



**Northern Ireland Water Limited**

**Auditors' Report and  
Commentary on the Annual  
Information Return  
Year ended 31 March 2016**

1 August 2016  
This report contains 37 pages  
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## Notice about this report

- 1.1.1 This report is made to Northern Ireland Water Limited ('NI Water') and the Northern Ireland Authority for Utility Regulation ('NIAUR') in accordance with the terms of our engagement letter dated 23 January 2012.
- 1.1.2 This report is confidential and has been prepared solely for the purpose of NI Water and NIAUR (the Beneficiaries), and has been released to the Beneficiaries on the basis that it will not be copied or disclosed to any third party or otherwise quoted or referred to, in whole or in part, without our written prior consent.
- 1.1.3 This report is not suitable to be relied on by any party wishing to acquire rights against KPMG (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtain access to this report or a copy (under the Freedom of Information Act 2000 or otherwise) and chooses to rely on this report (or any part of it) does so at their own risk. To the fullest extent permitted by law, KPMG does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Beneficiaries.
- 1.1.4 The contents of the report should not be taken as reflecting the views of KPMG except where explicitly stated as being so.
- 1.1.5 To a certain extent the content of this report comprises general information that has been provided by, or is based on discussions with, management and directors of the Company. Except to the extent necessary for the purposes of the audit, this information has not been independently verified.
- 1.1.6 This report refers to Northern Ireland Water Limited as 'NI Water' and makes references to 'Oracle', 'Rapid Xtra', 'CIDA', 'FAR', 'Echo' and 'UK GAAP'. Oracle is the accounting system used by NI Water, Rapid Xtra is the billing system, FAR is the fixed asset register and CIDA is the capital investment driver allocation system. Echo has been subcontracted to provide billing, credit management and customer services to NI Water. UK GAAP refers to old UK GAAP prior to the introduction of FRS102 as the new format for UK GAAP. The Regulatory Accounting Guidelines have not been updated to reflect the introduction of FRS102.
- 1.1.7 The Statutory Accounts for the year ended 31 March 2016 were approved by the Board of Directors and signed on 28 June 2016. The Regulatory Accounts for the year ended 31 March 2016 were approved by the Board of Directors and signed on 28 June 2016.
- 1.1.8 This report should be read in conjunction with the Annual Information Return prepared by NI Water for the year ended 31 March 2016.
- 1.1.9 Where no guidance has been given to auditors, we have assumed that comment is not required on these Tables and have therefore not included these within the scope of our work.

## **Report of the Independent Auditors to Northern Ireland Water Limited and the Northern Ireland Authority for Utility Regulation**

We have reviewed the Regulatory Accounts Tables 6a, 18 to 31, 33, 34, 39, 42 and 43 set out in the Annual Information Return in respect of Northern Ireland Water Limited (“the Company”).

This report is made to the Company in accordance with the terms of our engagement letter dated 23 January 2012 (the “Contract”). This report is made also to the Northern Ireland Authority for Utility Regulation (the “Regulator” or “NIAUR”) in order to meet the requirements of the Instrument of Appointment by the Department for Regional Development of Northern Ireland Water Limited as a Water and Sewerage undertaker under the Water and Sewerage Services (Northern Ireland) Order 2006 (the “Regulatory Licence”) and to enable the NIAUR to verify that a report from independent auditors has been issued in connection with the Regulatory Accounts Tables 6a, 18 to 29, 33, 34, 39, 42 and 43. Our work has been undertaken so that we might state to the Company and to the NIAUR those matters we have been engaged by the Company to state in this report and for no other purpose.

### **Opinions and conclusions arising from our audit**

#### **1. Our opinion on the specified Regulatory Accounts Tables as set out in the Annual Information Return is unmodified**

Based upon our review, in our opinion, the Regulatory Accounts Tables contain the information for the year to 31 March 2016 required to be submitted to the NIAUR by the Company to comply with Condition F of the Regulatory License and are materially consistent with the information submitted to NIAUR in the Regulatory Accounts.

#### **2. Our Opinion on the Regulatory Accounts Tables as set out in the Annual Information Return is accompanied by an emphasis of matter – basis of valuation of tangible fixed assets**

The accounting policies to the Regulatory Accounts set out details in respect of the current cost basis of valuation of tangible fixed assets. We draw your attention to the fact that the valuation is not based on a Modern Equivalent Asset Value (MEAV) as required by the Regulatory Accounting Guidelines following agreement between the Company and NIAUR that this is not required in the first three years of PC15. Our opinion is not qualified in this regard.

