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Section 1: Overview

Structure and processes

- 1 The purpose of this document is to set out the Anglian Water Services (AWS) approach to the allocation of totex costs between price controls (table 2B, wholesale water and wastewater and 2C, retail) and the more detailed upstream services included in our 2021 Annual Performance Report (table 4D wholesale water and 4E wholesale wastewater).
- 2 The contents of this document are aimed at helping stakeholders to understand our systems, processes and methodology used to complete the published tables.
- 3 AWS does not organise or manage its business on the same basis as reported in the regulatory accounts tables and therefore, some costs are not directly attributable to either a price control or service. Where no direct allocation is possible, the guidance contained in the regulatory accounting guidelines has been followed.
- 4 AWS uses SAP as its integrated financial and business management system. The financial system is configured to reflect the way in which we manage our business by business unit, by location and by cost driver. Financial transactions are captured on SAP and Tagetik is used to allocate costs and form the regulatory tables.
- 5 Our business is divided into 4 business streams (water services, water recycling services, customer and wholesale and enabling functions). The enabling functions business stream contains back office directorates such as Finance, HR and Legal Services.
- 6 The water services business stream is split into three geographic regions: East, North and South. Each region is divided into a number of management areas, and within these, costs are charged directly at a site level or an aggregation of smaller sites. Maintenance and repair work on our water network is primarily undertaken via an alliance of Anglian Water Services and strategic partners.
- 7 Wastewater services network+ is split into four regions with separate maintenance, collection and support departments. Each treatment region, maintenance department and collection department are divided into smaller geographic areas or patches. Within these regions, costs are charged directly at a site level for our sewage treatment works and grouped for pumping stations and network costs by manager. Bioresources is managed as one unit with no sub-area definitions.
- 8 Customer services consists of six individual units: resource & planning, billing, customer care, debt collection, contract & process change and customer experience. Customer services costs make up approximately 79% of total household retail costs. Within customer services, we have off-shored a large part of our back office function. This off-shore service is not customer facing and is primarily responsible for dealing with transactions arising from customer contact and correspondence.
- 9 The costs within the enabling functions are charged directly to those business units, and are managed by budget holders within the business units.
- 10 We use SAP as our corporate financial system and costs are coded to a large number of individual cost elements which are then amalgamated into cost element groups. These groups form our key cost drivers and are the basis of our internal reporting. Key cost element groups are:
 - Employment costs
 - Power
 - Rates
 - Chemicals
 - Tools & materials
 - Hired and contracted services
 - Customer debt
- 11 The vast majority of our costs are coded at source. This includes payroll costs, purchase requisitions and works orders. The number of costs not coded at source is small and is generally from month end transactions which by their nature are temporary, pending a system generated allocation (for example, the coding used when a purchase order is first raised).

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12 In order to produce regulatory accounts, and in addition to the accounting structure used for internal management reporting, the water recycling business stream uses a separate operational cost centre and account code hierarchy in SAP. This means that directly coded wastewater operational costs can largely be assigned to the appropriate regulatory service and cost heading. Further reallocation of costs to service type is required in order to comply with reporting guidelines. Where costs are not directly coded to a specific service, management have assessed the appropriate allocation.

13 The allocation of support costs into the water, wastewater and retail tables is carried out using a Tagetik model using pre-determined allocation principles in line with RAG 2.08 and RAG 4.09 definitions. Where possible, support costs are directly allocated to service and where costs are not directly allocated, an appropriate cost driver or management estimate determines the allocation of costs between services. Allocation assumptions are reviewed annually to ensure that the basis of allocation is still appropriate. Appendix 1 summarises the support cost allocation methodology.

14 The reporting structure of our customer services business unit within SAP is closely aligned to the cost drivers on the retail analysis return, table 2C. The vast majority of costs reported in customer services and therefore retail are coded at source with the allocation of remaining costs following an appropriate cost driver. Further details on our assumptions can be found in the table in paragraph 48.

15 We allocate a share of all support overheads to the retail functions (for example Human Resources, IT and Finance). Where not directly attributable, these costs are allocated on the most appropriate basis decided by management review. Details of our allocation methodology are in appendix 1.

Scope

16 The tables have been prepared in accordance with the current Regulatory Accounting Guidelines (RAGs) which provide guidance on the allocation of costs between the six price controls; water resources, water network +, wastewater network +, bioresources, household retail and non-household retail.

17 The RAGs referred to in the preparation of our annual return are:

- RAG 1.09 - principles and guidelines for regulatory reporting under the 'new UK GAAP' regime
- RAG 2.08 - guideline for 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 in the annual performance report
- RAG 5.07 - guideline for transfer pricing in the water and sewerage sectors

Section 2: Reporting Principles

18 RAG 2.08 sets out the principles to be used when allocating costs. We have set out those principles below with commentary on how AWS has applied those principles.

19 *Transparency - the cost attribution and allocation methods applied to allocate costs within the Annual Performance Report need to be transparent. This requires 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 also be clearly explained to enable robust assurance against this guidance*

- Costs are coded at source to each of our 4 business streams
- The proportion of costs directly attributable to each price control are: sewerage 81%, water 83% and household retail 79%.
- RAG guidance is followed in the allocation of costs and revenues to price controls

20 *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 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.*

- Anglian Water uses SAP as its integrated financial and business management system. The financial system is configured to reflect the way in which we manage our business by business unit, by location and by cost driver.
- The majority of our water and wastewater sites are individually costed.
- Where possible, costs are allocated directly to service in our regulatory accounts. If this is not possible, the allocation guidelines contained in the RAGs have been followed. Where the option to use more than one cost driver is available, we use the one that most closely reflects the cost burden.
- Anglian Water Services operates strict internal control processes, including budgetary control that ensure costs are allocated at the most appropriate level.

21 *Non-discrimination - Companies should ensure that no undue preference or discrimination is shown by water undertakers in relation to the provision of services by themselves or other service providers. 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.*

- AWS allocates costs in a way that reflects as fully as possible the cost burden on any given service and price control and we are committed to improving the disaggregation of costs further.

22 *No cross subsidy between price controls - following the introduction of separate binding price controls at the 2014 price review, 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. Therefore, companies should also ensure that there is no cross subsidy between price control units. In accordance with RAG 5, transfer prices for transactions between price control units should be based on market price unless no market exists, in which case transfer prices should be based on cost. There will also be instances where the transfer price for some internal services and activities should be based on cost, even though a market may exist, for example activities such as treasury, legal or payroll etc. Provided the service or activity is company specific and is being provided internally to all of the price control units, or being provided solely to both the appointed and non-appointed business, then the transfer price should be based on cost.*

- As for non-discrimination, we allocate costs in a way that reflects as fully as possible the cost burden on any given service and price control.
- The services provided internally are company specific, and therefore charging to price controls is based on actual cost.

23 *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.*

- We want to allocate costs in the most accurate way possible, and accordingly, where costs cannot be allocated directly, fair and consistent cost drivers are used.
- Where there is a choice over the cost driver used to apportion costs, we ensure that we use the one we believe most accurately reflects the burden of costs.

