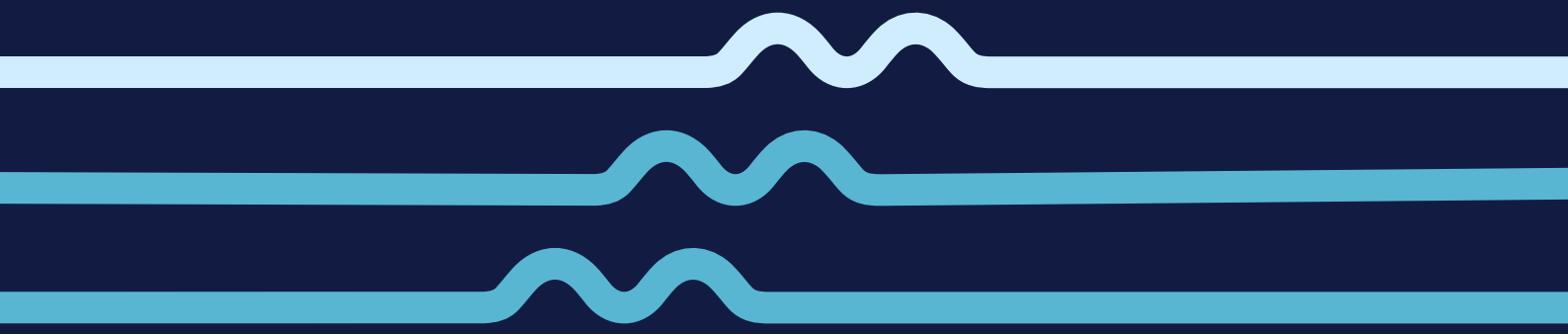


Accounting Separation Methodology Statement

Published July 2022



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 financial APR data is robust and meets all of 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 the regulatory accounting guidelines - RAG 3.13, the document is separated into the following three sections:

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

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

2. High level overview



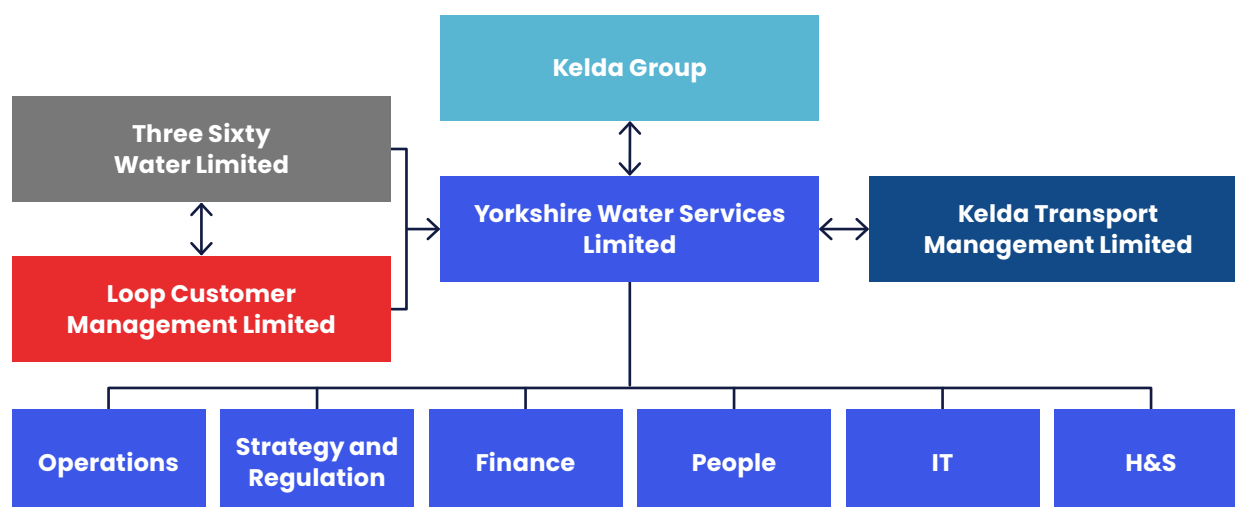
High level overview

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; and
- Systems and processes.

