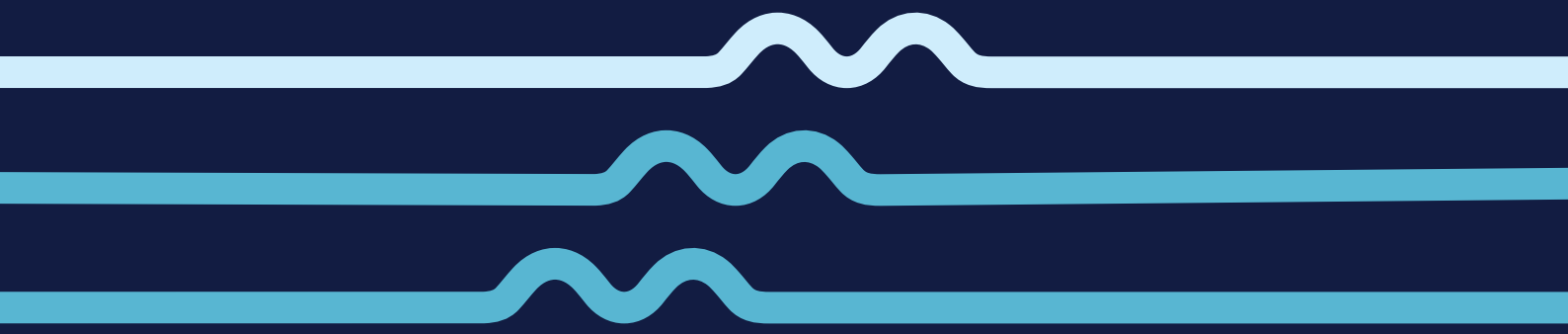


Accounting Separation Methodology Statement

Published July 2021



YorkshireWater

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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 data in APR financial is robust and meets all of Ofwat's requirements. This document includes the enhancements made to processes this year and details the methods of the allocation of totex costs between price controls, as well as the allocations for the upstream services described in Section 4 of the APR.

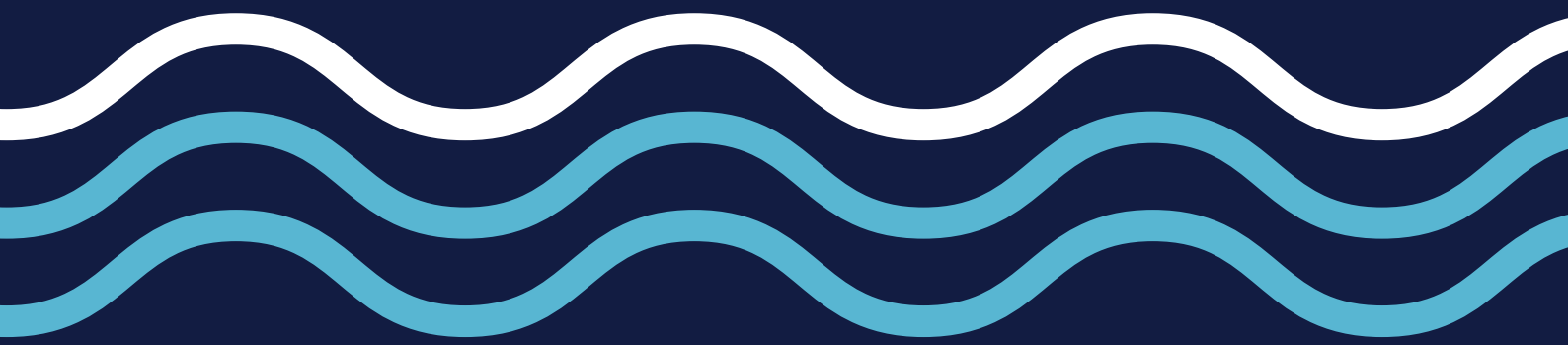
The contents of this document are intended to help stakeholders understand the robustness and method of producing our regulatory accounting statements, with particular focus on Price Control Units (Annual Performance Report Section 4) and wholesale upstream services (Annual Performance Report Section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

In accordance with RAG 3.12, 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/