24 *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*

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- Costs are allocated on a consistent basis from one year to the next. Any changes to our methodology would result from changes in the RAGs or other instruction from Ofwat, or where we have refined our methodology with the result that cost allocation has become more accurate.
- Any change in approach is highlighted in this document.

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

- Both capital expenditure and depreciation are allocated to price controls and business units based on and internal business investment category (BIC) code, and are therefore, by default, allocated to the business unit of principal use.
- The exception to this is for management and general expenditure, where use of the asset is shared between two or more price controls and where an assessment of principal use is made.
- The majority of shared use assets are classified under wastewater network plus. A recharge equivalent to depreciation is then made in table 2A between price controls and upstream services in proportion of their use. The recharge is calculated on an individual asset basis.

26 This document also addresses the reporting requirements set out in RAG 3.12 for the *disclosures to be included in companies' accounting methodology statements*, specifically:

- Confirmation that the principles of RAG4 have been followed (16,17, 28-52).
- Description of the method or cost driver used to calculate allocations between price control units (where specific guidance has not been prescribed) (33-49, appendices 1&2).
- Any change in methodology compared to the previous year with reasons for the change and the impact quantified (48).
- A description of significant changes in reported costs at the price control unit level compared to the previous year (53-59).
- Reasons for any significant movement in a particular cost type between the price control units (53-59).
- A description of how power costs are disaggregated when it is consumed at sites that cover more than one price control unit (41).
- The percentage split of M&G costs across the price control units (82).
- Any planned improvements for future years (118-120).

27 Our accounting methodology statement also describes:

- the method used to calculate recharges for the use of assets where an asset is recorded in a single price control
- how we have disaggregated costs to upstream services
- the derivation of the quantities used to calculate unit costs
- changes to reported costs compared to the previous year and the movement of costs between services

Section 3: Governance

28 The financial tables of our APR are prepared in accordance with the Regulatory Accounting Guidelines issued by Ofwat and are subject to review by the company's independent auditors, Deloitte, to ensure compliance with Condition F of our Instrument of Appointment. In addition to the external audits conducted by Deloitte, our financial controls are reviewed throughout the year by our Internal Auditors, PwC. A financial controls self-assessment process also provides assurance that key financial controls are operating on a monthly basis. Further, we set out our proposals for assuring year end data in an assurance plan ('Performance Reporting') that we publish on our website prior to year end, and we report the findings of the assurance activity we have carried out in a Data Assurance Summary within our APR. Our APR also contains our independent auditors' report and the summary report of our non-financial assurance provider.

29 Prior to the end of the financial year, briefings are undertaken with all contributors to the regulatory accounts submission to ensure a common understanding of the regulatory accounting guidelines, changes from previous guidelines and the submissions timetable. Roles and responsibilities are established including the allocation of named data providers for each line of data.

30 Where management estimates are used in the allocation or apportionment of costs, these are reviewed, as are the cost allocations that are based on specific cost drivers.

31 The key contributors in the preparation and publication of our regulatory accounts are:

- Economic Regulation - ownership of the overall process, setting out the assurance plan, timetable and publication of the annual report alongside all other regulatory reports.
- Finance - ownership of the financial tables and ensure the accuracy of cost allocation and drivers, preparation of financial commentaries, ensure compliance with Ofwat guidance.
- Operational teams - responsible for review and validation of cost apportionment where management estimate is required.
- External Audit (Deloitte) - responsible for forming an independent opinion on our regulatory accounting statements and to report the opinion to the company and regulator. Deloitte perform a regulatory audit on sections 1 and 2 of our annual report, the scope of which is agreed between the audit firms and Ofwat. Deloitte extend their regulatory audit to include financial data in certain tables in section 4 of our annual report as this provides more robust assurance than the agreed upon procedures approach previously adopted.
- Management Board and Main Board - final review, approval and sign-off of the external audit review and annual report and accounts.

32 The vast majority of operating costs are consolidated and reported via the Tagetik corporate performance management system. This enables the direct input of cost drivers and takes information directly from our business system, SAP. Totals are reconciled to source records and any changes made during the process flow automatically to the affected tables. Likewise for reporting capital expenditure, we have developed reporting from SAP (our ERP system) that, whilst updating spreadsheets, does so in an automated process requiring minimal intervention.

Section 4: Allocation Principles

Wholesale operating expenditure cost allocation, table 2B

Direct costs

33 For the purpose of this commentary, we define direct costs as those charged directly to our water and wastewater operational business units.

34 The majority of direct costs are coded at source with 83% of water service total operating expenditure and 81% of wastewater total operating expenditure reported in table 2B, row 9 directly allocated.

35 Some costs are clearly identifiable as either water resources or water network+ or wastewater network+ and sludge. Where they are not, our allocation methodology is set out in the table below.

36 In the absence of directly derived financial information, we believe that this methodology represents a reasonable assessment of the split of costs between these activities.

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37 The boundary points used for the allocation of costs between water operations are in line with Ofwat guidance in RAG 4.08, but for clarity, we use the diagrams shown in Appendix 2 to ensure our assessment of water boundary points is made consistently.

38 Bulk supply imports make up only 0.9% of reported water opex costs and given the materiality of these costs and the fact that the majority of costs incurred are through a joint venture arrangement rather than supplied by an appointed entity, we continue to treat the cost of bulk supply imports wholly as a water treatment cost.

39 Recharges are made between services and business units to reflect the cost burden of activities undertaken.

40 Whilst we continue to refine our allocation methodology, we have not made any material changes to the way in which we allocate costs in the last year.

41 The table below sets out how wholesale services direct costs are allocated in table 2B.

Basis of allocation of direct costs for water services

Table Line	Method of allocation	Why allocation is appropriate
Power	Directly costed to all water sites. Where a site spans more than one service, then costs are split based either on a pumping head calculation or management assessment	Majority of costs directly costed via meter reads where available with some management estimate as required by RAGs 2.08 and 4.09
Income treated as negative expenditure	Directly costed to site or pro-rated to power costs where activity spans more	Direct allocation
Abstraction Charges/discharge consents	Abstraction licence costs and water treatment discharge consents are both directly allocated	Direct allocation
Bulk supply	Directly costed to water treatment using a bottom-up costing	Direct allocation
Other operating expenditure - renewals expensed in year	Directly costed to service using an internal business investment category or identified cost centres	Direct allocation
Other operating expenditure	Majority of costs can be allocated directly to service. Where not, costs are allocated by an appropriate cost driver including management assessment. The majority of these are on an FTE or direct cost apportionment.	Direct allocation or management estimate required by RAGs 2.08 and 4.09
Local authority rates	Allocated based on historic GMEAV at a service level	Required by RAG 4.09
Third party services	Directly costed to all water sites. Where a site spans more than one service, then costs are split based either on a pumping head calculation or management assessment	Direct allocation

Basis of allocation of direct costs in wastewater services

Table Line	Method of allocation	Why allocation is appropriate
Power	Directly costed to all wastewater sites. Where a site spans more than one service, then costs are split based energy audit data	Majority of costs directly costed via meter reads where available with some management estimate as required by RAGs 2.08 and 4.09
Income treated as negative expenditure	Income derived from CHP and ROCs credits is directly allocated to sludge. Income from farm sales also directly allocated to sludge disposal Other income associated with energy is directly allocated to site	Direct allocation

Table Line	Method of allocation	Why allocation is appropriate
Discharge consents	Direct costing to network plus and sludge	Direct allocation
Other operating expenditure - renewals expensed in year	Directly costed to service using an internal business investment category or identified cost centres	Direct allocation
Other operating expenditure	Majority of costs can be allocated to service. Where not, costs are allocated by an appropriate cost driver including management assessment. The majority of these are on an FTE or direct cost apportionment.	Direct allocation or management estimate required by RAGs 2.08 and 4.09
Local authority rates	Allocated across services based on GMEAV	Required by RAG 4.09
Third party services	Directly costed by site	Detailed cost assessment of third party treatment costs

Retail operating expenditure cost allocation, table 2C

Accounting Methodology Statement

42

Our total retail costs reported in table 2C are substantially the sum of the customer services and doubtful debts costs reported internally.