Business structure



Yorkshire Water Services Limited (Yorkshire Water) 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 (YW) for domestic retail services and wholesale customer service, and to Three Sixty for non-household (NHH) customers up to 31 March 2022 (see below).
- **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 (Three Sixty):** 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 Scottish Water Business Stream Ltd (Business Stream) on this date. Under the Transitional Services Agreement Business Stream retained the Three Sixty group to continue to support delivery of NHH retail services to their Yorkshire customers until 30th September 2021. At this point a six-month migration period to

31 March 2022 saw customer support services transferred to Business Stream. Operations have now ceased with effect from 31 March 2022.

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 and 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 to Yorkshire Water;
- **People** includes facilities as well as Human Resources;
- **IT** includes technology, data and business change; and
- **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 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 and operations have now ceased with effect from 31 March 2022.

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 2022.

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 – non-household customers	Three Sixty (until 31 March 2022)
Yorkshire Water	Capital delivery	UK based contract partners
Yorkshire Water	Below ground network repair	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 the regulatory accounting guidelines – RAG 5. 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, being: 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:

- 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 2.09 – Guideline for the classification of costs across the price controls (for table 8C lines 18 to 23);
- RAG 3.13 – Guideline for the format and disclosures for the annual performance report;
- RAG 4.10 – Guideline for the table definitions for the annual performance report (inclusive of appendices); and
- 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 lessons 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 RAGs. 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. 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 (FTE) employees, and are in some cases are subject to external assurance.
- The attribution of costs and revenues are allocated consistently across all business units, price controls and to the 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 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 are allocated, where possible, 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 2D 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	29.582	0.548	11.655	12.931	1.761	2.687
Offices	FTE	1.627	0.030	0.633	0.702	0.096	0.166
Operational	FTE	7.528	0.153	3.258	3.615	0.492	0.010
R&D	FTE	0.386	0.008	0.167	0.185	0.025	0.001
Regulation	FTE	0.141	0.003	0.054	0.060	0.008	0.016
Stores/ Depots	FTE	0.081	0.002	0.035	0.039	0.005	–
Telemetry	FTE	1.131	0.023	0.490	0.544	0.074	–
Vehicles	FTE	1.834	0.037	0.794	0.881	0.121	0.001
Total		42.310	0.804	17.086	18.957	2.582	2.881

The overall value of amounts recharged between business units has increased from £36.1m in 2020/2021 to £42.3m in 2021/2022. There has been further investment in Information Technology (IT) in the last year, including improvements to data storage, IT security and further upgrades to the accounting system, 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 2O and then recharged across price controls using FTEs. There was also a large investment in telemetry in 2021/2022 which has increased the depreciation recharged across the wholesale business.

Whilst the assets follow principal use set out in RAG 2, with depreciation recharged to other price controls, in 2020/2021 the principal use recharge impact for wholesale was presented within depreciation and amortisation in Section 4: Pro forma tables of the APR, Table 2A. We have continued with this approach in 2021/2022, and the principal use recharge impact is included within the relevant lines in Section 4: Pro forma tables of the APR, Table 2D and 2O.

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 is a practical approach as the alternative would be to capitalise each asset separately – hence, we apportion expenditure using the same approach to ensure consistency from year to year.

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; and
- 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 half year 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 meets on a weekly basis to ensure compliance with 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.