### **Basis of our report, responsibilities and restriction of use**

- (i) The Company’s directors are responsible for the preparation of the Regulatory Accounts Tables.
- (ii) Our responsibilities, as independent auditors, are established in the United Kingdom by relevant legal and regulatory requirements and the Contract and the Accounting Guidelines and other relevant material issued by the NIAUR. It is our responsibility to form an independent opinion based on our review, on those Tables and to report our opinion to the Company and (on the basis set out above) to the NIAUR.
- (iii) We conducted our review in accordance with the Regulatory Accounting Guidelines, the Annual Information Return reporting requirements issued by NIAUR dated 31 March 2016 and other relevant material issued by the NIAUR and the Contract. A review

includes examination, on a test basis, of evidence relating to the amounts and disclosures in the Regulatory Accounts Tables. It also includes an assessment of the significant estimates and judgments made by the Company's directors in the preparation of the Regulatory Accounts Tables, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

- (iv) We planned and performed our review so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts Tables are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the Regulatory Accounts Tables in terms of UK Generally Accepted Accounting Practice and the Regulatory Accounting Guidelines.

This report has been released to the Company and to the NIAUR on the basis that it shall not be copied, referred to or disclosed, in whole (save for the Company's or the NIAUR's own internal purposes) or in part, without our prior written consent. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our work, for this report, or for the opinions we have formed. We will accept such responsibility to the NIAUR on condition that the NIAUR agrees in writing to the Contract by signing the notice appended to the Contract.



KPMG  
Chartered Accountants  
Belfast  
1 August 2016

## Part A – General Procedures

Requirement (in bold followed by our commentary for each procedure listed)

- 3.1 **From discussions with management and sight of underlying documentation, describe NI Water’s sign off procedures. Describe the nature of the underlying documentation observed.**
- 3.1.1 Assurance for the AIR16 submission process was completed using Sharepoint ‘Workflows’. Lines within tables and commentaries can only be amended by the designated ‘author’ who is sent a task by email from the Sharepoint system. Once the authors have compiled the final version of their table lines and commentaries they complete the task assigned to them confirming completeness and accuracy and the System administrator locks the relevant files so they cannot be changed. A task is then sent to the reviewer who then reviews the files and approves their task. When the reviewing task is complete an email is sent to the approver and when they approve their task an email is sent to the System Administrator to update the master copy for final formatting. If the reviewer or the approver reject the files the System Administrator is advised, the permissions for the files are changed to allow the author to edit and the workflow is restarted.
- 3.1.2 On 28 June 2016 the Board approved the text of the AIR 2016’s Board overview and agreed submission of all final AIR16 Tables and commentaries to the Utility Regulator. This ensured consistency of approach.
- 3.2 **For each Regulatory Table\*, check that NI Water has complied with the Definitions Manual or has included a commentary as to why the guidance has not been followed.**
- \*we have considered only those Tables on which we are required to report – as set out in the Auditors’ report on pages 2 and 3*
- 3.2.1 For each of the Tables/elements of Tables where the Auditors had specific responsibilities as referred to in Sections B - J of the Auditors’ guidance, and reported on in our Auditors’ Report (Tables 6a, 18 to 31, 33, 34, 39, 42 and 43), we carried out procedures to satisfy ourselves that the requirements of the guidance had been complied with. We noted the following observations and/or exceptions:
- 3.2.2 **Part A General Procedures**
- There were no adjustments made to the 2016 figures between the date which the Regulatory Accounts were signed and the date which the Annual Information Return was submitted.
- 3.2.3 **Part B Activity Cost Analysis**
- During the current year NI Water allocated £1.85m (2014/15: £1.98m) of dividends to non-appointed activities.

#### 3.2.4 **Part C Pensions**

- (i) We draw your attention to the fact that the actuarial valuation provided by the company's actuary is an IAS19 valuation in accordance with International Financial Reporting Standards as adopted by the EU. The primary difference between an IFRS (IAS19) valuation and a UK GAAP (FRS17) valuation arises in the allocation of certain pension costs as an expense to the profit and loss account or to reserves. If the actuarial gain had been calculated in line with UK GAAP, rather than IFRS, the actuarial gain charged directly to reserves (through the statement of total recognised gains and losses (STRGL)) would have been approximately £1.2m lower and the pension costs charged to the profit and loss account would have been approximately £1.2m lower. For the company, in this respect, there is no overall balance sheet impact of following IFRS in comparison to UK GAAP.
- (ii) The Company has not carried out an exercise to separately analyse staff members included in the Pension Scheme between those involved in Appointed and Non-Appointed activities, and consequently have not analysed the pension deficit or the associated net interest income between Appointed and Non-Appointed activities. This issue was also raised in prior years. Management have provided full explanation in their commentary to Tables 21 and 22 and assert the cost of calculating the impact for these members in isolation to be unjustified. We recommend that management continue to monitor this area and, in the event that the systems allow this allocation to be made in future years, take appropriate action. Management note in their commentary that in the process of apportioning costs (including total wages, salaries and pensions) to non-appointed activities it is assumed that an element of this apportionment will cover pension costs. Management have advised in their commentary that an exact split between appointed and non-appointed pension costs cannot be determined as all operating costs in aggregate (including pension costs) are allocated to non-appointed activities based on non-appointed activity turnover.

