Accounting Methodology Statement

Published July 2025

Wessex Water
YTL GROUP

Contents

1. Introduction

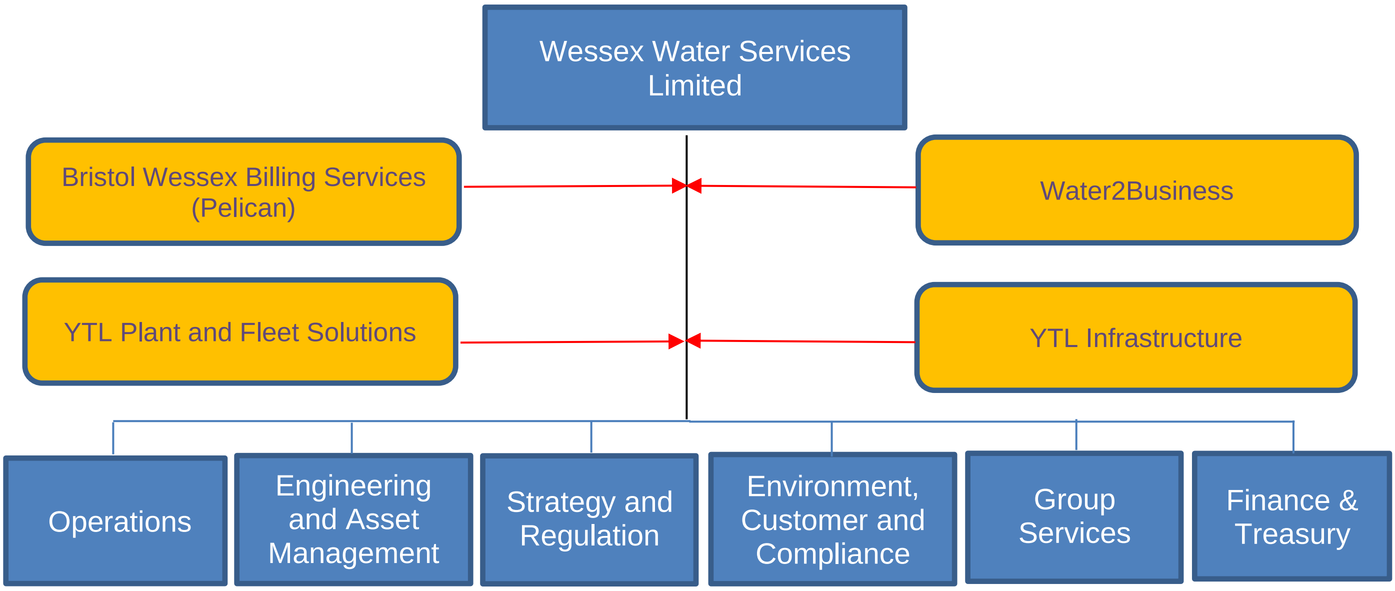
1.1. Purpose

The Annual Performance Report (APR) aims to provide clear information regarding our delivery of performance commitments and financial performance.

The purpose of this methodology statement is to assist the reader of the APR, in particular on how the company has met the requirement of the Regulated Accounting Guidelines (RAGs) regarding financial costs in sections 2 and 4. This covers the attribution of costs between price control units and further subdivisions of costs by activities as required by Ofwat, and the systems and processes used to achieve this outcome.

2. Overview

2.1. Business Structure:



Wessex Water Services Limited (WWSL) is the legal entity containing all regulatory costs. The company is managed by a Board of Directors and executive committee who manage the significant business areas.

2.2. Insourced Functions

The majority of our activities are insourced within four business areas:

- Operations – split into Water Supply and Water Recycling, which encompasses Bioresources
- Engineering and Asset Management – includes Risk Management and Investment, Commercial, Asset Management.
- Strategy and Regulation – Economic Regulation and Strategy, performance reporting and Developer Services.
- Environment, Customer and Compliance – includes Environmental Solutions, Customer policy and services, the Control room and Supply and Waste Compliance.
- Group Services – includes People, PR, Legal, Health and Safety and Information Technology and Security.
- Finance & Treasury represents all financial functions except procurement.