Internal governance

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 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

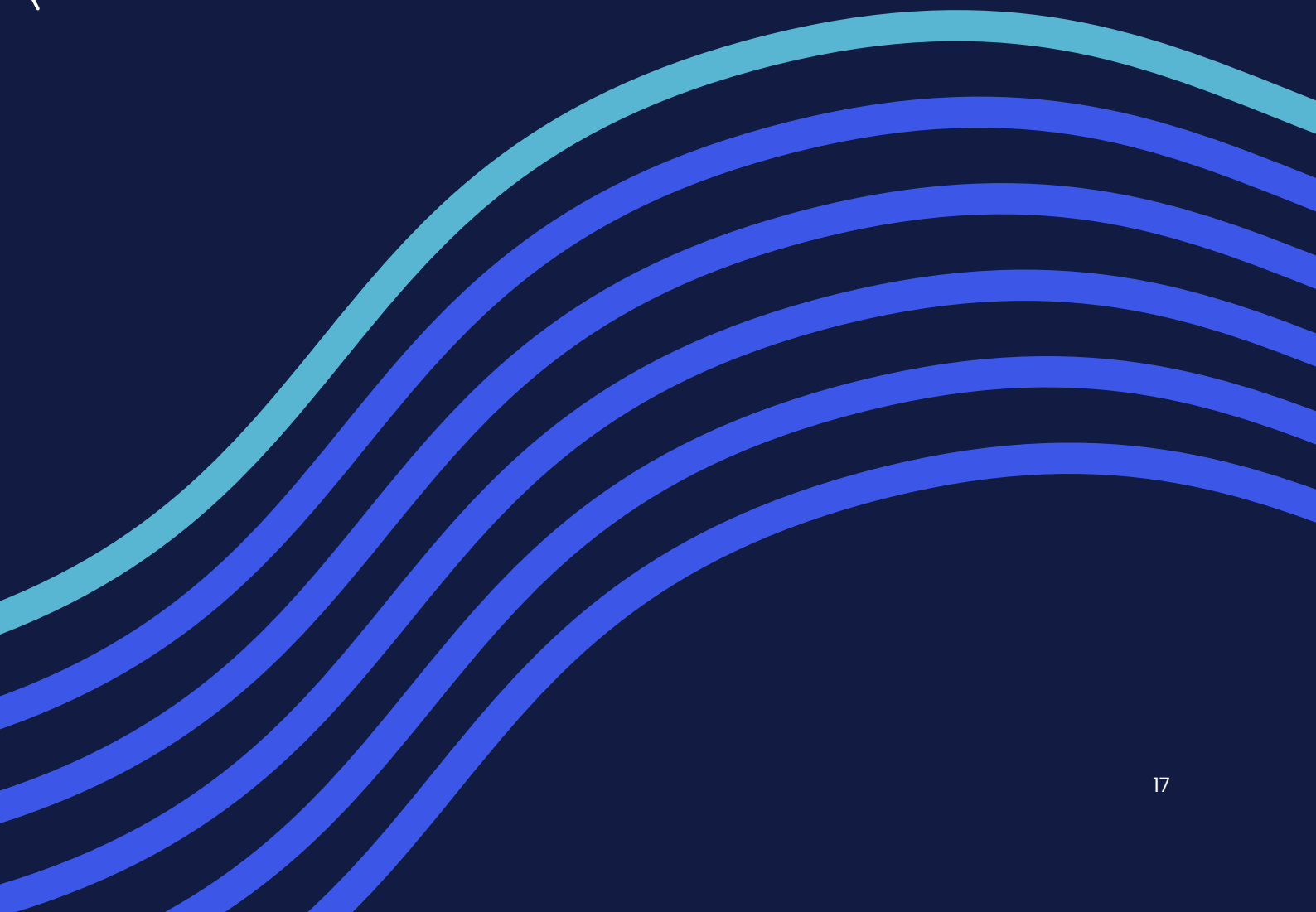
Yorkshire Water uses SAP as the corporate financial system, which is the only system used for producing the regulatory accounts. A new version of SAP was introduced in 2019/2020, and a consistent approach for cost assessments and allocations have been used.

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 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, allowing operational managers to review and control 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, 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 Finance 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 project 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 4.10 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 3.13.