#### 3.2.5 **Part D Income**

No matters noted.

#### 3.2.6 **Part E Bad Debt**

No matters noted.

#### 3.2.7 **Part F Taxation**

[Section 3.2.7 has been redacted]

#### 3.2.8 **Part G Accounting Charges**

We note that the current cost valuation of fixed assets was not based on a Modern Equivalent Asset Value ("MEAV") basis as is required in regulatory accounting guidelines. This fact was disclosed by management in the Regulatory Accounts and we have drawn this to the attention of the reader of the accounts in our audit opinion.

#### 3.2.9 **Part H Land Sales**

[Section 3.2.9 has been redacted]

#### 3.2.10 **Part I Borrowings**

No matters noted.

3.2.11 **Part J General**

No matters noted.

3.3 **Check that management has included a commentary, including an explanation for reporting requirements that do not apply to NI Water.**

3.3.1 For all Tables reviewed, management has included a commentary (if applicable) including an explanation for reporting requirements that do not apply to the Company, as outlined in 3.4.1 below.

3.4 **Read NI Water's explanation of reporting requirements that do not apply and check details set out in the commentary to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.**

[Section 3.4.1 has been redacted]

3.5 **Check that the figures reported in the Regulatory Accounts Tables 6a, 18 to 31, 33, 34 and 39 (and 42 and 43 by virtue of supplementary guidance from NIAUR) in the Annual Information Return agree to the underlying accounting records and the final Regulatory Accounts.**

3.5.1 We have reviewed the Tables as follows:

N.B. References to the 15/16 accounts relate to the audited Statutory and Regulatory Accounts for the year ended 31 March 2016.

Table	Description	Comment
Table 6A	Outstanding revenue and breakdown of customer services operating expenditure	Lines 1-28 have no figures as there was no household billing in 15/16. We have agreed lines 29, 31, 33, 35, 37, 43, 45, 47, 49, 51 57a and 58a (for 15/16) to the Oracle nominal ledger. Lines 29, 31, 33, 35, 37, 43, 45, 47, 49 and 51 have also been agreed to the Aged Debt Listing at 31 March 2016. Household numbers in lines 30, 32, 34, 36 and 38 have been extracted from the Rapid Xtra billing System. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.
Table 18	Profit and Loss Account (Historical Cost Accounting)	We have agreed lines 1 to 15 (for 15/16) to the 15/16 Regulatory Accounts, to the Oracle nominal ledger and client schedules detailing adjustments made for regulatory purposes. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.
Table 18A	[Redacted]	[Redacted]
Table 18B	[Redacted]	[Redacted]
Table 18C	Statement of total recognised gains and losses	We have agreed lines 1 to 4 (for 15/16) to the 15/16 Regulatory Accounts. The actuarial gain reported in line 2 has been agreed to the Statutory Accounts. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.
Table 18D	Analysis of dividends and interest charges for year	We have agreed lines 1 to 3 and 8 to the 15/16 Regulatory Accounts, to the Oracle nominal ledger (as reconciled to take account of interest allocated to non-appointed activities) and client schedules detailing