2. High level overview



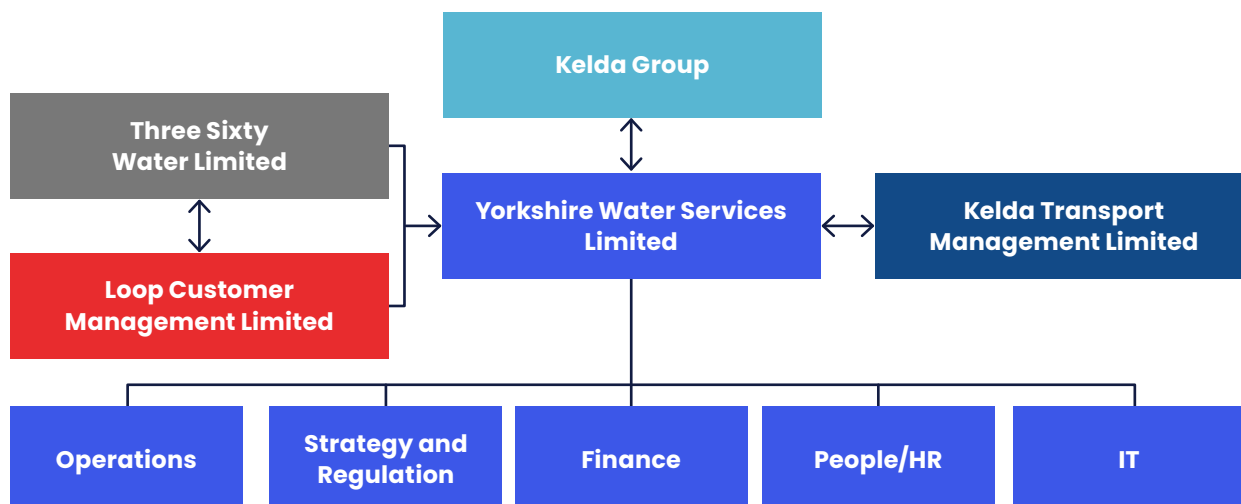
High level overview

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 functions.
- 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 three sister companies.

These are our three 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 for domestic Retail services and wholesale customer service and to Three Sixty for non-household (NHH) customers.
- 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.
- Three Sixty Water Limited – offered water and wastewater retail and added value services to non-household customers across the UK up to 1 October 2019. The non-household retail business was sold to Business Stream on this date. Three Sixty continues to provide services to Business Stream under a transition services agreement.

These are our five major business areas

- Operations includes the Water, Waste and Customer Experience areas of the business. A Chief Operations Officer (COO) leads a team which includes: Director of Water Service Delivery, Director of Wastewater Service Delivery, Director of Customer Experience, and the Heads of Asset Management and Programme Delivery.
- Strategy and Regulation incorporates the regulatory team that undertakes price submissions, tariff setting and both asset and company strategy teams.
- Finance includes procurement, with other areas of finance such as tax and treasury costs within Kelda Group, and recharged across to Yorkshire Water.
- People/HR includes facilities as well as Human Resources.
- IT includes enterprise change, data science, and IT.

Outsourced functions

A significant proportion of Retail activities have been performed by Loop and Three Sixty, which are both UK based companies. All the costs associated with these contracts are charged to Yorkshire Water via an annual contract fee. Yorkshire Water, Loop and Three Sixty companies are wholly owned subsidiaries of Kelda Group Limited. The non-household retail business was sold to Business Stream on 1 October 2019, with the company continuing to support some of the operational functions to Business Stream.

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 2021.

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	Customer service, billing, payment handling and debt management	Three Sixty (transitional period)
Yorkshire Water	Capital delivery	UK based contract partners
Yorkshire Water	Below ground network repair	UK based contract partners
Yorkshire Water	Operator License and the servicing costs for the Heavy Goods Vehicles (HGV) and plant	Kelda Transport
Yorkshire Water	Finance – statutory and management accounts, tax and treasury, Internal audit	Kelda

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, network plus water, network plus wastewater, 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:

- Information Notice (IN) 20/08 Regulatory accounting guidelines 2020/2021 and IN 21/01 Expectations for monopoly company annual performance reporting 2020/2021.
- Ofwat's 'Changes to the 2020-21 regulatory accounting guidelines since IN 20/08 2020/2021 Annual Performance Report tables'.
- 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 3.12 – Guideline for the format and disclosures for the annual performance report.
- RAG 4.09 – Guideline for the table definitions for the annual performance report (inclusive of appendices).
- RAG 5.07 – Guideline for transfer pricing.