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	2021/2022 Cost Driver	2021/2022 Why considered appropriate	2020/2021 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)

Activity Wholesale/ retail	Company	2021/2022 Cost Driver	2021/2022 Why considered appropriate	2020/2021 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 developer 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 preference has been used	HR on headcount, everything else FTEs

Table 1 – Wholesale/retail allocations (continued)

Activity	Company	2021/2022	2021/2022	2020/2021
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. 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 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 in 2020/2021 we had residual retail non-household costs in relation to doubtful debts. For 2021/2022 retail non-household just includes developer services cost as specified in RAG 2.08.

Activity	Company	2021/2022	2021/2022	2020/2021
Retail household/ Non-household		Cost Driver	Why considered appropriate	Cost Driver
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 a meter level and this is 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 4.10	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
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

Table 3 – Wholesale Water cost allocations (continued)

Expenditure line	Method of allocation	Why considered appropriate	How satisfied
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. 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 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 reviewed to ensure directly allocated costs are correct

Table 3 – Wholesale Water cost allocations (continued)

Expenditure line	Method of allocation	Why considered appropriate	How satisfied
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	Allocated 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
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

Table 3 – Wholesale Water cost allocations (continued)

Expenditure line	Method of allocation	Why considered appropriate	How satisfied
Local authority rate – Cumulo rates (water)	Use GMEAV to allocate costs (rateable assets only)	Based on value of assets assigned to 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

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 4.10	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

Table 4 – Wholesale wastewater cost allocations (continued)

Expenditure line	How costs are allocated	Why considered appropriate	How satisfied
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
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. 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

Table 4 – Wholesale wastewater cost allocations (continued)

Expenditure line	How costs are allocated	Why considered appropriate	How satisfied
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
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

Table 4 – Wholesale wastewater cost allocations (continued)

Expenditure line	How costs are allocated	Why considered appropriate	How satisfied
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
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	Complies with guidelines
Costs associated with lane rental scheme	N/A	Nil operating expenditure	Nil operating expenditure
Costs associated industrial emissions directive	Directly allocated	Directly allocated	Directly allocated

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	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)

Expenditure line	How costs are allocated	Why considered appropriate	How satisfied
Customer services – Network enquiries and complaints	Contact centre costs are allocated 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	Completed 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	Directly allocated	Directly allocated	Directly allocated
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 a call upon HR services	FTE 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 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 4.10

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

Function	Length, Kilometres	Split by function, %
Foul	12,116	39%
Surface Water	13,339	43%
Highways	5,368	18%
Total	30,823	100%

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 2020/2021	2%	39%	27%	18%	6%	7%	1%	100%
Total overhead 2021/2022	2%	38%	24%	18%	6%	11%	1%	100%
Management services and finance 2020/2021	1%	47%	27%	13%	5%	6%	1%	100%
Management services and finance 2021/2022	1%	40%	34%	12%	5%	8%	–	100%
Data processing 2020/2021	1%	45%	26%	15%	5%	7%	1%	100%
Data processing 2021/2022	1%	40%	31%	14%	4%	9%	1%	100%
Facilities 2020/2021	1%	43%	25%	17%	5%	8%	1%	100%
Facilities 2021/2022	1%	40%	28%	16%	5%	10%	–	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. 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 plus	Network plus sewage collection	Network plus sewage treatment	Bioresources	Retail HH	Retail NHH	Total
	£m	£m	£m	£m	£m	£m	£m	£m
General and support variance	(0.7)	(10.1)	1.6	–	(1.2)	0.8	(0.1)	(9.7)

General and support (G&S) expenditure has decreased from 2020/2021 by £9.7m. The variance from 2020/2021 can be seen in Table 9.

Last year we incurred one off legal and advisory costs in relation to the referral of the AMP7 Final Determination (FD) to the Competition and Markets Authority (CMA).

In 2020/2021 we included £3.7m in relation to the innovation fund within G&S. As per the guidance in the information notice (IN22/01) we have reversed out the provision in 2021/2022.