Table	Description	Comment
		adjustments made for regulatory purposes. Lines 4 to 12, (interest analysis), could not be agreed to the Regulatory Accounts as this disclosure is not required. However the total in line 12 agrees to 'net interest payable' in the Regulatory Accounts. We have agreed lines 4 to 12 to the Oracle nominal ledger and client supporting schedules detailing adjustments made for regulatory purposes. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.
Table 19	Balance Sheet (Historical Cost Accounting)	We have agreed lines 1 to 33 (for 15/16) to the 15/16 Regulatory Accounts except for lines 13, 18, 19, 21, 22 and 24. This is due to specific disclosure requirements in Table 19 relating to the presentation of deferred income. However the net assets employed total in line 28 agrees to the Regulatory Accounts as it is merely a reclassification within liabilities. We have agreed all lines to the Oracle nominal ledger and client supporting schedules detailing adjustments made for regulatory purposes. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.
Table 19A	Analysis of borrowings due after more than one year (Historical Cost Accounting)	We have agreed the principal sum, nominal interest rate and the carrying value to the 15/16 Statutory Accounts/Audit File and the carrying value to the Oracle nominal ledger. The principal sum and carrying value has also been agreed to the Regulatory Accounts but the nominal interest rate is not included in the Regulatory Accounts. The years to maturity has been agreed as the number of years from 31 March 2016 to the maturity date of 31 March 2027 per the loan note agreement. As this is a fixed rate instrument, the real coupon rate is agreed as the nominal interest rate adjusted for the RPI assumption.
Table 20	Profit and Loss Account (current cost Accounting)	We have agreed lines 1 to 16 (for 15/16) to the 15/16 Regulatory Accounts, to the Oracle nominal ledger and to client supporting schedules detailing adjustments made for regulatory purposes.
Table 21	Activity Cost Analysis – Water Services	We have agreed lines 1 to 34 (for 15/16) to the 15/16 Regulatory Accounts except for lines 16, 23 and 24 as the Regulatory Accounting Guidelines do not specifically require this disclosure within the Regulatory Accounts.  We have agreed the total of line 22 in Table 21 and line 21 in Table 22 as being the total taken from the Oracle nominal ledger less non-appointed costs supported by client schedules. The apportionment of costs to Water and Sewerage has been agreed to client allocation/apportioning model.  The sum of the total of lines 24, 25 and 26 in Table 22 and lines 25, 26 and 27 in Table 21 has been reconciled to the Oracle nominal ledger and current cost fixed asset register.

Table	Description	Comment
		<p>We have confirmed the arithmetic accuracy of line 16, total business costs which is the sum of lines 13, 14 and 15. Lines 23 and 24 classify certain elements of operating expenditure included in lines 1 to 22 between infrastructure and non-infrastructure reactive and planned maintenance. Lines 23 and 24 are for disclosure purposes only and are not included in total costs.</p> <p>All balances in the NI Water Total Table have been agreed as being the sum of the NI Water only Table and the PPP only Table.</p>
Table 22	Activity Cost Analysis – Sewerage Services	<p>We have agreed lines 1 to 33 (for 15/16) to the 15/16 Regulatory Accounts except for lines 15, 22 and 23 as the Regulatory Accounting Guidelines do not specifically require this disclosure within the Regulatory Accounts.</p> <p>We have agreed the total of line 22 in Table 21 and line 21 in Table 22 as being the total taken from the Oracle nominal ledger less non-appointed costs. The apportionment of costs to Water and Sewerage has been agreed to client allocation/apportioning model.</p> <p>The sum of the total of lines 24, 25 and 26 in Table 22 and lines 25, 26 and 27 in Table 21 has been reconciled to the Oracle nominal ledger and current cost fixed asset register.</p> <p>We have confirmed the arithmetic accuracy of line 15, total business costs which is the sum of lines 12, 13 and 14. Lines 22 and 23 classify certain items of operating expenditure included in lines 1 to 21 between infrastructure and non-infrastructure reactive and planned maintenance. Lines 22 and 23 are for disclosure purposes only and are not included in total costs.</p> <p>All balances in the NI Water Total Table have been agreed as being the sum of the NI Water only Table and the PPP only Table.</p>
Table 23	Analysis of Turnover and Operating Income	<p>We have agreed lines 1 to 21, with the exception of the subsidy in line 2 and line 7a (for 15/16) to the 15/16 Regulatory Accounts, the Oracle nominal ledger and client supporting schedules detailing adjustments made for regulatory purposes. The subsidy in Line 2 was agreed to the Statutory Accounts. Line 7a refers to road drainage revenue which is not separately identified within the Regulatory Accounts. We have agreed the road drainage revenue in line 7a as being included within other third party services in the Regulatory Accounts. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.</p>
Table 24	Balance Sheet (current cost Accounting)	<p>We have agreed lines 1 to 29 (for 15/16) to the 15/16 Regulatory Accounts, the Oracle nominal ledger and</p>

