site costs based on management assessment of power usage on liquor treatment.</p>
<b>Bioresources</b>	Sludge transport	<p>It is assumed that liquid sludge movements are included under transport. Our tankering function has been outsourced since 2020/2021. All costs are directly coded to sludge transport.</p>
	Sludge treatment	<p>The YW costing structure is set up in such a way that the cost centres within the SAP system reflect the definition of sludge treatment. Salary costs are posted at service level based upon management assessment and power costs are a split of whole site costs based on management assessment of power usage.</p>
	Sludge disposal	<p>The YW costing structure is set up in such a way that the cost centres within the SAP system reflect the definition of sludge disposal. Salary costs are posted at service level based upon management assessment. A focused sludge disposal team means all disposal costs are allocated to one budget, and collating these costs is much easier than other upstream services.</p>



# Significant changes in cost, or movements in a cost type between upstream services

## Water

Overall operating costs for the water service increased by £58.1m, c22.5% from 2021/2022. However, as detailed previously, principal use recharge wasn't included in operating expenditure numbers for 2021/2022 so removing these to look at the true year on year variance shows the water service has increased by £41.4m.

A summary of movements by upstream service is shown in the below table:

Clean Water			Water Resources		Water Network+				Total
	Units	DPs	Abstraction Licence	Raw Water Abstraction	Raw Water Transport	Raw Water Storage	Water Treatment	Treated Water Distribution	
Total operating expenditure excluding third party services 2022/2023 (inc. PU recharge)	£m	3	11.248	31.464	15.674	3.165	85.283	169.264	<b>316.098</b>
PU recharge 2022/2023	£m	3	0.059	0.910	0.204	0.270	3.613	11.646	<b>16.702</b>
Total operating expenditure excluding third party services 2022/2023 (exc. PU recharge)	£m	3	11.189	30.554	15.470	2.895	81.670	157.618	<b>299.396</b>
Total operating expenditure excluding third party services 2021/2022	£m	3	5.218	25.977	10.916	2.607	64.360	148.890	<b>257.968</b>
Variance	£m	3	5.971	4.577	4.554	0.288	17.310	8.728	<b>41.428</b>
Variance	%	3	114.4	17.6	41.7	11.0	26.9	5.9	<b>16.1</b>

## Operating expenditure

In AMP6, we set ourselves stretching upper quartile targets across several performance commitments. To meet these targets, we made improvements to the operational business. This has put us in a strong position operationally for AMP7. Our overall operating cost has increased by £41.4m for the water price control in 2022/2023 for the following reasons:

- This financial year we experienced the first drought in Yorkshire for more than 25 years, including the lowest recorded rainfall in parts of the county since records began 130 years ago. Whilst the mix of raw water sources across the region provided increased resilience, the unusually dry weather meant that our reservoir stocks dropped swiftly throughout Spring and Summer. This atypical expenditure led to an additional c.£25m of costs incurred which are solely within the water price control, as follows:
  - As a result of the drought, Yorkshire Water responded through increased pumping of raw and treated water around the region. This led to a significant increase in our energy costs (£13.7m) due to increased consumption to ensure that customer supplies were protected, combined with being unable to hedge this consumption in advance since the circumstances were unforeseen. This is at a time where energy costs are at the highest, they have been in years.
  - To further protect our worst affected region (Worth Valley), a temporary reconfiguration of our network was put in place enabling Yorkshire Water to pump raw water from an alternative reservoir and transfer to the Worth Valley (c£1.9m).
  - We also focused resources to maximise the levels of water maintained in the pipes (i.e. timely detection and repairs of leaks), although during hot summer periods this can also be challenging due to increased risk of pipes cracking due from movement caused by drier ground. This led to £4.8m of additional costs relating to repairs and maintenance.
  - To mitigate the impact on the business, react accordingly and implement the drought plan, there has been an increase in requirements and responsibilities for many individuals and teams including strategic treatment works being manned for 24 hours a day during the periods of highest demand. This increased staff costs by £1.2m.
- In addition to the atypical expenditure relating to the drought there have also been several inflationary pressures:
  - As a result of increased fuel, energy and raw material prices combined with decreased

market availability of raw materials we have seen considerable inflationary pressures in the chemical supply chain. This has resulted in accelerated price increases from suppliers being passed onto us. This has impacted our cost for water treatment.