We continue to incur costs in relation to the transformation project we commenced last year 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 plus, wastewater network plus and bioresources

	Water Resources	Water network plus	Waste network plus	Bioresources
Water usage	–	–£1.0m	£0.1m	£0.9m
Wastewater disposal	–	£4.8m	–	–£4.8m

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.

For 2021/2022 we have reported costs to wastewater network of purchasing energy from Bioresources within Section 4: Pro forma tables of the APR, Table 4K as per RAG 2. The income received by bioresources in relation to this is reported in Section 4: Pro forma tables of the APR, Table 4K and Table 8C.

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. The 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; and

- 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. The majority of our costs are directly allocated with a small amount 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	67%	33%	65%	35%
Other operating expenditure	85%	15%	85%	15%

Revenue allocation for each price control

A fundamental change between AMP6 to AMP7 was the further disaggregation of wholesale across 4 price controls instead of the 2 which were introduced in PR14. This change resulted in YW having 5 price controls; water resources, water networks, wastewater networks, bioresources and retail household. Each price control has a separate revenue allowance, these are defined within our final determination, and we are required to report our recovered revenues across the relevant price controls.

To enable the recovery of revenue, across the 5 price controls, we develop our tariffs each year to recover the revenue allowances. Tariffs are set based on our assessment of the forecasted customer numbers, consumption and the services that we will be providing. Our tariffs are split across the 5 price controls, this ensures that we are able to set the overall tariff at the level required to meet the revenue allowances within each price control, and to enable the allocation of the revenue recovered to the correct price control.

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 2021/2022. These costs are expected to increase 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 2021/2022 are:

- As per the information notice (IN 22/01 Expectations for monopoly company annual performance reporting 2021/2022) the provision relating to the innovation fund in 2021/2022 has been reversed, with no corresponding adjustment to revenue. The accrual that was reported in 2020/2021 has also been reversed, with corresponding adjustment to the regulatory profit and loss account reserves at 31 March 2021.
- Assets follow the principal use set out in RAG 2, with depreciation recharged to other price controls. In 2020/2021 the principal use recharge impact for wholesale was presented within depreciation and amortisation in Section 4: Pro forma tables of the APR, Table 2A. We have continued with this approach in 2021/2022 and the principal use recharge impact is included within the relevant lines in Section 4: Pro forma tables of the APR, Table 2D and 2O.
- We have continued to report pension costs 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 detailed review 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 is 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.

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 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 undertaken 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>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	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 undertake 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.
	Surface water drainage	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.
	Highway drainage	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.
Network plus sewage treatment	Sewage treatment and disposal	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.
	Imported liquor treatment	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.
Bioresources	Sludge transport	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.
	Sludge treatment	The YW costing structure is set up in such a way that the cost centres within the SAP accounting 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.
	Sludge disposal	The YW costing structure is set up in such a way that the cost centres within the SAP accounting 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.

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

Water

Overall, operating costs for the water service decreased by £1.6m, c0.6% from 2020/2021. A summary of movements by upstream service is shown in the below table:

Clean Water			Water Resources		Water network plus				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 2021/2022	£m	3	5.218	25.977	10.915	2.606	64.360	148.891	257.967
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
Variance	£m	3	(0.168)	1.382	(0.979)	0.248	3.684	(5.752)	(1.585)
Variance	%	3	(3.2)	5.6	(8.2)	10.6	6.1	(3.7)	(0.6)

Operating expenditure

In AMP6, we set ourselves stretching operational targets across a number of performance commitments. To meet these targets, we made improvements to the operational business which has put us in a stronger operational position for AMP7. Our overall operating cost has decreased by £1.6m for the water price control in 2021/2022 for the following reasons:

- COVID-19 led to increased costs in 2020/2021 due to 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. As well as 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. As restrictions have eased during this

year, we have seen these costs decrease. During the year we have continued to carefully monitor the impact of COVID-19 and maintained safe operations as our colleagues returned to work.