Table	Description	Comment
		client supporting schedules detailing adjustments made for regulatory purposes. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.
Table 25	Analysis of Fixed Assets by Asset type	We have agreed lines 1 to 16 (for 15/16) to the 15/16 Regulatory Accounts. The total of lines 1-16 have also been agreed to the current cost Fixed Asset Register plus client schedules of adjustments made for regulatory purposes.
Table 26	Working Capital	We have agreed lines 1 to 13 (for 15/16) to the 15/16 Regulatory Accounts and supporting mapping schedules from the Oracle nominal ledger. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.
Table 27	Movement on current cost Reserve	We have agreed lines 1 to 7 (for 15/16) to the 15/16 Regulatory Accounts. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.
Table 28	Cash Flow Statement	We have agreed lines 1 to 23 (for 15/16) to the 15/16 Regulatory Accounts and client workings based on the Statutory Accounts. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.
Table 29	Reconciliation of Operating Profit to Net Cash Flow	We have agreed lines 1 to 9 (for 15/16) to the 15/16 Regulatory Accounts and client workings based on the Statutory Accounts. Line 8 - other non-cash profit and loss items is the sum of other non-cash items included, and separately disclosed, in the Regulatory Accounts. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.
Table 33	Depreciation charge by asset type	We have agreed the depreciation charge for the year for both Water and Sewerage to the Regulatory Accounts. We are unable to agree lines 2, 3 and 4 to the Regulatory Accounts as the Regulatory Accounting Guidelines do not specifically require this disclosure within the Regulatory Accounts. The total IRE and IRC charge have been agreed to the Regulatory Accounts, with the cumulative balance being recalculated based on the actual IRE charge and the charge within PC15. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.
Table 34	Analysis of non-infrastructure fixed asset additions by life categories	We have agreed lines 1-7 and 9-13 to the CIDA summary model. We have reconciled lines 8 and 14 to the Regulatory Accounts and Table 32. All comparatives (for 12/13, 13/14 and 14/15) have been agreed to the 2015 Annual Information Return.
Table 39	[Redacted]	[Redacted]
Table 42	[Redacted]	[Redacted]
Table 43	[Redacted]	[Redacted]

3.6 Where there are subsequent changes to the Regulatory Accounts, compared to the submitted Regulatory Tables, NI Water should write to NIAUR setting out any differences between the submitted Regulatory Tables and the finalised Regulatory Accounts and the reasons for the changes. Read NI Water's explanation and agree

**details set out in the commentary to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.**

- 3.6.1 Regulatory Accounts were signed on 28 June 2016, pre-submission of the Annual Information Return. There were no adjustments made to the 2016 figures between the date which the Regulatory Accounts were signed and the date which the Annual Information Return was submitted.
- 3.7 **Read NI Water's response to the Regulator's queries and check that NI Water's commentary is consistent with the Regulatory Accounts and the underlying accounting records.**
- 3.7.1 We have reviewed NI Water's log of queries received from NIAUR in respect of AIR16 and the responses provided by NI Water in respect of financial tables only. There were no issues raised in relation to any of the financial tables which we have audited.
- 3.8 **The full wording of the opinion NIAUR require for the Regulatory Accounts for 2015-16 is set out in the Engagement Letter between NI Water's Auditors, the Regulator and NI Water. Where NI Water submits a set of Regulatory Accounts that does not contain this wording, NIAUR will not consider it to be compliant with licence condition F. The wording of the opinion NIAUR require for the Annual Information Return is set out in Annex B.**
- 3.8.1 The wording of the audit opinion on the Regulatory Accounts is consistent with the wording within the latest version of the engagement letter dated 23 January 2012, as stipulated in Annex A of the Auditors' Guidance (the format has been amended to reflect current best practice as set out by the Financial Reporting Council). We have also included an emphasis of matter paragraph in our audit opinion on the Regulatory Accounts in respect of the basis of valuation of tangible fixed assets.
- 3.8.2 The wording of the opinion on the Regulatory Tables as presented on page 2 and 3 is the same of that in Annex B of the Auditor's Guidance (as amended to reflect current best practice as set out by the Financial Reporting Council). We have included an emphasis of matter paragraph in our audit opinion in respect of the basis of valuation of tangible fixed assets.
- 3.9 **NIAUR expect, given the timescales of submission for the Annual Information Return 2016, that information in the Annual Information Return submission and the Regulatory Accounts will be consistent and that auditors will be able to agree the Annual Information Return figures to the Regulatory Accounts. Where this is the case, we would expect auditors to issue an opinion confirming consistency of the information in the Annual Information Return and the Regulatory Accounts as set out in Annex B.**
- If there are any material differences between the Annual Information Return submission and the Regulatory Accounts, these should be detailed and explained in a covering letter by the auditors.**
- 3.9.1 As noted in 3.6.1 above, there were no changes identified in the period between the Regulatory Accounts were signed and the AIR Tables were submitted.

## Part B – Activity Cost Analysis (Tables 21 & 22)

In line with the NIAUR guidance the following materiality has been used for Part B:

- All items excl. bad debt charge & atypicals (higher of £100k or 1% of OPEX) - £3.13m (£313.154m x 1%)
- Bad debt charge (10% of £264k) - £26k
- Atypicals - all items reviewed

**4.1 Read NI Water’s explanation of the procedures used to allocate costs, starting from the point where such data is extracted from the general ledger. Check that this explanation is consistent with the preparation basis of the Regulatory Table and the underlying accounting records.**

4.1.1 The Company’s explanation of the procedures used to allocate costs is consistent with our understanding, and our review and walkthrough, of the allocation and apportionment model designed and implemented by the company.