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 allocated directly to service (e.g. Water Treatment). 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 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 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 in order 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 others 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 plus 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 Plus £m	Waste Network Plus £m	Bioresources £m	Retail HH £m
IT	FTE	25.552	0.413	10.168	11.520	1.563	1.888
Offices	FTE	1.674	0.028	0.679	0.768	0.104	0.095
Operational	FTE	4.819	0.084	2.069	2.340	0.318	0.008
R&D	FTE	0.398	0.007	0.171	0.193	0.026	0.001
Regulation	FTE	0.000	0.000	0.000	0.000	0.000	0.000
Scientific Services	FTE	0.103	0.002	0.044	0.050	0.007	0.000
Stores/ Depots	FTE	1.211	0.021	0.521	0.589	0.080	0.000
Telemetry	FTE	0.139	0.002	0.055	0.062	0.008	0.012
Vehicles	FTE	2.172	0.038	0.933	1.055	0.143	0.003
Total		36.068	0.595	14.640	16.577	2.249	2.007

The overall value of amounts recharged between business units has increased from £29.5m (2019/2020) to £36.1m in 2020/2021. There has been significant investment in Information Technology (IT) in the last two years, including replacement of the company's accounting and work management systems, which has increased the depreciation and amortisation of IT assets. As in prior years these assets are allocated to wastewater network plus in Section 4: Pro forma tables of the APR, Table 2D, and also this year in Section 4: Pro forma tables of the APR, Table 2O, and then recharged across price controls using Full-Time Equivalent (FTE). In addition, the depreciation of the PR14 development project completed in AMP6 and the equivalent PR19 work was not capitalised, meaning that the amount recharged in the 'Regulation' category has significantly reduced in AMP7.

Whilst the assets follow principle use set out in RAG 4, with depreciation recharged to other price controls, 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.