- In 2020/2021 we incurred one-off costs in relation to legal and advisory costs for the referral of the AMP7 Final Determination (FD) to the Competition and Markets Authority (CMA). The majority of these costs were allocated to water.
- The severe winter in 2020/2021 led to high repair and maintenance costs. This along with a backlog from COVID-19 resulted in higher hired and contracted costs. For 2021/2022 these costs have decreased.
- Despite these decreases and tightly managing our operating budget, there have been a number of inflationary pressures including:
 - Energy prices – unhedged energy costs is exposed to the day ahead energy market, which has been volatile in 2021/2022. Consumption for the water price control has remained relatively stable, but we have experienced a slight growth impact with increased volumes treated to meet distribution requirements (demand). We are managing the risk of energy prices by fixing contract prices where possible and operating within an energy purchasing policy that is designed to manage price volatility risk. As at 31 March 2022, Yorkshire Water had fixed over 70% of its wholesale energy costs for AMP7, including 100% for the 2022/2023 financial year, through a combination of forward contracts and energy swap transactions.
 - Chemical costs – as a result of increased fuel, energy and raw material prices we have seen market pressures in the chemical supply chain. This has resulted in a surcharge from suppliers being passed onto us, impacting the cost of water treatment.
- There have been a number of significant storms in 2021/2022 from Storm Arwen in November 2021 to storms Dudley, Eunice and Franklin in February 2022. Storm Arwen severely impacted Northern Power Grid with over 240,000 customers without power. The power loss directly impacted our assets and led to a loss of supply for some of our customers. We had a great response from our operational teams to minimise the impact.
- We continue to incur costs in relation to the transformation programme we commenced last year 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 FD. This transformation programme includes a right-sizing in some areas resulting in associated severance costs.

- A realignment of terms and conditions, and inflationary pressures has resulted in increased staff costs.
- Pension costs of £5.7m has been presented in cash expenditure in 2021/2022, consistent with the treatment in 2020/2021.
 - In relation to pension costs, RAG 4.10 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 2021/2022 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.

Capital expenditure

- We have seen a net increase of £9.6m from 2020/2021 reported level of expenditure. This was due to an increase of £15.2m of gross expenditure, offset by an increase in grants and contribution by £5.7m.
- The table commentary we have provided in Section 4 of the APR focuses on the variance to our Final Determination.

Wastewater

Overall operating costs for the wastewater service decreased by £1.8m, c0.5% from 2020/2021. A summary of movements by upstream service is shown in the below table:

Wastewater	Units	DPs	Network plus Sewage Collection			Network plus 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 2021/2022	£m	3	29.574	27.052	21.294	106.498	(0.095)	7.612	11.636	9.195	212.766
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
Variance	£m	3	(3.377)	(3.265)	2.351	9.236	(0.019)	1.110	(5.783)	(2.025)	(1.772)
Variance	%	3	(10.2)	(10.8)	12.4	(9.5)	(25.0)	17.1	(33.2)	(18.0)	(0.5)

Operating expenditure

As with water, wastewater also made improvements in the operational business in AMP6 to put us in a strong position for AMP7. Our overall operating cost has decreased by £1.8m for the wastewater price control in 2021/2022 for the following reasons:

- COVID-19 led to increased costs in 2020/2021 due to 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 led to engaging third party contractors. As restrictions have eased during this year, we have seen these costs decrease. During the year we have continued to carefully monitor the impact of COVID-19 and maintained safe operations as our colleagues returned to work.
- Strong treatment works compliance continued throughout 2021/2022, keeping associated costs related to 'at risk' and 'high risk' works to a minimum.
- 2015, 2019 and 2020 floods had significant impact on wastewater operations and mitigation costs were still impacting wastewater in 2020/2021. There was also the impact of the extreme wet weather in 2020/2021 which led to an increase in pumping costs and electricity usage.
- Despite these decreases in costs and tightly managing our operating budget, there have been a number of inflationary pressures:
 - Energy prices - unhedged energy costs is exposed to the day ahead energy market, which has been volatile in 2021/2022. Consumption for the wastewater price control has remained relatively stable, with a year on year reduction in flows treated for sewage treatment upstream service and an increase in consumption for bioresources. Bioresources has seen improved generation performance with a year on year increase due to generation assets at sites such as Esholt, Dewsbury and Upper Brighouse coming online. As mentioned for water, we are managing the risk of energy prices by fixing contract prices where possible.