4.1.2 We selected five expenses from Table 21 and five expenses from Table 22, obtained a breakdown by service activity for each expense selected and traced the balance back to the statutory nominal ledger to ensure that the balance was (i) complete, and (ii) accurately allocated in accordance with the company methodology as detailed in the management commentary.

4.1.3 Each balance could be traced from the Oracle nominal ledger through to the Regulatory Accounts and relevant Tables from the Annual Information Return, and had been allocated correctly as detailed in the management commentary.

4.1.4 Furthermore, a reconciliation was carried out on the Oracle nominal ledger in order to ensure that all statutory operating costs less any non-appointed costs were accounted for correctly within Tables 21 and 22. These reconciled and all relevant costs had been included.

**4.2 For any judgements, apportionments or adjustments identified by management in (4.1), agree that these are consistent with the basis of preparation of the Regulatory Table and, where relevant, the underlying accounting records.**

4.2.1 Operating costs are extracted from Oracle by nominal ledger code into an excel spreadsheet where they are allocated to services (i.e. Water or Sewerage) and then service areas (i.e. Resources and Treatment, Distribution). As general and support expenditure cannot be directly mapped to service areas, a basis of apportionment is applied. The cost apportionment methodology is based on the total direct costs incurred in each service area.

4.3 Obtain management's commentary for changes in judgements, apportionments or adjustments when compared with the prior year. Read NI Water's commentary and, where relevant, agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.

4.3.1 There have been no changes in the methodology with respect to the calculation of direct and general and support costs.

4.3.2 Operating expenditure costs from the general ledger have been allocated between Water and Sewerage services and between service areas within the Water and Sewerage activities by mapping the company's general ledger to the Tables using the coding structure described in management's commentary to Tables 21 and 22. The only exception to this is in relation to indirect general and support expenditure which can relate to more than one service area or activity. These costs are collated into five separate 'overhead pots' and are apportioned either on the basis of directly coded spend or on the basis of total direct costs. The allocations to Water and Sewerage from these overhead pots, together with the comparative figures, are set out below:

Pot	2016				2015			
	Water		Sewerage		Water		Sewerage	
	£'k	%	£'k	%	£'k	%	£'k	%
Pot 1 – Non-operational general spend	[Redacted]	51	[Redacted]	49	[Redacted]	51	[Redacted]	49
Pot 2a – water related activities only	[Redacted]	100	[Redacted]	-	[Redacted]	100	[Redacted]	-
Pot 2b – sewerage related activities only	[Redacted]	-	[Redacted]	100	[Redacted]	-	[Redacted]	100
Pot 3a – water and sewerage network spend	[Redacted]	51	[Redacted]	49	[Redacted]	51	[Redacted]	49
Pot 3b – mechanical and engineering	[Redacted]	27	[Redacted]	73	[Redacted]	17	[Redacted]	83
Directly coded costs	[Redacted]		[Redacted]		[Redacted]		[Redacted]	
<b>Total</b>	[Redacted]		[Redacted]		[Redacted]		[Redacted]	

The allocation to Water from general and support overhead pot 1 and pot 3a has remained consistent with AIR15. The allocation to Water from general and support overhead pot 3b has increased from approximately 17% to 27% largely as a result of a revision of the split based on the activity of the Mechanical and Engineering function of the organisation during the year. [Redacted]

4.3.3 During the current year NI Water allocated £1.85m (2014/15: £1.98m) of dividends to non-appointed activities.

4.4 **Obtain management’s commentary on all items noted as being ‘exceptional’ or ‘atypical’. Read NI Water’s commentary and, where relevant, agree details set out in the commentary to the underlying accounting records or other supporting documentation. For atypical items, compare the costs in the report year with historic actual costs for that item. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

4.4.1 There were £1.7m of atypical costs incurred under the Business Improvement Programme and £0.6m of atypical costs were incurred in respect of voluntary early retirements/voluntary severance. The table below sets out the atypical costs in respect of the business improvement programme and VER/VS costs over the past four years.

Category	2012/13 (£m)	2013/14 (£m)	2014/15 (£m)	2015/16 (£m)
Business improvement	1.0	1.4	1.6	1.7
Voluntary severance / early retirement	3.4	1.3	0.7	0.6

We note that the items of atypical expenditure set out above, and included in management’s commentary is based on the final determination provided by NIAUR.