2.3. Outsourced Functions

We continue to work with Bristol Wessex Billing Services Limited (Pelican Business Services) for retail household billing, collection, debt recovery and customer services. Over 30% of total retail costs are invoiced to WWSL by Pelican.

The non-household retail services are carried out by a separate group company Water2Business Ltd.

Note – Retail customer-side leak repairs and water efficiency promotional activities are undertaken by WWSL, predominantly using in-house resources.

From November 2024 the largest outsourced activity going forwards will be the delivery of our investment programme utilising YTL infrastructure (UK) Ltd. The Group Procurement function has been migrated to YTL Construction (UK) Ltd and will continue to provide procurement services to WWSL. Fleet and plant management/hire has also been migrated to YTL Plant and Fleet Solutions (UK) Ltd, incorporated in 2024.

2.4. Data Sources:

Wessex Water uses the accounting software Unit4 Business World. The system allows detailed cost allocation to site, process, asset and job level, whilst being cross referenced to detailed account cost types within headings of employment, chemicals, power, equipment, transport, IT and external services.

Unit4 Business World information is downloaded into spreadsheets using Unit4 Excelerator or direct reporting extracts.

3. Reporting Principles

3.1. Principles:

Our methodology is aligned with RAG 2.09 and RAG 4.13 to the extent they cover the principles, definitions and cost drivers to be used in pro forma tables sections 1, 2, 4, 5, 7 and 8 of the annual performance report between:

- Retail and wholesale services
- Household and non-household retail services
- Services for measured and unmeasured customers

We have separately confirmed WWSL complies with the principles of RAG 5.07 – Transfer Pricing in the Annual Performance Report.

This statement explains the basis on which we have confirmed that we have prepared our APR in accordance with RAG2 as required by RAG3.

We confirm we have followed the general principles as set out in RAG 2.09 as follows:

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.*

Causality: c*ost 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.

Non-discrimination: c*ompanies 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 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.*

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.*

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.*

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*

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

4. Cost Allocation

4.1. Material changes to methodology for 2024-25

We have not materially changed our methodology from that applied in 2023-24.

4.2. Operating cost allocation

All operating costs are booked against a cost centre with an owner that manages those costs and against a budget.

All costs are given an account code that describes the type of cost that has been incurred.

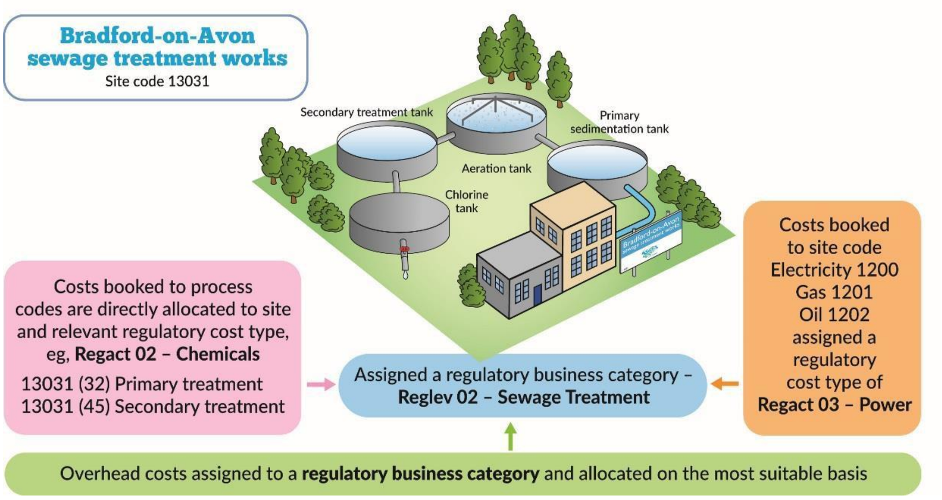
All cost centres within the company finance system are aligned to regulatory business units for regulatory reporting purposes which is different from the internal management accounting structure.

All account codes are linked to a regulatory account code that conforms to the cost types that companies are required to show separately in the accounting separation tables, e.g., Power, local authority rates, service charges.