43 Additional specific costs accounted for internally in the wholesale business are transferred to retail in accordance with RAG 4.09 reporting requirements.

44 An appropriate share of general support costs are also allocated to the retail business.

45 The retail business therefore consists of:

- Direct internal customer services costs
- Doubtful debts
- A relevant share of IT, data processing, systems support and maintenance
- A relevant share of Financial, legal, management, administrative
- Property costs and utilities
- Certain costs that are currently accounted for internally in wholesale such as customer side leaks.

46 The majority of retail costs incurred are coded at source. The cost drivers listed have been used for those costs not coded directly at source.

47 Costs coded to wholesale and then re-allocated to retail are customer side leaks and network enquiries and complaints:

- Customer side leaks are directly costed to water services and are transferred in their entirety to retail. We believe that further guidance is required to ensure a consistent allocation of costs between retail and wholesale controls.
- The value of network enquiries and complaints is assessed by reference to jobs undertaken in water and sewerage operations where they are assessed as a customer related job.

48 Whilst we continue to refine our allocation methodology, we have not made any material changes to the way in which we allocate costs in the last year.

Cost drivers and assumptions used to allocate between measured and unmeasured customers

Activity	Driver	Rationale for cost driver
Billing	Number of bills raised	Rag 2.08 guidance
Payment handling, remittance and cash	Number of payments received	Rag 2.08 guidance
Vulnerable customer schemes	Number of customers	Rag 2.08 guidance
Non-network customer queries and complaints	Time spent on calls	RAG 2.08 - we have developed reports using our telephony system that log the time spent on a call by customer type.
Network customer queries and complaints	Time spent on calls	RAG 2.08 - we have developed reports using our telephony system that log the time spent on a call by customer type.
Debt Management	Debt outstanding > 30 days.	RAG 2.08
Doubtful Debts	Direct allocation	Actual charge can be calculated by customer category.
Meter reading	Number of meter reads	RAG 2.08
Disconnections	Number of disconnections - costs are directly attributable to non HH only	RAG 2.08 guidance

Activity	Driver	Rationale for cost driver
Demand side water efficiency initiatives	Customer type	Analysis available by customer type. Tariff used to determine service received
Customer side leaks	Directly allocated	Actual costs are directly allocated to customer type
Other direct costs	Various - either number of bills raised, number of customers or direct allocation	The most appropriate driver has been taken.
General & support - IT	Number of customers	Due to our structures and nature of shared support services, a meaningful FTE split cannot be established between customer types. Customer numbers adequately reflect the burden of cost between retail services, as they can be taken as a proxy for time spent and the consumption of resource
General & support - vehicles	Number of customers	
General & support - Finance, HR payroll	Number of customers	
General & support - CEO and non-execs	Number of customers	
General & support - Facilities	Number of customers	
General & support - insurance	Number of customers	
Other general and support	Number of customers	
Other business activities - regulation	Number of customers	
Local authority rates	Number of customers	
Depreciation	Number of customers	See above

49 Indirect costs are allocated on the basis set out in appendix 1.

Billing and collection

50 We have billing arrangements in place with a number of other water companies and local authorities that bill on our behalf where we provide the sewerage service in that area. These billing arrangements accounted for 7.4% of our total household revenue in 2020-21.

51 We do not issue bills addressed to 'the occupier', we only issue a bill when we have a customer name.

52 Where a customer has vacated a property, a provision is made against any debt at an appropriate rate depending on the age of the debt. For the purposes of provisioning, we do not differentiate between vacated and other classes of debt. The debt balance is retained on the account until such time as a write off of the debt is approved. Should the customer re-appear in our region but at a different address, the outstanding debt will be pursued. We do not issue credit notes to cancel debt, but a customer may be entitled to a credit towards outstanding debt via our assistance fund.

Significant changes in operating costs since 2019-20**Wholesale table 2B**

Movement in wholesale operating costs 2018-19 to 2019-20

	Water £m	Wastewater £m	Total £m
2019-20 reported expenditure	260.0	295.4	555.4
2019-20 atypical costs	(1.5)	(2.9)	(4.4)
2019-20 reported expenditure less atypical costs	258.5	292.5	551.0
Inflation @ 0.8%	2.1	2.3	4.4
Underlying 2019-20 operating costs indexed to 2020-21 prices	260.6	294.8	555.4
2020-21 reported operating costs	245.6	276.5	522.1
Change to operating costs from 2019-20 favourable/(adverse)	15.0	18.3	33.3

Key variances in operating costs (real terms)**Water**

53 An increase in demand for water during the year (warm summer / pandemic lockdown) drove power, abstraction and bulk supply costs to be £1.4m higher than last year across all of water's price controls. However, the need to live within the final determination lead to a number of cost savings and efficiency projects which yielded significant cost reductions across treatment (£4.8m) and treated water distribution (£9.3m).

Wastewater**Sewage Collection**

54 Total collection costs decreased by £2.3 million in real terms, as a result of ongoing cost saving efficiencies, offset by higher operating costs during the prolonged heavy rainfall from late December through January and February.

Sewage treatment.

55 Total treatment costs decreased by £8.5 million in real terms, due to cost saving efficiencies made in response to the demanding efficiency challenge of AMP7.

Sludge

56 Sludge costs decreased by £11.1m in real terms, a proportionately larger decrease than the rest of wastewater services. The decrease in sludge was due to the general cost saving efficiencies made, plus several one-off savings that are not expected to be repeated. A significant lime rig expense incurred in 2019/20 (£1.4m) which was not incurred in 2020/21 and transportation costs were £1.2m lower in 2020/21 as excess mileage was reduced due to increased STC availability. The prolonged heavy rainfall in late December through February resulted in higher tankering costs in Collection and a corresponding decrease in Sludge, as our tanker fleet was diverted from routine sludge haulage to serve flood-affected customers.