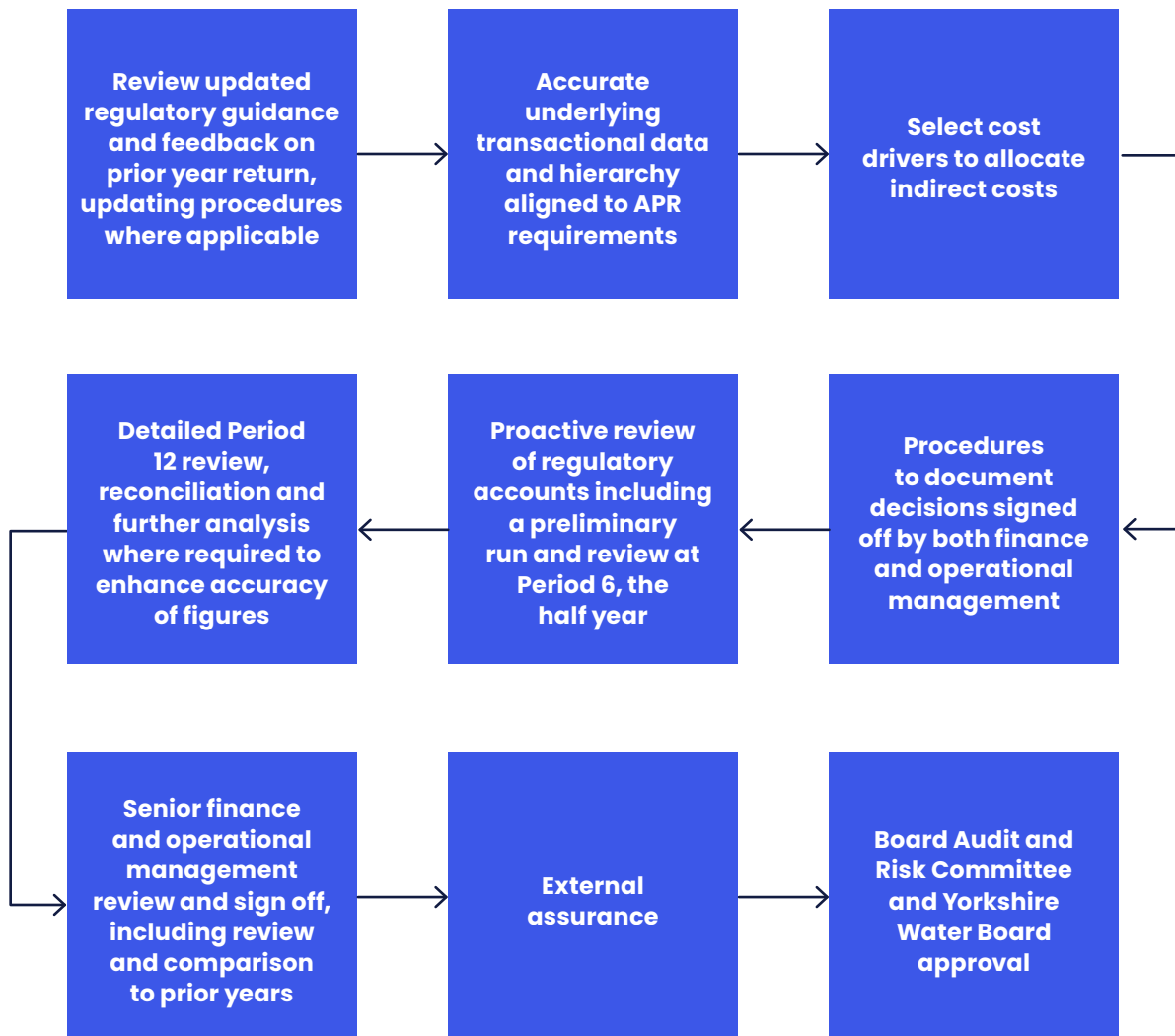
Governance

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 interim position of elements or regulatory accounts to assist operational teams to make decisions for investment and/or efficiency.
- 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 meets on a weekly basis 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.
- Attendance at the regulatory accounting working group to ensure compliance and informed on the latest regulatory accounting guidelines.
- 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 had a sense check 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 & 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 the assurance section of this report.

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 have 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 on SAP 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 close aligned to Ofwat's price controls.

3. Price control units



Price control units

The principles and guidance set out in RAG 4.09 have been applied in the preparation and completion of the regulatory accounting tables.

The price controls which Ofwat have specified are: water resources, network plus water, network plus wastewater, bioresources and 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 Regulation department), and system controls prevent any project going live until these positions have been assured.

Monthly capital expenditure is reported to our Board Investment Committee (BIC), which holds delegated authority from the Yorkshire Water Board to actively manage 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 have re-designed and expanded the hierarchy of investment categories used to record capital expenditure data. This has created a structure which is future proof and 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 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 6 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 4.09 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 or associated costs, such as the carbon reduction commitment charge, are allocated directly to the correct service cost centre in SAP in accordance with RAG 3.12.

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	2020/2021 Cost Driver	2020/2021 Why considered appropriate	2019/2020 Cost Driver
Customer Services – Billing	Loop	Wholly in retail	Per Ofwat RAG 2.08	Wholly in retail
Customer Services – Payment 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)

Activity Wholesale/ retail	Company	2020/2021 Cost Driver	2020/2021 Why considered appropriate	2019/2020 Cost Driver
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)

Activity	Company	2020/2021	2020/2021	2019/2020
Wholesale/ retail		Cost Driver	Why considered appropriate	Cost Driver
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
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 principle use, partly in retail	Per Ofwat RAG 2.08	Assets allocated per principle use, partly in retail

Table 2 – Retail household/non-household allocations

Yorkshire Water exited the retail non-household market in October 2019 and, as a result, only residual retail non-household costs remain in Yorkshire Water in 2020/2021. Table 2 shows the cost drivers used for developer services and doubtful debts, as specified in RAG 2.08.

Activity	Company	2020/2021	2020/2021	2019/2020
Retail household/ Non-household		Cost Driver	Why considered appropriate	Cost Driver
Doubtful debts	YW	Direct allocation	Per Ofwat RAG 2.08	Direct allocation
Services to developers	YW	100% 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. If it is not available management estimate is applied per RAG 4.09	Management estimates are reviewed by the finance team with operational colleagues
Income treated as negative expenditure	Allocated to main service, sub split to individual service using the same allocations as power above	No sub metering at large sites so the only way that this allocation is possible	Management estimates are reviewed by the finance business partners with operational colleagues
Service charges – Abstraction	Directly allocated	Directly allocated	Directly allocated
Service charges – Other	Directly allocated	Directly allocated	Directly allocated
Service charges – Discharge	Directly allocated	Directly allocated	Directly allocated
Bulk Supply	Directly allocated	Directly allocated	Directly allocated – bulk supply solely related to raw water

Table 3 – Wholesale Water cost allocations (continued)

Expenditure line	Method of allocation	Why considered appropriate	How satisfied
Other operating expenditure – Employment costs based on Gross (i.e. prior to capital recharges)	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. 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, assessment is done 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 allocated directly to service and premiums are allocated using an appropriate cost driver based on the type of 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
Other operating expenditure – Other direct costs – Professional subscriptions	Directly allocated	Directly allocated	Directly allocated

Table 3 – Wholesale Water cost allocations (continued)