Each time a new account code or cost centre is created within the corporate finance system it is linked to the appropriate business unit or cost type with reference to the latest regulatory guidelines.

This is reviewed annually to ensure consistency and continual improvement of accuracy.

The diagram below shows how costs booked against the corporate General Ledger system are attributed to the correct regulatory business category (Reglev) (In this instance – Sewage Treatment) and correct regulatory cost type (Regact).



We continue to develop our work and asset management systems so that we make greater use of site process and asset codes within the finance system to help automate the split of costs where certain sites undertake activities for more than one regulatory business category.

These codes sit below the cost centre in the system hierarchy. For instance, within a sewage treatment works cost code the process codes would be primary treatment, secondary treatment, sludge treatment, sludge disposal and each asset code is allocated to one of these treatment processes depending on its function. In this way the costs of maintaining and operating assets can be collected at an asset level and charged automatically to the appropriate business category with no or minimal manual intervention.

Support functions require allocation to the published business units. In many cases, we use the internal charges used in the management accounts as the basis for the allocations – in this way the accounting separation data most closely reflects how the business charges itself for use of support services. We carry out this analysis for Information Technology, Scientific Services, Facilities Management, Transport and Plant and the Mechanical & Electrical departments.

In line with guidance, we allocate the costs of the following activities based on full time equivalent employees: Human resources including training and payroll, Finance & treasury, Legal & estates and public relations.

We use OFWATs request of 1/9th split to price controls of Economic Regulation. The cost allocation noted above resulted in the following split of Management and general costs in 2024-25.

Water Resources	**Water Treatment**	**Water Distribution**	**Sewerage**	**Sewage Treatment**
4%	15%	23%	17%	28%

Sludge Transport	**Sludge Treatment**	**Sludge Disposal**	**Retail**
5%	6%	1%	1%

4.3 Significant movements in the year

We have identified significant movements in costs from 2023-24 below:

- Power consumption decreased overall: 6.2gWh (2.4%) decrease in total, 0.1gWh (0.1%) reduction in Water Treatment, 3.1gWh (8.9%) decrease in Sewerage and 3.1gWh (2.1%) decrease in Sewage and Sludge Treatment. All changes were influenced by the weather experienced in the year.

- Power prices decreased across all areas: average of £18.13 per MWh (8.9%) in total; £19.30/MWh (10.9%) in Water Treatment; £20.20/MWh (9.76%) in Sewerage and £16.55/MWh (9.2%) in Sewage / Sludge Treatment.

- Income treated as negative expenditure has decreased by circa £0.2m from 2023-24 as a result of the decrease in energy prices.

- Third party services saw a £0.9m decrease in sewage treatment rechargeable work due to a reduction in high value third party damages jobs incurred compared to last year.

- Other operating and enhanced operating expenditure increased by £17.9m of which 68.5% was coded directly to price control. Business unit increases are explained further below but increases that impacted all areas included:

    - Relatively small increase in fuel cost of £0.2m
    - Chemical price increases amounting to £0.5m with pollution treatments impacted most
    - Labour inflation of 5.0% equating to approx. £8.1m
    - Other direct costs and general and support costs have increased year on year by £4.3m due to inflationary increases and significant refinancing activities in the year

- Water resources – No other material change in other operating expenditure year.

- Water treatment – operating costs increased by £1.8m, comprising of a £0.9m increase in staff, hired and contracted cost, a £0.6m increase in lab costs due to an increased volume of testing and a £0.3m increase in general and support and other direct costs.

- Water distribution – operating costs increased by £1.2m including £0.2m related to employment cost and £1.0m of general and support and other direct costs.

- Sewerage – Other operating costs increased by £2.5m with £3.2m on staff costs due to inflation and FTE increases to support pollution reduction. This was partially offset by a £0.9m decrease on contractors. Additional increases relate to general and support costs and other direct costs

- Sewage treatment – Other operating costs increased by £6.6m, with a £2.9m increase on employment due to inflation and increased FTEs and a £1.3m increase on hired and contracted due to adverse weather requiring more equipment hire. Materials and consumables and lab charges also increased by £0.5m and £0.7m respectively due to increased levels of testing and volumes treated. General and Support costs have increased by £1.2m.