Retail table 2C

Movement in retail operating costs 2018-19 to 2019-20

	Total £m
2019-20 reported operating costs	88.6
Atypical costs - re-structuring provision	(0.6)
Atypical cost - IFRS9 adjustment (bad debt provision) recognising potential impact of Covid 19	(12.0)
Underlying operating expenditure 2019/20	76.0
Inflation @ 0.8%	0.6
2019-20 costs indexed to 2020-21 prices	76.6
2020-21 reported operating costs	73.8
Change to operating costs from 2019-20 favourable/(adverse)	2.8

Key variances in operating costs (in real terms)

Household Retail

57 The underlying reduction in costs of £2.8 million from the prior year is due to reductions across a number of headings. These are primarily made up of reduced customer service costs of £2.3 million, reduced debt management costs of £1.5 million and reduced general and support costs of £1.8 million all being partially offset by an increase in the bad debt charge of £2.8 million. Customer service decreases were seen on people costs and bought in services due to a combination of efficiency initiatives and reduced activity in the early part of the year due to Covid 19. Likewise on debt management costs, due to the cessation of collection activities by AWS and WOCs billing on our behalf in the early part of the year, costs for these activities have been suppressed and are expected to at least partially reverse in 2021/22. The reduction in general and support costs is the result of efficiency initiatives.

58 Following agreement by the Audit Committee in March 2021, management have enhanced their provisioning methodology to provide better granularity of debt less than one year old. As part of this review management have taken the more prudent view that, whilst not yet billed and substantially offset by payments already received, the measured income accrual carries an element of bad debt risk. Had the previous methodology been applied, the bad debt provision would have been £1.1 million higher. Management continue to take a prudent approach of providing for debt greater than 48 months old in full.

Debt written off

59 Total debt written off was £9.4 million, an decrease of £9.5 million over the prior year. Our write off policy has not changed.

Section 5: Capital Expenditure

Capitalisation policy

60 AWS capitalises expenditure which is incurred to acquire, to materially extend the useful life of, or to enhance the capability of its assets.

61 The cost of assets includes the purchase price and any costs directly attributable to bringing it into use.

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62 Directly attributable costs are the costs of own employees arising from the construction or acquisition of the asset and incremental costs which would have been avoided if the asset had not been constructed or acquired.

63 Borrowing costs attributable to the acquisition, construction or production of assets are capitalised in accordance with IAS 23, and added to the total asset cost. The interest rate used is the gross cost of debt as advised by our Treasury section, and is revised each half year. Finance costs are reported separately to acquisition, construction and production costs. This principle is applied to the company's statutory reporting, however for regulatory reporting Ofwat require capitalised interest costs to be backed out in the regulatory accounts.

64 AWS does not revalue assets for statutory reporting on a regular basis, the exception being on initial adoption of reporting under IFRS (2014/15) when infrastructure and operational assets were revalued based on regulated capital value.

65 Expenditure is only capitalised where the resultant asset has an economic life of at least three years.

66 AWS has a de minimus limit of £2,000 on capital expenditure. New or replacement single assets with a total cost below £2,000 are charged to opex unless they are part of a collective programme of related work approved in advance.

67 Own costs capitalised are only those costs which can be shown to be incremental to the business due to the AWS capital programme i.e. costs which would be avoided in the event of the capital programme being removed.

68 Controls are in place to ensure methods used to recover own costs capitalised do not result in over recovery.

Wholesale totex analysis – Tables 2B, 2C, 4D and 4E

69 With the exception of shared management and general assets (M&G), all additions and disposals are allocated directly to business units. This is achieved through mapping our Business Investment Category (BIC) coding for asset additions and through reviewing each asset disposal and allocating to business unit for disposals. We currently use about 500 individual BIC codes. Individual projects can have up to five separate codes but are usually proportionally allocated to no more than two or three different categories, and in many cases will be single purpose.

70 Where possible M&G additions and disposals are also allocated directly to business unit. where this is not possible, for assets where the use is shared by two or more business units, the spend is assigned in full to the business unit of principal use. As the largest business unit, most shared assets are allocated in full to waste water network plus.

71 For shared assets, a recharge is then made in table 2A equivalent to the annual depreciation for the asset use by other business units. The depreciation recharge is calculated on an asset by asset assessment of the percentage use by each price control where this is known. For assets which are in general use for the benefit of multiple price controls, the recharge of the annual depreciation is based upon the relative size of the price control units.

72 Anglian Water does not maintain a current cost accounting register (CCA).

Change in capital expenditure from 2019/20

73 Gross wholesale capital expenditure is down by £23.5 million compared to 2019/20.

74 This relatively small decrease on the prior year is the result of us entering the first year of a new AMP, with many of this AMPs large capital schemes still progressing through planning and design stages of delivery.

75 It is not meaningful to comment on specific variances as the expenditure in a given year is largely unrelated to the expenditure in another.

Recharges from and to other segments

76 We have followed the guidance set out in RAG 4.09 whereby depreciation is recorded in a single price control unit which then makes recharges.

77 Assets which are used by multiple price controls are classified to the price control unit of principle use. This means that the majority of shared use assets are classified under wastewater network plus. A recharge equivalent to depreciation is then made in table 2A between price controls to account for their use.

78 The depreciation recharge between price control units is calculated on an asset by asset assessment of the percentage use across units where this is known. For assets which are in general use for the benefit of multiple price control units the recharge of the annual depreciation is based upon the relative size of the price control units.

79 Recharges made from the appointed business to the non-appointed business include a charge for the use of assets where relevant.

80 We do not include any financing costs in our recharges to and from other segments as table 2A does not report finance costs at a business unit level and therefore inclusion would distort the reported operating profit.

81 There has been no material change in the level of recharges between price controls compared to the prior year.

Allocation of M&G to price control units

82 The table below shows the allocation of M&G to price controls.

Percentage split of M&G costs across price control units

Water Resources	Water network +	Wastewater network +	Sludge	Retail
1%	4%	82%	8%	5%

Section 6: Cash Expenditure

83 The only cash expenditure incurred is for pension deficit recovery payments. The allocation of cash payments is in line with our final determination and is based on the number of employees in our defined benefit pension scheme.

Section 7: Tables 4D and 4E - Upstream services

Overview

84 The purpose of the publication of upstream service costs is to understand the approaches and methodologies that companies take to allocate costs to services.

85 Our allocation to upstream services mirrors the process undertaken to complete table 2B and therefore, our allocation methodology is as described in paragraphs 33-49 in this document.

86 The allocation of indirect support costs is set out in appendix 1.

Water Services - total operating expenditure

Abstraction licence

87 Total costs charged by the EA less any recharges made through bulk supply agreements. The cost of licences is readily identifiable and allocated directly to service

Raw water abstraction

88 Total water resources operating expenditure less abstraction licence costs.

Raw water transport

89 The total of raw water distribution operating expenditure less raw water storage costs

Raw water storage

90 Having reviewed the guidance on raw water storage, four minor sites and associated costs that were previously included within water treatment have been re-classified under raw water storage. This includes reservoirs with no natural catchment, no abstraction licence and with storage of less than 15 days.

Water treatment

91 Direct operating expenditure can be identified by service with an allocation of support costs. As bulk supply imports make up only 0.9% of reported water opex costs and given the materiality of these costs and the fact that the majority of costs incurred are through a joint venture arrangement rather than supplied by an appointed entity, we continue to treat the cost of bulk supply imports wholly as a water treatment cost.