4.5 **Obtain management’s capitalisation policy which should also highlight any changes from the prior year. Read NI Water’s commentary and check that it is consistent with the policies applied in the Regulatory Accounts and the underlying accounting records.**

4.5.1 There has been no change in management’s capitalisation policy which is detailed in the commentary to Tables 21 and 22. The commentary is consistent with the policies applied in the Regulatory Accounts and the underlying accounting records and agrees to the capitalisation guidance published by NI Water. Sampling of expenditure on capital projects performed during the statutory audit fieldwork confirmed that the policy in place during the 2015/2016 financial year was applied.

4.6 **Trace the costs relating to ‘movements in provisions’ (including legal provisions) to the Regulatory Accounts and the underlying accounting records.**

4.6.1 All material movements in provisions have been agreed to the Regulatory Accounts, statutory nominal ledger and client schedules based on legal advice and management assessment.

We have noted an issue in our board report in respect of management’s classification of a provision as an accrual in the amount of £12.23m, however, we have not modified our opinion in this regard. We also raised this issue in the prior year.

4.7 **Obtain management’s commentary in relation to reorganisation costs which should include a brief description of what costs have been included (split between redundancy costs and pension strain etc.) along with details of when the expenditure is expected to be incurred. Read NI Water’s commentary and, where relevant, agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

4.7.1 The Company have noted two reorganisation costs in their commentary. The Business Improvement Programme (‘BIP’) which consists of a series of major projects set up

with an aim to meet or exceed performance levels of similar English and Welsh Water companies. These costs have no redundancy or pension element.

- 4.7.2 Costs in respect of the Voluntary Early Retirement (VER) programme have been split into pension and non-pension elements and the Company has noted how much has been paid and accrued at the year end.
- 4.7.3 Both costs have been agreed as included in operating expenditure in the Regulatory Accounts and reconciled to the Oracle nominal ledger. The expected timing of expenditure has been disclosed in the commentary to Tables 21 and 22, if known.
- 4.8 **To the extent not covered by Ofwat's RAG 5.04 on transfer pricing, check if any adjustment has been made to exclude non-appointed business costs from the Regulatory Accounts Table. Agree the adjustment to the underlying accounting records and/or the Regulatory Accounts.**
- 4.8.1 The Company excludes non-appointed operating costs (£3.47m) from the activity cost Tables in the Regulatory Accounts. The activity costs reported in the AIR have been reconciled and agreed to both Statutory and Regulatory Accounts. The amount deemed non-appointed has been agreed to client apportioning schedules.



## 5 Part C – Pensions (Tables 18, 18c, 18d, 19, 20, 21, 22 & 24)

In line with the NIAUR guidance, 5% of the FRS17 operating profit charge (5% of £11.2m = £0.56m) has been used as materiality for Part C.

We draw your attention to the fact that the actuarial valuation provided by the company's actuary is an IAS19 valuation in accordance with International Financial Reporting Standards as adopted by the EU. The primary difference between an IFRS (IAS19) valuation and a UK GAAP (FRS17) valuation arises in the allocation of certain pension costs as an expense to the profit and loss account or to reserves. If the actuarial gain had been calculated in line with UK GAAP rather than IFRS the actuarial gain charged directly to reserves (through the statement of total recognised gains and losses (STRGL)) would have been approximately £1.2m lower and the pension costs charged to the profit and loss account would have been approximately £1.2m lower. For the company, in this respect, there is no overall balance sheet impact of following IFRS in comparison to UK GAAP.

As this is the only difference, no amendments have been made to the references to FRS17 set out in this section.

- 5.1 **Obtain an explanation of the procedures used to allocate costs, starting from the point where such data is extracted from the general ledger. Check that NI Water's explanations and, in particular the apportionments of the FRS17 (or other relevant standard) charge across several lines in Tables 21 and 22, is consistent with the Regulatory Accounts and the underlying accounting records.**
  - 5.1.1 An explanation of the procedures used to allocate costs including pension costs, is included in the commentary for Tables 21 and 22. Tables 21 and 22 have been agreed to the Regulatory Accounts as detailed in section 3.5.1 and reconciled to NI Water's Oracle nominal ledger. Pension costs for those employees who can be directly attributed to service or business activities are directly mapped to these areas via the wages and salaries codes. However pension costs that relate to either employees not engaged directly on service/business activities or that relate to past service costs have been apportioned to activities in line with the treatment of general and support expenditure (see 4.3.2). We have not identified any inconsistencies between the Company's explanations, the Regulatory Accounts and underlying information.
- 5.2 **Check that an adjustment has been made for employees who are outside of the appointed business.**
  - 5.2.1 Management have been unable to separate out the FRS17 charge or the pension deficit relating to those employees in the non-appointed business. However, these employees represent a small minority of the total number in the scheme and any allocation is not expected to be material. The commentary to Tables 21 and 22 notes this departure from reporting requirements.
- 5.3 **Check that the amounts included for the interest cost in Table 18d and the balance sheet position in Tables 19 and 24 can be agreed to the Regulatory Accounts, and where relevant, the pension disclosure notes provided by NI Water's actuary.**
  - 5.3.1 The total net interest per Table 18d has been agreed to the Regulatory Accounts. The interest charges for pension could not be agreed to the Regulatory Accounts as this disclosure is not required.
  - 5.3.2 Tables 19 and 24 have been agreed to the Regulatory Accounts and pension disclosure notes provided by the Company's actuary where applicable.