Expenditure line	Method of allocation	Why considered appropriate	How satisfied
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
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
Scientific services	Allocated on costs of sampling	Costs are driven by complexity of sampling, for which cost is a proxy	Monitor sampling for DWI purposes
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
Local authority rates – Cumulo rates (water)	Use Gross Modern Equivalent Asset Value (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
Exceptional items	Directly allocated	Analysis of operational costs identified as exceptional for statutory financial reporting has been separately undertaken	Complies with guidelines

Table 4 – Wholesale wastewater cost allocations

Expenditure line	How costs are allocated	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	Where metered data is available it is used, otherwise a management estimate is applied per RAG 4.09	Management estimates are reviewed by finance business partners with operational colleagues
Income treated as negative expenditure	Allocated to main service, sub split to individual service using the same allocations as power above	No sub metering at large sites so the only way that this is possible	Management estimates are reviewed by finance business partners with operational colleagues
Service charges – Abstraction	Directly allocated	Directly allocated	Directly allocated
Service charges – Other	Directly allocated	Directly allocated	Directly allocated
Service charges – Discharge	Directly allocated	Directly allocated	Directly allocated
Bulk Supply	Directly allocated	Directly allocated	Directly allocated
Other operating expenditure – Employment costs based on gross manpower costs (i.e. prior to capital recharges)	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. 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)

Expenditure line	How costs are allocated	Why considered appropriate	How satisfied
Other operating expenditure – Other direct costs – Telephone	Mainly via data processing under non-operational overheads via assessment based on headcount	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 allocated directly to service, and premiums are allocated using an appropriate cost driver based on the type of 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 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
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

Table 4 – Wholesale wastewater cost allocations (continued)

Expenditure line	How costs are allocated	Why considered appropriate	How satisfied
General and Support – Other	FTE	Based on Ofwat guidelines	Complies with guidelines
Scientific services	Allocated on costs of sampling	Costs are driven by complexity of sampling, for which cost is a proxy	Monitor sampling for DWI purposes
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
Local authority rates – Cumulo rates (Wastewater)	Use Gross Modern Equivalent Asset Value (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
Exceptional items	Directly allocated	Analysis of operational costs identified as exceptional for statutory financial reporting has been separately undertaken	Complies with guidelines

Table 5 – Retail cost allocations

Expenditure line	How costs are allocated	Why considered appropriate	How satisfied
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	No costs	N/A	N/A
Customer services – Vulnerable customer schemes	Costs are allocated directly	Direct cost allocation	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 which is what drives the costs	The number of contacts used to apportion costs are assured through existing processes

Table 5 – Retail cost allocations (continued)

Expenditure line	How costs are allocated	Why considered appropriate	How satisfied
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 which is what drives the costs	The number of contacts used to apportion costs are assured through existing processes
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	No costs	N/A	N/A
Debt management	Most is done by separate household and non-household teams whose costs are allocated directly. 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	Costs are allocated directly	Costs are allocated directly	Costs are allocated directly
Meter reading	Costs are allocated directly	Costs are allocated directly	Costs are allocated directly
Services to developers	Costs are allocated directly	Costs are allocated directly	Costs are allocated directly
General and support – IT	Loop Customer Management Limited (LCML) costs are allocated directly. For Yorkshire Water Services Limited (YWSL), costs are allocated based on headcount	Assumed each person employed has a PC, Laptop or hand-held device	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 – HR	LCML costs are allocated directly. For YWSL, costs are allocated based on headcount	Assumed each person employed has a call upon HR services	FTE from payroll by section
General and support – Facilities	LCML costs are allocated directly. For YWSL, 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	LCML costs are allocated directly. For YWSL, 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 rechargeable work where the appointee is not a statutory supplier	RAG 4.09 Appendix 1
Operating costs	Associated operating costs with revenue stated above, fully including with depreciation when appropriate	RAG 4.09

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

Function	Length, Kilometres	Split by function, %
Foul	12,055	39%
Surface Water	13,386	43%
Highways	5,382	18%
Total	30,823	100%

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 2020/2021 are:

- We have changed our allocation of wholesale market service costs to 50% water and 50% waste. The direct costs are then used to apportion amongst upstream services. In 2019/2020 the MOSL fees were allocated using 58% Wholesale and 42% Retail (the 58% Wholesale is split 27% to Water and 31% Waste). This change in allocation is in line with the industry and costs are allocated to those activities and services that cause the cost to be incurred.
- Another change is to pension costs which for 2020/2021 are included in cash expenditure rather than operating costs for the wholesale business. This has been done to ensure comparability with the treatment of financial tables Ofwat required as part of the most recent price review and in line with the accounting standards applied by most of the water and sewerage companies. Further detail can be found in water and wastewater year-on-year comparisons section.