Treated water distribution

92 Direct operating expenditure can be identified by service, as we separately identify this function in our internal management reporting.

Water Services - capital expenditure

93 We use our business investment code (BIC) code allocations for each capital project, and these can be used to accurately reflect a direct cost allocation.

Water Services - cash expenditure

94 Pension deficit costs are allocated broadly in line with our final determination.

Sewerage Services - total operating expenditure

Foul, surface water and highways drainage

95 We have further developed our hydraulic models which now cover 100% of our region and assess the relative volumes used in the unit cost analysis. Foul flows are based on population data, including non-residential population. Surface water and highways volumes consider the annual rainfall experienced in our region and use an assessment of surface types such as highways and roofed area to derive volumes. We have derived a split of 66%, 24% and 10% for 2020/21 respectively.

Sewage treatment and disposal

96 Total cost for sewage treatment less the calculated costs of imported sludge liquor treatment.

Imported sludge liquor treatment

97 Liquor treatment occurs at our sewage treatment works where we also have sludge treatment processes and no stand-alone dedicated liquor treatment plant. To calculate the costs associated with liquor treatment, a population equivalent is assigned to the return liquors on sludge treatment sites. We have then apportioned costs based on a population equivalent between sewage treatment and liquor treatment.

Sludge transport

98 Costs of our internal and contracted liquid sludge transport service and internal contact centre used to manage routine liquid haulage work. Costs are separately identifiable with minimal estimates required in cost allocation. In line with the reporting requirements for table 8B, we have refined our cost allocation methodology and are now able to report power costs in relation to sludge transportation via pipeline.

Sludge treatment

99 Total sludge costs less liquid sludge transport and sludge disposal costs. Includes raw cake haulage and local de-watering centres where thickening exists to >10% dry solids.

Sludge disposal

100 Sludge disposal costs are already separately identified, captured and reported in the business and are generally directly allocated to this activity via our accounting system.

Sewerage Services - Capital expenditure

Foul, surface water and highway drainage

101 Capital expenditure at a sewage collection level is directly coded. Costs are then allocated in line with our hydraulic model as described above adjusted for direct allocations.

Network+ sewage treatment and sludge

102 We use our business investment code (BIC) code allocations for each capital project, and these can be used to accurately reflect a direct cost allocation.

Sludge disposal

103 Total capex cost as reported in the regulatory accounts.

Sewerage Services - cash expenditure

104 Pension deficit costs are allocated broadly in line with our final determination.

Variances between 2019-20 and 2020-21 (excluding atypical expenditure)

Table 4D

105 Underlying water operating expenditure decreased by £15.0 million (5.8 per cent) in real terms

Water resources

106 Operating expenditure was £1.5 million lower vs 2019/20 levels with the net savings being delivered in the upstream services of River abstraction (£0.3 million) and Borehole abstraction (£0.9 million) categories as the increased power required to support elevated DI volumes was more than offset by savings in the majority of other cost lines as the business focused on local efficiency programmes. In addition these same categories also benefited in a combined reduction in rates allocation of £0.5 million following a successful challenge on carparking rateable values. Abstraction Licences also saw a minor 2% reduction (£0.2 million) vs 2019/20 as a one off benefit from an over accrual in prior years was adjusted for in the current financial year.

Raw Water

107 Operating expenditure was £0.2 million higher than last year with increased power costs impacting Raw Water Transport Costs due to the for mentioned elevated DI volumes. Raw Water Storage costs were broadly inline with prior year costs.

Water treatment

108 Operating expenditure reduced by £4.2 million as a mixture of local cost efficiency programmes, savings from lockdown and more resources be moved to capital to support the large WRMP capital programmes which commenced in 2020/21. These operating cost savings more than offset the cost increase in variable costs due to higher volumes of water needing treatment for both Anglian Water customers and bulk supply arrangements.

Treated water distribution

109 Operating expenditure in real terms reduced by £9.5 million compared to the prior year; this saving was seen in Other costs due to local efficiency programmes and a focus on discretionary expenditure and also in Infrastructure renewals as productivity improvements were delivered by both Anglian Water and its key alliance partners.

Table 4E

110 Having introduced a significant number of efficiency measures during the year, underlying wastewater operating expenditure decreased by £18.3 million (6.2 per cent) in real terms.

Sewage Collection

111 Total collection costs decreased by £1.2 million in real terms. Operating expenditure in the Foul Drainage upstream service was overall broadly flat year-on-year, however costs associated with direct employees and hired and contract services increased by £3.5 million, both as a result of the increased workload from the wet weather over the winter months and a focus on reducing pollutions. This increase was offset by reductions made in general and support costs allocated to Foul Drainage of £3.4 million. Various efficiency programmes were put in place across the business to reduce general and support costs in order to live with the challenging final determination and this can be seen in each of the wastewater upstream services.

112 The Surface Water Drainage upstream service saw operating expenditure decrease overall year-on-year by £2.8 million, with a decrease of £1.2 million in infrastructure renewals expensed in the year, as a result of local cost efficiency programmes. General and support costs allocated to the upstream service decreased by a further £1.2 million.

113 Operating expenditure in Highway Drainage increased slightly year-on-year, with direct employee and hired and contract services costs increasing by £1.4 million, also as a result of the increased workload from the wet weather over the winter months and a focus on reducing pollutions. This was offset by a decrease in general and support costs allocated to the upstream service of £0.6 million.

Sewage treatment

114 Total treatment costs decreased by £6.9 million in real terms. The Sewage Treatment and Disposal upstream service saw a decrease in allocated general and support costs of £7.0 million, due to the cost saving efficiencies implemented to live with the final determination.

Bioresources

115 Total bioresources costs decreased by £10.3 million in real terms. Direct employee, hired and contract service and materials and consumable costs associated with the Sludge Transport upstream service decreased by £2.5 million, due to a reduction in excess mileage as STC availability was increased, as well as the tankering fleet being diverted from routine sludge haulage to flood relief in the winter. This upstream service also saw a reduction in its allocated general and support costs of £2.0 million.

116 The Sludge Treatment upstream service saw operating expenditure decrease by £4.4 million, with direct employee and hired and contract services costs decreasing by £2.0 million as a result of local cost efficiency programmes. Direct materials and consumables costs decreased by £1.7 million, primarily due to a temporary lime rig treatment plant that was hired in 2019/20 that was not needed in 2020/21 (£1.4 million). The allocation of general and support costs to Sludge Treatment decreased by £1.4 million.

117 Sludge Disposal costs decreased by £1.6 million, with £0.7 million of the decrease coming from the allocation of general and support costs for the same reasons as with the other upstream services. Additionally, direct costs of employees, hired and contract services and materials and consumables decreased by £0.9 million due to local cost saving efficiency programmes.

Section 8: Improvement Plan

Improvement Plan

118 We have again improved our cost capture and reporting system and this will continue to be developed in the coming 12 months.