- Sludge transport – Other operating costs increased by £1.6m. Employment and contractor costs increased by £1.1m due to increased volumes and distance required to be transported. General and Support costs have increased by £0.2m.

- Sludge treatment – Other operating costs increased by £3.2m. £2.5m relates to employment and contractor costs for inflation and FTE increases. Materials and consumables increased by £0.4m and other operational support and general support increases account for the rest of the movement.

- Sludge disposal – other operating costs increased by £0.4m. There were increased employment and contractor costs of £0.2m relating to inflation.

5. Compliance & Audit

5.1 Compliance with RAG 2.09

We confirm that we have applied the principles and guidance as set out in:

- Table 1. Cost drivers for allocation operating costs between retail and wholesale, with the exception of:

Executive and Non-Executive Directors' remuneration is not captured on a timesheet basis. It is identified through the accounts as a support activity and therefore is allocated to service by FTE's.

We confirm that we have applied the principles and guidance as set out in:

- Table 2. Cost drivers for allocated operating costs between household and non-household

Specific details around the attribution of these costs are below:

Pelican legally and functionally separates the non-household function (Water2business) from its household function. This has lessened the need to make allocation of costs between household and non-household services.

Billing

All billing costs are captured directly to cost centres associated with Pelican and no allocation is required.

Payment handling

All payment-handling costs are captured directly to cost centres associated with Pelican Business Services and no allocation is required.

Vulnerable customer schemes

All vulnerable customer schemes administration is handled in one department and is wholly within the household service.

Non-network customer enquiries

We have separate call centres for Pelican and W2B and so costs relating to non-network customer enquiries are booked directly with no manual allocation required.

Debt management

We have separate debt management teams for Pelican and W2B and so costs relating to debt management are booked directly with no manual allocation required.

Meter reading

Meter reading costs are allocated between HH & NHH based on the number of meter readings taken.

Overheads – IT costs, finance, HR, payroll, facilities management

Water2Business Ltd have general management, finance and accommodation allocated directly. Charges from Pelican are excluded, where Water2Business is supported by Pelican Business Services, based on customer numbers.

Non-Pelican retail costs

The costs attributable to doubtful debts, £13.3m, are directly attributable to household customers.

Operational customer services costs are included within the "Customer Services" cost type and allocated based on the volume of network customer enquiries and complaints (contacts).

Operational customer services costs include:

- The scheduling of jobs triggered by a customer contact by our control room schedulers
- The inspectors that visit a customer's address to investigate a problem where it is found not to be a network issue
- Internally generated calls to the retail call centre to enable the customer contacts to be resolved.

The costs of our customer magazine are included as retail costs and are allocated to customer type based on customer numbers.

Centrally incurred debt management charges are allocated in full to household and represent the payment made to independent debt advice agencies such as the Citizens Advice Bureau. These payments support the agencies work in providing holistic debt advice. It enables our customers to have access to the Wessex Water's "tap" programme of affordability assistance.

The retail element of developer services costs are charged in full to non-household and include the cost of customer contact and raising quotes for new connections. Developer services costs are split between the administration (retail function) and the physical works on the network (wholesale). This allocation is possible due to separate cost centres and management review of work activities.

Local authority rates are allocated between customer numbers. The overall cost of local authority rates within Retail is small as it relates solely to our offices occupied by Pelican and an allocation for retail staff based at our head office.

Other operating expenditure includes the full cost of repairing and/or replacing customers' service pipes where there are leaks and the costs associated with the provision of water efficiency initiatives. The costs of customer side leaks between household and non-household are based on the categorisation of jobs and is reported directly from the workflow system.

Demand-side water efficiency are allocated in full to the retail business unit, as we have no identified wholesale outcomes.

Customer-side leak repairs are attributed wholly to the Water distribution price control in line with the industry standard and based on the wholesale impact.

5.3 WWSL Capital costs

Our asset management framework subdivides our asset base into multiple asset groups. All capex is then allocated to one of these as the capital scheme is set up and the allocation and spend are reviewed quarterly.