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 manpower allocations as business changes take place. We continue to use our Business Intelligence (BI) tools using data recorded from SAP, which provides a detailed view of operational staff time.

In Section 4: Pro forma tables of the APR, Table 2E, all capital income is included under 'Capitalised and amortised in accounts' as in previous years. This reflects the presentation of capital income in the statutory accounts in line with FRS102, whereby all capital income is transferred to Deferred Income.

Table 8 below shows the percentages in management and general allocations 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:

FTE % allocations	Water resources	Water Network Plus	Network Plus sewage collection	Network Plus sewage treatment	Bioresources	Retail HH	Retail NHH	Total
Total overhead 2019/2020	2%	41%	25%	18%	6%	7%	1%	100%
Total overhead 2020/2021	2%	39%	27%	18%	6%	7%	1%	100%
Management services and finance 2019/2020	1%	52%	25%	13%	3%	5%	1%	100%
Management services and finance 2020/2021	1%	47%	27%	13%	5%	6%	1%	100%
Data processing 2019/2020	1%	50%	24%	14%	4%	6%	1%	100%
Data processing 2020/2021	1%	45%	26%	15%	5%	7%	1%	100%
Facilities 2019/2020	2%	47%	24%	16%	4%	6%	1%	100%
Facilities 2020/2021	1%	43%	25%	17%	5%	8%	1%	100%

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. These allocations were introduced in 2017/2018 and have been continually improved 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 Plus	Network Plus sewage collection	Network Plus sewage treatment	Bioresources	Retail HH	Retail NHH	Total
General and support variance	£0.6m	£11.4m	£4.4m	£3.0m	£1.7m	£2.2m	-£2.3m	£21.0m

General and support (G&S) expenditure has increased from 2019/2020 by £21.0m. The variance from 2019/2020 can be seen in Table 9.

We have invested in a transformation programme across the business which has identified efficiencies and will allow us to make a step change in operational performance over the AMP to meet our stretching Final Determination (FD).

Included within G&S in 2020/2021 is £3.7m in relation to Ofwat's new innovation fund for AMP7. The income has been offset by a provision to operating costs for the obligation to pay this to the Innovation award recipients with £nil net profit recorded in the income statement in 2020/2021.

In addition, we have incurred legal and advisory costs in relation to the referral of the AMP7 Final Determination (FD) to the Competition and Markets Authority (CMA).

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 plus, wastewater network plus and bioresources

	Water Resources	Water Network Plus	Waste Network Plus	Bioresources
Water usage	£0.0m	-£0.9m	£0.1m	£0.8m
Wastewater disposal		£4.9m		-£4.9m

Inter-price control charges are included for the consumption of water by wastewater network plus 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 plus 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. We will continue to review this with the industry and Jacobs to ensure that the whole industry has a common way of reporting for liquor treatment recharges, which can then be translated into Table 4E.

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 assets and electricity rating of the assets.

This has further refined the process to ensure that 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 showing a majority of these costs directly allocated and the remainder allocated, both water and wastewater show that they are consistent.

Table 11 – Split between Directly Coded and Allocated Costs

	Wholesale			
	Water		Waste	
	Direct	Allocated	Direct	Allocated
Power	70%	30%	68%	32%
Other operating expenditure	83%	17%	87%	13%

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.
Water resource	Raw water	The Yorkshire Water (YW) 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
Water Network Plus	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>Above Ground Assets</p> <p>The following types of assets were split between trunk and local:</p> <ul style="list-style-type: none"> • Water Pumping Stations (WPS) • Water Towers (WTR) • Service Reservoirs (SRE) • Critical Supply Reservoirs (CRE) <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 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>Below Ground Assets</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 networks plus upstream services.</p>

Table showing Water upstream cost methodology & assumptions (continued)

Price control	Upstream service	Yorkshire Water methodology & assumptions
Network Plus sewage collection	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. In order to do the apportionment, an analysis of sewer lengths in each of the three 'Network Plus' categories has been undertaken from our Asset Inventory (AI) system and remains consistent with prior year.</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>
Network Plus sewage treatment	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>
Bioresources	Sludge transport	<p>It is assumed that liquid sludge movements are included under transport. There is a separate and centralised tankering team using dedicated staff and vehicles coded directly to sludge transport. Sludge transport assets include vehicles used in the transport of sewage sludge from one site to another, and also equipment found at treatment facilities used in loading such vehicles, for example tanker loading pumps.</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 £13.1m, c5.3% from 2019/2020. A summary of movements by upstream service is shown in the below table:

Clean Water	Units	DPs	Water Resources		Water Network+				Total
			Abstraction Licence	Raw Water Abstraction	Raw Water Transport	Raw Water Storage	Water Treatment	Treated Water Distribution	
Total operating expenditure excluding third party services 2020/2021	£m	3	5.386	24.595	11.894	2.358	60.676	154.643	259.552
Total operating expenditure excluding third party services 2019/2020	£m	3	5.231	23.597	9.998	1.732	57.097	148.793	246.448
Variance	£m	3	0.155	0.998	1.896	0.626	3.579	5.850	13.104
Variance	%	3	2.963%	4.229%	18.964%	36.143%	6.268%	3.932%	5.317%

Operating expenditure

In AMP6, we set ourselves stretching upper quartile targets across a number of performance commitments. To meet these targets, we made improvements to the operational business. This has put us in a strong position for the first year of AMP7. Despite this strong start to the AMP, our costs have increased due to the following reasons in 2020/2021:

- Dry weather in summer 2020 and incidents caused by adverse winter weather.
- The impacts of COVID-19 including:
 - increased household water consumption resulting in an increase of power and chemical usage;
 - increased operational costs such as enhanced cleaning regimes, social distancing requiring additional vehicles, and protective equipment to keep our colleagues safe and allow essential working in accordance with government guidance; and
 - payments to key delivery partners to employ personnel who were considered critical responders in the event of operational emergencies in the business such as leakage incidents.
- Our insurance premiums have increased this year as a result of sizeable claims in previous years, typically due to major weather events.
- Chemical prices have increased above inflation and there has been an increase in electricity prices.
- There has been an increase in our General and Support (G&S) costs:
 - We have invested in a transformation programme across the business which has identified efficiencies and will allow us to make a step change in operational performance over the AMP to meet our stretching Final Determination (FD).
 - In addition we have incurred legal and advisory costs in relation to the referral of the AMP7 FD to the Competition and Markets Authority (CMA). The majority of these costs have been allocated to water.

In 2019/2020, we presented pension costs in operating expenditure. In 2020/2021, we have presented pension costs in cash expenditure rather than operating expenditure. In relation to pension costs RAG 4.09 states 'Companies that report under FRS102 should include the element of the statutory charge attributable to deficit payments in this line.' In line with this guidance, pension costs for 2020/2021 are included in cash expenditure. This ensures comparability with the treatment of financial tables Ofwat required as part of the most recent Price Review, and ensures comparability with the treatment applied by most of the water and sewerage companies who adopt different statutory accounting standards for pensions.

This difference in treatment is because Yorkshire Water's defined benefit scheme is accounted for under the FRS102 accounting standard which applies the same rules as a defined contribution scheme. The historical pension scheme deficit recovery payments cannot be allocated between the different Kelda group entities and all cash contributions are, therefore, recognised as operating expenditure. The treatment contrasts to most other WASC's who have adopted IFRS and are required to follow defined benefit pension scheme accounting, therefore excluding cash contributions in excess of the IAS 18 defined benefit pension cost from the operating expenditure.

The impact of this change in methodology for pension costs is that £5.8m has been reported in cash expenditure rather than operating expenditure.

Capital expenditure

As this is the first year of the AMP and with significant changes to categorisation of costs within the reporting tables a year-on-year comparison is less relevant this year, however this will be completed for all future years as we progress through the AMP.

This year, the table commentary we have provided in Section 4 of the APR focuses on the variance to the Final Determination received following the CMA process.

Wastewater

Overall operating costs for the wastewater service increased by £1.1m, c1.0% from 2019/2020. 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 2020/2021	£m	3	32.951	30.317	18.943	97.262	-0.076	6.502	17.419	11.220	214.538
Total operating expenditure excluding third party services 2019/2020	£m	3	30.348	30.199	18.772	100.858	0.827	4.837	16.719	10.897	213.457
Variance	£m	3	2.603	0.118	0.171	-3.596	-0.903	1.665	0.700	0.323	1.081
Variance	%	3	8.577%	0.391%	0.911%	-3.565%	-109.190%	34.422%	4.187%	2.964%	0.506%

Operating expenditure

As with clean, wastewater also made improvements in the operational business in AMP6 to put us in a strong position for the first year of AMP7. Despite this strong start to the AMP, our costs have increased due to the following reasons in 2020/2021:

- Extreme wet weather from the start of November 2020 until February 2021, including storms Bella, Christoph and Darcy, has led to an increase in pumping costs.
- There has also been an increase in electricity prices.
- Insurance premiums have increased following historic flood claims.
- COVID-19 has increased operational costs such as enhanced cleaning regimes, social distancing requiring additional vehicles, and protective equipment to keep our colleagues safe and allow essential working in accordance with government guidance. Furthermore, shielding and COVID-19 related absences has led to engaging third party contractors.
- Bioresources has seen an increase in sludge transport costs predominantly due to outsourcing of this function to an external contractor. Though there has been an increase in opex costs, from an overall totex perspective bioresources will see a benefit over AMP7 given the ageing asset life of sludge tankers and requirement for significant capital expenditure. Previously transport opex costs included salaries and fuel, with the tankers bought on capex - now the contract costs are all opex.