119 Following changes in our business operating model we have reviewed and amended our regulatory reporting models as appropriate. We will continue to review all aspects of the models in-depth over the coming year to ensure continuous improvement in our reporting accuracy.

Accounting Methodology
Statement

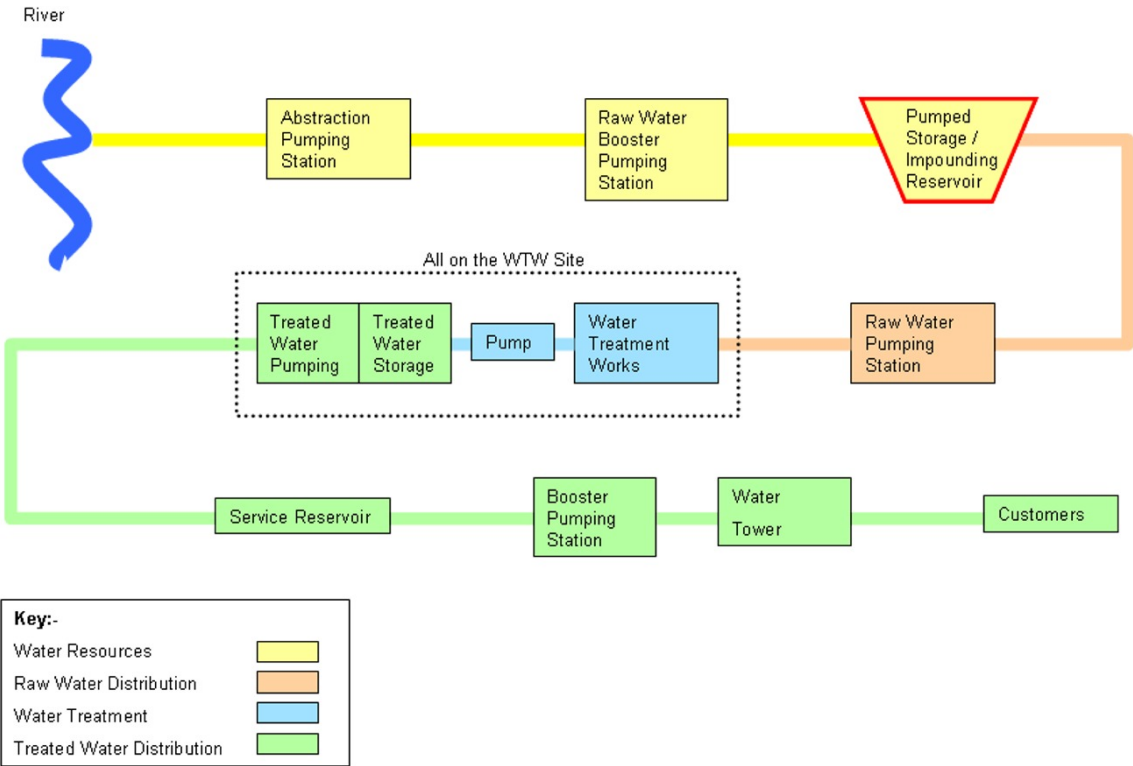
Appendix 1: Summary of Support Cost Allocations

Business Unit	Narrative	Basis of allocation to Retail or Wholesale	Allocation within table 4D, 4E and 2C	Why considered appropriate
Customer Services	Customer Services including billing, payment handling, vulnerable customer schemes, network & non-network queries and complaints	Direct cost to retail	See section 52	RAG 2.08
	Doubtful debts	Direct cost to retail. Any legacy non-household costs are other operating expenditure included in wholesale		RAG 2.08
	Debt management	Direct cost to retail		RAG 2.08
	Meter reading	Direct cost to retail		RAG 2.08
	Services to developers	(1) Activity Acct Mgt and admin - all in retail (2) Activity Water Regulation split between Water and wastewater using number of billed customers		RAG 2.08
Wholesale services	Disconnections	(1) Decision and administration activity - direct cost retail (2) Physical disconnection - direct cost water	65% water, 35% wastewater and then pro-rated to direct costs Operational direct costs 65% water, 35% wastewater and then pro-rated to direct costs Direct employee costs 50/50 water and wastewater, then direct costs	RAG 2.08
	Demand side water efficiency initiatives / Other direct costs / General and support expenditure	All in retail		No wholesale outcome being met
	Customer side leaks	All in retail		No wholesale outcome being met
	Asset maintenance and information	All wholesale		RAG 2.08 - a number of different drivers are used that most accurately reflect cost causality. These are assessed by management in the absence of timesheets.
	Asset delivery	All wholesale		
	Business resilience	All wholesale		
	Tactical operations	All wholesale		
	Wholesale market services	All wholesale		

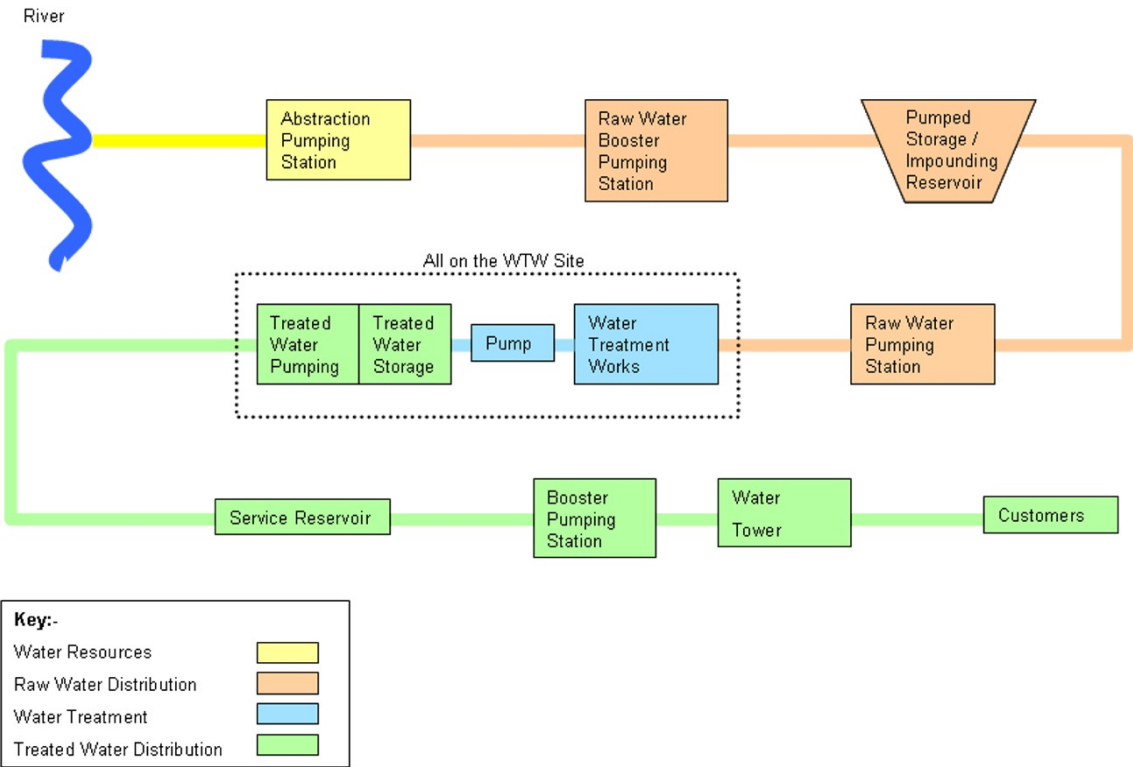
Business Unit	Narrative	Basis of allocation to Retail or Wholesale	Allocation within table 4D, 4E and 2C	Why considered appropriate
	Networks support	All wholesale	50/50 water and wastewater, then direct costs	
	Operational contact centre	All retail	Customer numbers	
Information Services	IT costs	(1) Costs of application support, software, licences, support & maintenance contract directly attributable to service (2) For the rest of the costs split between Wholesale and retail based on FTE or users	Costs of application support, software, licences, support & maintenance contract directly attributable to service (2) For the rest of the costs split between Wholesale and retail based on FTE or users	RAG 2.08
Enabling Functions	Regulation	FTE	FTE	Timesheets unavailable, second option FTE in RAG 2.08
	SD&CA	Mostly wholesale though some costs allocated on FTE	FTE	
	Human resources	FTE	FTE	
	Finance	FTE	FTE	
	Brand and Communications	FTE	FTE	
	Legal	FTE	FTE	
	Health and safety	FTE	FTE	
	Strategy and risk	FTE	FTE	
Shared services	Insurance premium	A combination of direct costs, FTEs, vehicle numbers depending on the insurance type	FTE	Drivers reflect the causality of costs
	Bonus, pensions charge, welfare scheme, employee savings scheme, class 1A NI and PSA	FTE	FTE	Timesheets unavailable, second option in RAG 2.08
	Corporate overhead recovery to capex	Capital salaries	Capital salaries	On-cost is born equally across the capital programme