- Chemical costs – as a result of increased fuel, energy and raw material prices we have seen market pressures in the chemical supply chain. This has resulted in a surcharge from suppliers being passed onto us. This has impacted our sewage treatment process. Whilst the impact of chemical prices is greater on the water price control in 2021/2022, we are experiencing increased chemical price pressures in 2022/2023 for wastewater in both the sewage and sludge treatment process.
- Bioresources continues to see an increase in sludge transport costs predominantly due to outsourcing of this function to an external contractor. Although there has been an increase in opex costs, from an overall totex perspective bioresources will see a benefit over AMP7 as a result of no longer needing to replace the ageing sludge tankers which would have required significant capital expenditure.
- There have been a number of significant storms in 2021/2022 from Storm Arwen in November 2021 to storms Dudley, Eunice and Franklin in February 2022. For wastewater the main impact was damage to our assets from the strong winds. We had a great response from our operational team in terms of localised flooding and planning ahead.
- We continue to incur costs in relation to the transformation programme we commenced last year 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 FD. This transformation programme includes a right-sizing in some areas resulting in associated severance costs.
- A realignment of terms and conditions as well as inflationary pressure has resulted in increased staff costs.
- Pension costs for 2021/2022 continue to be reported in cash expenditure. Please see explanation under water variance analysis. Pension costs reflected in the wastewater price control for 2021/2022 are £6.6m.

Capital expenditure

- We have seen a net increase of £17.8m from 2020/2021 reported level of expenditure. This was due to a reduction of £13.4m of gross expenditure, and an increase in grants and contribution by £4.4m.
- 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 increased by £10.1m (c14.2%) to £80.5m in 2021/2022 principally due to:

- £8.9m increase in doubtful debts:
 - £6.2m due to increase in bad debt provision reflecting the cost of living crisis impacting vulnerable customers in 2022/2023 and future years. A high level of uncertainty remains around how current economic conditions could impact the recoverability of household debtors, particularly in light of the backdrop of COVID-19, rising energy prices, and high inflation rates which have adversely impacted typical household's disposable income affecting some customers' ability to pay.
 - £2.7m increase in write offs in the year partly due to an increase in 'legal' related write offs such as bankruptcy, liquidation and statute write offs which we are obliged to write off. Also there are more customers needing support in the year which we have seen through our 'Resolve' customer support scheme and an increased level of customers applying for debt relief orders.
- There has been an increase in staff costs partly due to the growth of the operational customer services team, which includes the full year impact of the insourcing from Loop. In addition, there has been a realignment of terms and conditions and inflationary pressure resulting in increased staff costs.
- The above, in part, has led to an increase in overhead costs where headcount is used as a cost driver.

Retail Non-Household

The non-household (NHH) part of the business was disposed of during 2019/2020. There has been an increase in costs of £0.5m to £0.4m in 2021/2022.

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

- Doubtful debt costs are £nil (2022/2021 £0.6m credit). The 2020/2021 credit reflected 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.
- Developer services has decreased by £0.1m to £0.4m. The majority of this decrease is attributable a decrease in General and Support (G&S) costs following a review of allocations since the exit from the non-household market.
- Pension costs (£1.5m) for retail has been presented 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. We are now producing regular updates for each Directorate on the regulatory accounts. In the future we want to provide this information on a more periodic basis.

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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