- We have reported liquor treatment recharge between wastewater network plus and bioresources in accordance with our PR19 submission. This has led to the decrease in costs in imported sludge liquor treatment.
- There has been an increase in our General and Support (G&S) costs:
 - We have invested in a transformation programme across the business which has identified efficiencies and will allow us to make a step change in operational performance over the AMP to meet our stretching Final Determination (FD).
 - In addition, we have incurred legal and advisory costs in relation to the referral of the AMP7 FD to the Competition and Markets Authority (CMA). The majority of these costs have been allocated to water.
- Pension costs for 2020/2021 are included in cash expenditure rather than operating costs. Please see explanation under water variance analysis. The impact of this change in methodology for pension costs is £6.7m has been reported in cash expenditure rather than operating expenditure.

Capital expenditure

As this is the first year of the AMP and with significant changes to categorisation of costs within the reporting tables a year-on-year comparison is less relevant this year. This will, however, be completed for all future years as we progress through the AMP.

This year, the table commentary we have provided in Section 4 of the APR focuses on the variance to the Final Determination received following the CMA process.

Retail Household

Retail household expenditure has increased by £4.9m (7.5%) to £70.5m in 2020/2021 principally due to:

- £2.0m increase in doubtful debts due to a higher household bad debt provision. This reflects increased household arrears due to increased and sustained household consumption during the COVID-19 pandemic by metered customers during periods of lockdown when householders were encouraged to work from home. The increased arrears are marginally offset by increased write-offs actioned in the year on schemes to assist certain customers to pay their bills (Fresh Start scheme and the new Direct Support scheme which commenced in 2020/2021).

- £2.8m increase in customer service costs due to increased group costs relating to general and support (G&S) as well as increased billing services costs at Loop. The higher billing service costs is to meet the challenges set by PR19 on Void and Gap sites with challenging targets to reduce the number of empty properties on the billing file and reduce the time taken to resolve properties missing from the billing file. Loop has increased its data services and field services to identify property occupiers and office resource to process the returns. Whilst this has increased billed income it has also increased billing costs. Overall, however Loop costs are in line with 2019/2020 with other favourable costs variances offsetting this increase.

Retail Non-Household

The non-household (NHH) part of the business was disposed of during 2019/2020 and so there has been a decrease in costs in 2020/2021. There has been a decrease of £14.4m to £0.03m credit in 2020/2021.

The price control continues to incur operational costs in the following areas:

- Doubtful debts has decreased by £6.7m from a cost of £6.1m in 2019/2020 to a net £0.6m credit in 2020/2021. The majority of this decrease relates to a re-assessment of the non-household retail bad debt provision in the year by Yorkshire Water Business Services (YWBS) following the sale of the non-household customer book in 2019/2020. The non-household doubtful debts charge is based on bad debt provision and write-offs actioned during the year.
- Developer services has decreased by £0.5m to £0.5m. The majority of this decrease is attributable to a bottom up review of the capitalisation of employee related costs and rechargeable works recharges in the year. This review resulted in an increase in recharges to capital and rechargeable works and a reduction of costs in the NHH price control.
- In addition, we are seeing the full year impact of the reduction in overheads allocation following the exit from the non-household retail market in October 2019.

We have presented pension costs for retail (£1.3m) in operating expenditure. This is consistent with the submission of these costs within the retail tables for PR19. This treatment is because Yorkshire Water's defined benefit scheme is accounted for under the FRS102 accounting standard which applies the same rules as a defined contribution scheme.

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, and we are now at the stage of producing periodic regulatory accounts alongside the normal management accounts which report costs for each Directorate.

The areas for future management accounts reporting are:

- Water Distribution.
- Water Production.
- Wastewater customer field services.
- Wastewater process and pumping.
- Bioresources.
- Household retail.

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Yorkshire Water Services Limited, Western House,
Halifax Road, Bradford, BD6 2SZ.
Registered in England and Wales No.02366682



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