Appendix 2: Water Operations Boundary Points

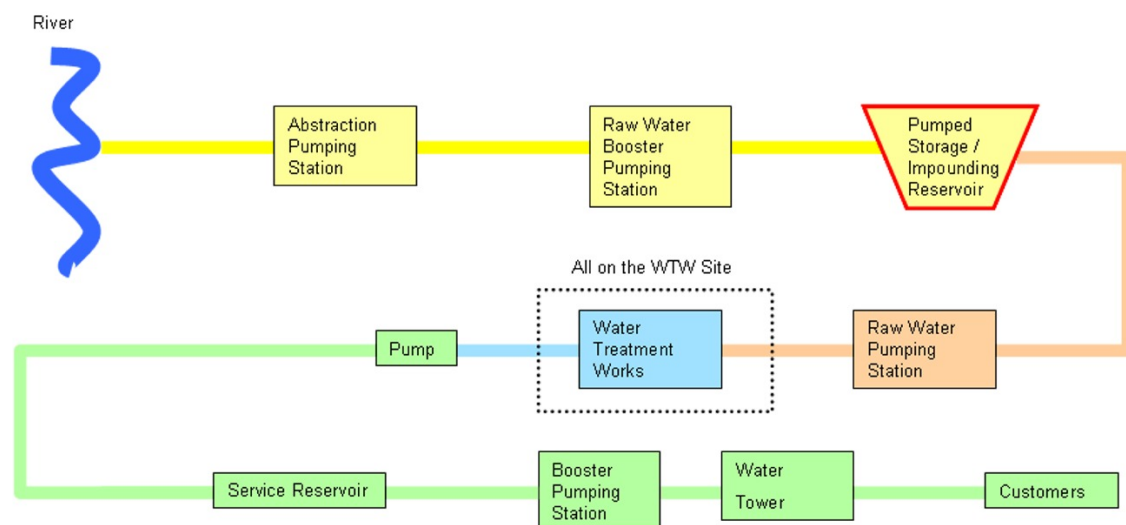
Surface Water Treatment Works where the **Impounding Reservoir** is governed by an abstraction licence (with on site storage)



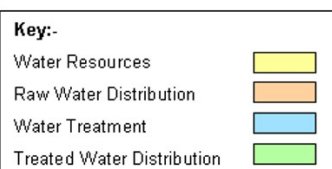
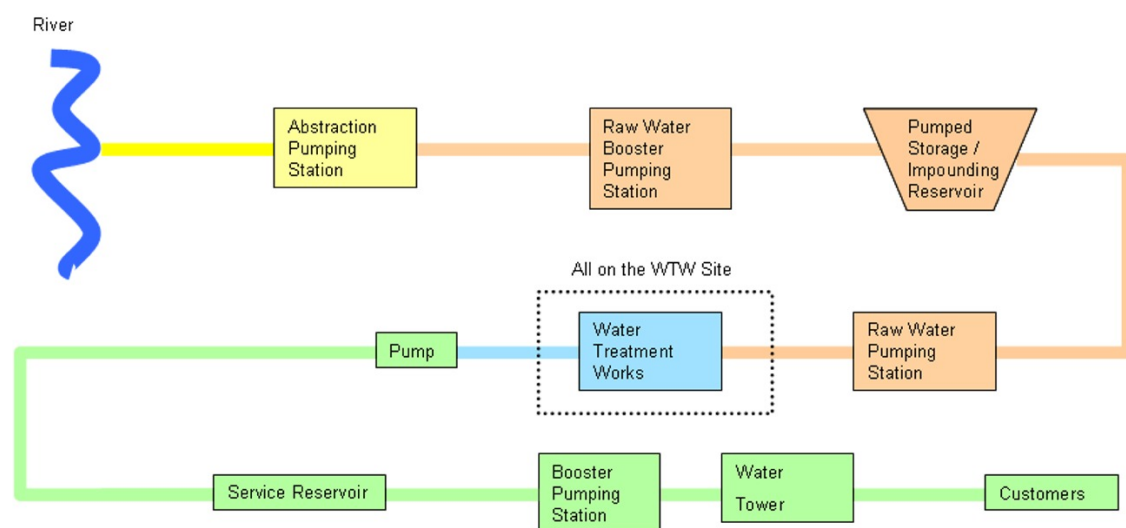
Surface Water Treatment Works where the Impounding Reservoir is NOT governed by an abstraction licence (with on site storage)