- Energy prices continued to increase through 2022/23 and unhedged energy baseload positions were exposed to volatile energy market pricing. YW continues to manage price risk by hedging according to the energy purchasing policy and making trades according to carefully governed price targets. As at 31 March 2023, Yorkshire Water had fixed over 77% of its forecast baseload power purchase requirements for the remainder of AMP7, including 98% for the year to 31 March 24. Hedges were made through a combination of forward commodity hedges and financial energy swaps. From October 2023, 20% of the forward baseload position will be met through a Corporate Power Purchase Agreement with a UK wind farm development. The percentage figures are presented relative to the purchased baseload volume. In addition, YW leaves 5 – 10% of the total purchased electricity volume to the Day Ahead index to make allowances for variations in volume due to operational factors.
- Following the EA's Water Resource consultation and Strategic Review of Charges for abstraction, YW have incurred abstraction charges at the new, revised rates in 2022/2023 increasing our annual fee from £5.0m to £9.6m.
- We continue to incur costs in relation to the transformation programme we commenced in 2020/2021. Across the business we identified efficiencies which will enable a step change in operational performance over the AMP to meet our stretching FD, and there are also associated severance costs.
- Pension costs for 2021/2022 were £5.7m which was reported in cash expenditure. However, as agreed at PR09 and reiterated in Information Note 13–17 at PR19, this was the final year of pension deficit payments to be funded by customers.

## Capital expenditure

- We have seen a net increase of £46.1m from 2021/2022 reported level of expenditure. This was due to an increase of £43.9m of gross expenditure, and a decrease in grants and contributions by £2.2m.
- The table commentary we have provided in Section 4 of the APR focuses on the variance to Final Determination.

## Wastewater

Overall operating costs for the wastewater service decreased by £11.3m, c5.3% from 2021/2022. However, principal use recharge wasn't included in operating expenditure numbers for 2021/2022 so removing these to look at the true year on year variance shows the waste service has increased by £8.4m.

A summary of movements by upstream service is shown in the below table:

Wastewater	Units	DPs	Network+ Sewage Collection			Network+ Sewage Treatment		Bioresources			Total
			Foul	Surface water drainage	Highway drainage	Sewage treatment and disposal	Imported sludge liquor treatment	Sludge transport treatment	Sludge treatment	Sludge disposal	
Total operating expenditure excluding third party services 2022/2023 (inc PU recharge)	£m	3	41.197	6.667	14.094	105.868	(0.023)	9.632	14.629	9.361	<b>201.425</b>
PU recharge 2022/2023	£m	3	(8.660)	(3.183)	(0.891)	(8.851)	(0.151)	0.104	1.843	0.030	<b>(19.759)</b>
Total operating expenditure excluding third party services 2022/2023	£m	3	49.857	9.850	14.985	114.719	0.128	9.528	12.786	9.331	<b>221.184</b>
Total operating expenditure excluding third party services 2021/2022			29.575	27.052	21.294	106.497	-0.095	7.611	11.635	9.195	<b>212.764</b>
Variance	£m	3	20.282	(17.202)	(6.309)	8.222	0.223	1.917	1.151	0.136	<b>8.420</b>
Variance	%	3	68.6	(63.6)	(29.6)	7.7	(234.7)	25.2	9.9	1.5	<b>4.0</b>

## Operating expenditure

As with water, wastewater also made improvements in the operational business in AMP6 to put us in a strong position for AMP7.

We have achieved a significant cost reduction in wastewater as detailed below, although these are offset by cost increases detailed later. This results in a net increase for the wastewater price control of £8.4m:

- We achieved our best Wastewater treatment works performance in 2022/2023, with discharge permit compliance at 99.7% putting us on track to achieve our end of AMP target of 100%. This resulted in associated costs related to minimising the number of 'at risk' and 'high risk' works.
- Trade effluent maintained a position of zero consented traders impacting on our sewage treatment works compliance, thereby eliminating related hired and contracted mitigation costs as seen at the start of the AMP.
- No UV failures on the East Coast this year, thus reducing bathing water pre-season preparedness costs.
- Although the drought caused significant cost pressures within the Water price control, the favourable weather conditions limited Waste's operating expenditure exposure unlike previous years. February 2023 was the driest February since 1993, compared to the same period in 2021/2022 where we experienced six storm events in January and February. Hence, there was a significant reduction in flows treated in that month alone, with YW seeing a 25% total reduction year on year. This translated to a reduction in energy consumption for sewage treatment.
- Bioresources has benefited from year on year increase in generation performance due to new generation sites (previously in commissioning phases).
- Our transformation programme recognised that current working patterns did not reflect the reality of work being completed by operational colleagues and, having reviewed the demand data, working patterns were changed. As the changes occurred in the final quarter of 2022/2023, the full year benefit will occur in 2023/2024.
- Despite these decreases in costs and tightly managing our operating budget, there have been several inflationary pressures:
  - As a result of increased fuel, energy and raw material prices combined with decreased market availability of raw materials we have seen considerable inflationary pressures in the chemical supply chain. This has resulted in accelerated price increases from suppliers being passed onto us. This has impacted our sewage treatment and sludge treatment processes.
  - Energy prices continued to increase through 2022/23 and unhedged energy baseload positions were exposed to volatile energy market pricing. YW continues to manage price risk by hedging according to the energy purchasing policy and making trades according to carefully governed price targets. As of 31 March 2023, Yorkshire Water had fixed over 77% of its forecast baseload power purchase requirements for the remainder of AMP7, including 98% for the year to 31 March 24. Hedges were made through a combination of forward commodity hedges and financial energy swaps. From October 2023, 20% of the forward baseload position will be met through a Corporate Power Purchase Agreement with a UK wind farm development. The percentage figures are presented relative to the purchased baseload volume. In addition, YW leaves 5 – 10% of the total purchased electricity volume to the Day Ahead index to make allowances for variations in volume due to operational factors.
- To limit inflation exposure in 2022/2023, operational teams continued to optimise chemical usage through various savings initiatives. Examples include reducing the use of poly on process sites which is used to improve final effluent quality and withdrawal of Taytech dosing at Scarborough STW.
- Bioresources continues to experience an increase in sludge transport costs predominantly due to outsourcing of this function to an external contractor who are also experiencing increased contract labour costs, fuel prices and inflationary pressure on parts. To help offset this we introduced further controls to approve only essential spend.

- Legislation changes (Farming for Water) has resulted in increased haulage costs, soil analysis costs and gate fees.
- We continue to incur costs in relation to the transformation programme which commenced in 2020/2021. Across the business we identified efficiencies which will enable a step change in operational performance over the AMP to meet our stretching FD, and there are also associated severance costs related to a significant reduction in FTE within this price control.
- Although we have seen a reduction in FTE within this price control, there has been an overall increase in staff costs following an external benchmarking exercise which resulted in salary increases for our operators and senior operators, partially offset by the part year benefit related to the FTE reduction.
- Pension costs for 2021/2022 were £6.6m which was reported in cash expenditure. However, as agreed at PR09 and reiterated in Information Note 13–17 at PR19, this was the final year of pension deficit payments to be funded by customers.

## Capital expenditure

- We have seen a net increase of £56.0m from 2021/2022 reported level of expenditure. This was due to an increase of £48.7m of gross expenditure, and a decrease in grants and contributions of £7.3m.
- The table commentary we have provided in Section 4 of the APR focuses on the variance to our Final Determination.

## Retail Household

Retail household expenditure has decreased by £18.1m (c22.5%) to £62.4m (exc. Principal use recharge) in 2022/2023 principally due to:

- Reduction in the household bad debt charge of £13.0m. This is made up of a decrease in the movement of the bad debt provision of £13.5m offset by an increase in write offs of £0.5m. A management estimate for the 'cost of living' crisis of £10.3m was included in 2021/2022 at the early stages of the crisis to reflect the extraordinary inflation and increase in energy price cap impacting customers. The management estimate has been reversed this year as we have seen an increased level of debt, arrears and base provision attributed to the 'cost of living' crisis during the current year. As a result, no further management estimate for 'cost of living' was recognised in 2022/2023.
- Household write offs have also increased in the year by £0.5m. In the main this is related to an increase in 'statute barred' write offs which we are obliged to write off.
- There remains a nominal non-household wholesale provision of £0.3m relating to retailers identified as high risk by the credit reference agencies for which we have provided for the exposure of default payments. This has been included in the Household line and consistent with previous years as the NHH line relates to retail NHH only in relation to the Yorkshire Water Business Services transactions which ceased in 2021/2022.
- Increased wholesale funding for Customer Side Leak and Demand Side Water Efficiency. Now fully funded by wholesale due to activities solely focused on improving wholesale outcomes.

## Retail Non-Household

The non-household (NHH) part of the business was disposed of during 2019/2020. There has been an decrease of £0.4m to £Nil in 2022/2023.

- In 2021/2022 £0.4m related to Developer Services costs. In 2022/2023 we no longer provide services via a Retailer intermediary and all costs are, therefore, classified as wholesale, with no associated costs within non-household retail.

# 5. Planned improvements for future years



# Planned improvements for future years

**We continue to reduce the number of adjustments required to produce the regulated accounts from our SAP system. We are now producing quarterly updates for each Directorate on the regulatory accounts.**

The areas for future improvements are:

- Streamlining cost driver process
- Quarterly Totex reporting
- Improved management information.

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