In most cases the asset groups align to the business units required, this is outlined in the table below:

Asset Group	Reporting Area
Impounding Reservoirs	Water Resources
Raw Water Aqueducts	Raw Water Transport
Trunk Mains	Treated Water Distribution
Distribution Mains	Treated Water Distribution
Service Pipes	Treated Water Distribution
Boreholes	Water Resources
Springs	Water Resources
Water Treatment Works	Water Treatment
Service Reservoirs	Treated Water Distribution
Booster Pumping Stations	Treated Water Distribution
Water Meters	Treated Water Distribution
Sewers	See note [1]
Rising Mains	Foul Sewers
Sea Outfalls	Foul Sewers
CSOs	See note [1]
Sewage Pumping Stations	See note [1]
Sewage Treatment Works	See note [2]
Sludge Treatment Centres	See note [3]
Transport and Plant	See note [4]
Information Systems	See note [4]
Lab Equipment	See note [4]
Property and FM	See note [4]
Monitoring and Control	See note [4]
Retail HH	See note [5]
Retail NHH	See note [5]

1. Sewers, CSOs and sewage pumping stations are allocated between foul, surface water & highway drainage based on:
    a. Capital maintenance is allocated directly at a scheme level Enhancement expenditure is allocated directly at a scheme level
2. Sewage treatment works costs at collocated sludge treatment centres are allocated between sewage treatment and returned sludge liquors:
    a. Capital maintenance is allocated using the same methodology as operational costs
    b. Enhancement expenditure is allocated directly at scheme level

3. Sludge expenditure is allocated based on a scheme level review of all capital expenditure
4. Management and general expenditure is allocated to the price control units based on principle use; this is then allocated within the price control units based on the split of depreciation

   For 2024/25 the expenditure has been allocated to price control units in the proportions below.

Water Resources	Water Network Plus	Wastewater Network Plus	Bioresources
2.33%	20.11%	73.11%	4.45%

5. Retail HH and NHH capex is assessed directly at a scheme level

5.3 Disaggregation of wholesale activities – Upstream reporting

Some costs are not allocated to the Ofwat requirements in our corporate finance system and it has been necessary to make a small number of adjustments. We make such adjustments where we consider the initial analysis is materially inconsistent with Ofwat guidance e.g., all fisheries costs charged to third party services rather than direct costs of resources.

Power costs are booked within the general ledger system at a site level. Where sites conduct more than one activity and there is no sub-metering then we make manual adjustments to allocated power costs appropriately. The allocation of power between the different water service activities is based on an average of three years pumping head data at a site level.

Historically we have aimed to identify specific operating costs that are identifiable as raw water distribution; however, the only material opex cost would potentially be power as we do have pumping costs for pumping raw water from sources to treatment works. Applying the rule that water is transferred to one business unit to another via a pump means that these power costs are actually included in the water resources business unit as the pumps are located at the water resources site. Considering this, along with the small amount of raw water aqueducts we have and the fact that we have no customers supplied with raw water, we do not believe there is a viable separated raw water distribution business unit within our boundary. Similarly, we have no raw water storage facilities and so do not consider that there is a viable separate raw water storage business unit within our boundary. As such, we allocate ‘Other business activities’ costs equally across eight business units – seven Wholesale and one Retail.

Table 4D - Water supply analysis

Water resources
We separately identify the operating costs of abstraction licences within the corporate finance system and allocate the remaining balance to the costs of raw water abstraction. Abstraction charges are set by the Environment Agency and are designed to recover the costs incurred in ensuring water resources are managed effectively. This includes ensuring the rights of existing licence holders to abstract water are protected against the granting of new licences.

Raw water distribution
As discussed above we do not consider ourselves to have a viable raw water distribution business unit and so no costs are allocated here.

Raw water storage
As discussed above we do not consider ourselves to have a viable raw water storage business unit and so no costs are allocated here.

Water treatment
This activity is not required to be analysed further.

Treated water distribution
This activity is not required to be analysed further.