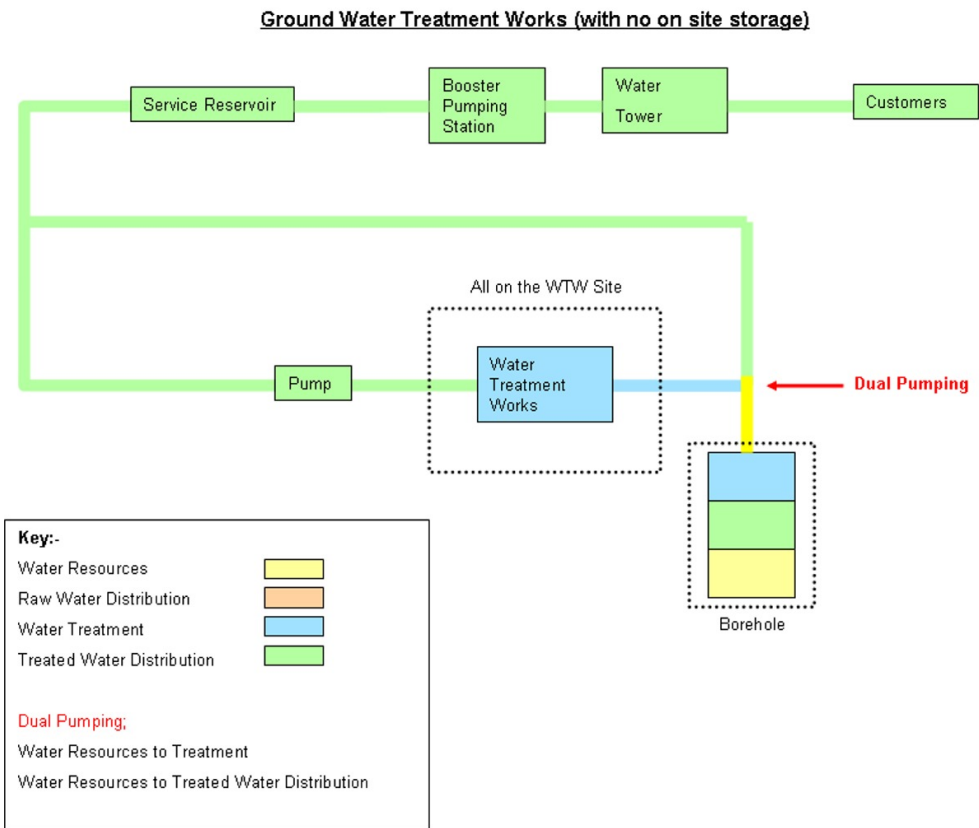
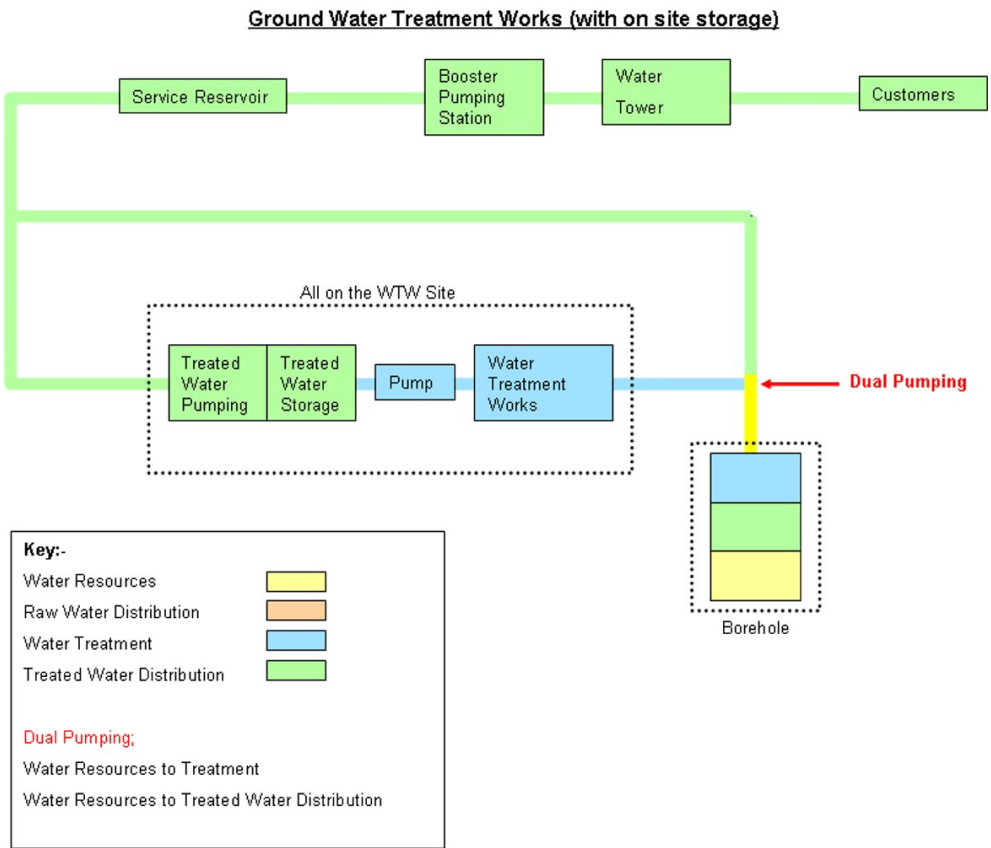


Surface Water Treatment Works where the Impounding Reservoir is governed by an abstraction licence (with no on site storage)



Surface Water Treatment Works where the Impounding Reservoir is NOT governed by an abstraction licence (with no on site storage)





Appendix 3: Glossary

Annual Performance Report (APR) – report produced by the Company for regulatory reporting purposes, known previously as the Regulatory Accounts.

Appointed business – the appointed business comprises the regulated activities of the Company which are activities necessary in order for a company to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991.

AWS - Anglian water Services.

CHP - combined heat and power. An energy efficient technology using the methane bi-product from sludge treatment to generate heat and electricity for on site use or export.

FTE - Full time equivalent. The conversion of the hours worked by employees, including part-time workers, to a full time basis.

GMEAV - Gross modern equivalent asset value. The cost to replace an old asset with a technically up to date new asset with the same service capability.

M&G expenditure – management and general expenditure. Non-infrastructure capital maintenance, typically made up of IT expenditure, vehicles and accommodation.

Ofwat – the name used to refer to the Water Services Regulation Authority (WSRA). The WSRA acts as the economic regulator of the water industry.

Price Control Units – at the 2014 price review, Ofwat introduced separate price controls for wholesale water, wholesale wastewater, retail household and retail non-household. AWS has now exited the non-household market and therefore no longer reports on this activity.

Regulatory Accounting Guidelines (RAGs) – the accounting guidelines for the APR issued, and amended from time to time, by Ofwat.

Retail Price Index (RPI) – the RPI is compiled and published monthly by the Office for National Statistics. RPI is an average measure of change in the prices of goods and services bought for the purpose of consumption by the vast majority of households in the United Kingdom.

Retail services – the elements of the business responsible for direct contact with customers e.g. the contact centre, billing and reading meters. From April 2017, following the opening of the non-household market, business customers are able to choose their retail supplier. The appointed business exited all non-household market activities.

ROCS - renewable obligation certificate. ROCS form part of a Government trading scheme which enables us to receive a payment for the energy we produce.

SAP - the enterprise software used by AWS to manage business operations and customer relations.

SD&CA - Strategic Development and Commercial Assurance directorate.

Tagetik - Corporate Performance Management software that takes a direct feed from SAP. Among other things it is used for running the regulatory accounting models.

Totex – total expenditure comprising operational expenditure (opex) and capital expenditure (capex).

Upstream services - the wholesale service split of activities contained in tables 4D and 4E.

Wholesale services – the elements of the business responsible for the abstraction, treatment and distribution of water and the collection, treatment and disposal of sewage and sludge.