Depreciation costs
Each asset is allocated to the individual business unit as appropriate, based on principal use. Support function HCD and any capitalised interest allocation is now based on principle use of the asset and recharged as appropriate based on the same cost drivers as opex allocation.

Table 4E - Waste water analysis

Sewage collection
Sewage collection has continued to prove particularly difficult to allocate to the required upstream services. We have used a consistent approach with previous years to deriving an allocation and this is described below:

The starting point is Table 2B from the Annual Performance Report, Wastewater.

Operating costs are allocated based on the measured foul flow at works as a proportion of total measured flows. These values are taken from our sewage works information management system (SWIMS) which has been independently certified by MCERTS. The foul flows element is allocated to the foul water sewerage consistent with our measured dry weather flow (DWF) at sewage treatment works with the balance being equally apportioned to surface water and highways drainage. This information is based on a three- year rolling average basis.

Foul flow at works	474 Ml/d
Additional storm flows	535 Ml/d
Total SWIMS flow at works	1,009 Ml/d

Capital charges are allocation based on the length of sewers with a weighting to the likely use (taken from Table 7C):

	Foul Only	Storm only	Dual	Rising Main	Total	%
Sewer length (km)	9,278	4,510	3,137	1,270	18,195	
Foul proportion (%)	100%	0%	80%	100%	13,058	72%
Storm proportion (%)	0%	100%	20%	0%	5,137	28%

Sewage treatment and disposal

This activity is not required to be analysed further except to remove the costs involved in imported sludge liquor treatment as below.

Imported sludge liquor treatment

Liquors from sludge treatment arise from both thickening and dewatering. These liquors are returned to the head of the sewage treatment works (STW) associated with the sludge treatment centre (STC) for treatment with incoming sewage. The proportion of STW costs associated with liquor treatment has been derived from an estimation of the sludge liquor volume and organic load and comparing it with the total load and flow treated by the STW.

To estimate sludge liquor volume and load, we calculate sludge production figures (mass and volume). This data originates from measured loads exported from each STC. These figures are shared between indigenous and imported sludge based on logger data for imported sludge (volume and thickness) and theoretically calculated figures for indigenous sludge. The costs of liquor treatment have been calculated and subtracted from the sewage treatment business unit.

The pipework to take liquors back to the head of the works are accounted for as non-infrastructure.

Sludge transport

The operating costs are captured separately within our corporate finance system, as it is run as if it were a separate business entity. The internal business unit is fully responsible for tankering between STW and STC. The business unit includes running an internal fleet of tankers and using external tankers when operational requirements cannot be met by the internal facility.

The cost types captured include staffing and fuel costs. This makes capturing costs at this disaggregated level more straightforward.

Sludge disposal

This activity is not required to be analysed further.

Depreciation costs

Each asset is allocated to the individual business unit as appropriate, based on principal use. Support function HCD and any capitalised interest allocation is now based on principle use of the asset and recharged as appropriate based on the same cost drivers as opex allocation.

5.4 Assurance processes

The assurance process involves an internal review procedure that includes segregated roles and sign off of individual table certificates by data compilers, owners and reviewers, in that order. This process is carried out to ensure compliance with Ofwat letter MD209 and a true and fair view of the performance of the company.

In this area, the data owners are the WWSL Head of Finance and the Pelican Head of Finance. The Regulatory Finance Manager, Regulatory Accountant and Financial Accountants compile the analysis and methodology statements.

Both the analysis and methodology statement are scrutinised and challenged by the Head of Economic Regulation and Group Financial Controller. A version and change control process is used throughout the process and a “major” version is recorded when the table owner, in this case, the Group Financial Controller is satisfied.

An external audit is carried out by our financial auditors, Ernst & Young LLP and our technical auditors, Mott MacDonald, with reference to current regulatory accounting guidelines and any annual specific guidance.

Following internal and external challenge, the Annual Performance Report is presented in full to the company Audit & Risk Committee. The Audit & Risk Committee use the meeting as an opportunity to challenge specific areas and presentations made by senior managers. Feedback from the Audit & Risk Committee is acted upon before being approved by Board members prior to publication.

Through this challenge and signoff process, the company’s management is satisfied that the attribution and allocation of costs is reasonable.