- 5.4 **Where any apportionments are identified in (1 and 3), obtain from management a commentary identifying any changes in the apportionment policy from the prior year. Agree the new basis to the basis of preparation of the Regulatory Accounts.**
- 5.4.1 Pension costs have not been split between Appointed and Non-Appointed business, as set out in 5.2.1 above - therefore no apportionments have been made in relation to pension costs.
- 5.5 **Obtain NI Water's commentary on the comparison of actual contributions to those set out in the final determination. Read NI Water's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.**
- 5.5.1 The Company's commentary to Tables 21 and 22 states employer's contributions were £10.3m for the year ended 31 March 2016. We have tested contributions through vouching to bank statements and confirm that these have been paid during the year.
- 5.6 **Through discussions with management, comment on any changes to future contribution levels that have been agreed with the pension scheme trustees which will commence after the year-end. If changes are noted, provide details and the details of supporting documentation that was made available.**
- 5.6.1 Future levels of contributions have been agreed between the company the trustees of the pension scheme and have been formally set out in a schedule of contributions. Note 21 of the Statutory Accounts indicate that management anticipate contributions of approximately £9.7m in 2016/17 based on the Schedule of Contributions agreed by the actuary.
- 5.7 **For defined benefit schemes, trace the level of cash contributions stated by NI Water to the underlying accounting records.**
- 5.7.1 Cash contributions for the defined benefit scheme have been agreed to bank statements as having been paid.
- 5.8 **Where NI Water contributes to both a defined benefit and a defined contribution scheme, check the split to the underlying accounting records.**
- 5.8.1 The Company does not have a defined contribution scheme.
- 5.9 **Trace any lump sum contribution to the underlying accounting records and NI Water's commentary.**
- 5.9.1 Additional lump sum contributions totalling £0.6m were paid into the Company Pension Scheme during the year. These contributions covered the costs of augmenting pensions in line with the Voluntary Early Retirement (VER) and Ill Health Retirement Schemes, as calculated by the scheme actuary. Such contributions have been agreed to bank statements as paid in the year and reconciled to the Oracle nominal ledger.
- 5.10 **Obtain from NI Water, detail of changes in the actuarial assumptions underpinning the FRS17 (or other relevant standard) valuation that have occurred since the previous year-end. Agree these assumptions to the FRS17 (or other relevant standard) report provided by NI Water's actuary.**
- 5.10.1 The valuation provided by the company's actuary is an IAS19 valuation as the Statutory Accounts are prepared under International Financial Reporting Standards as adopted by the EU and as such an FRS17 valuation has not been prepared. We note there is a difference between IAS19 and FRS17 in relation to the allocation of pension costs as an expense to the profit and loss account or directly to reserves (see above for details). The key assumptions in 2016 and 2015 are set out below:

<b>Assumption</b>	<b>2016</b>	<b>2015</b>
Discount rate	3.70%	3.40%
Inflation (RPI)	2.95%	3.00%
Inflation (CPI)	1.95%	2.00%
Rate of increase in salaries	1.95% for 4 years, 2.95% thereafter	2% for 5 years, 3% thereafter
Rate of increase in pensions in payment and deferred pensions	2.95%	3.00%

Details of mortality assumptions are set out below:

	<b>31 March 2016</b>			
	<b>Non-industrial</b>		<b>Industrial</b>	
	<b>Male</b>	<b>Female</b>	<b>Male</b>	<b>Female</b>
Member age 60 (current life expectancy)	<b>28.0</b>	<b>30.2</b>	<b>26.2</b>	<b>28.4</b>
Member age 40 (life expectancy at age 60)	<b>30.4</b>	<b>32.6</b>	<b>28.6</b>	<b>30.8</b>
	<b>31 March 2015</b>			
	<b>Non-industrial</b>		<b>Industrial</b>	
Member age 60 (current life expectancy)	27.9	30.1	26.1	28.3
Member age 40 (life expectancy at age 60)	30.3	32.5	28.5	30.6

A pension deficit (net of deferred taxation) of £5.9m (2015: deficit of £9.3m) has been recognised in the financial statements. The movement from the prior year primarily relates to changes in key underlying assumptions (discount rate, inflation rate and mortality) with the key contributing factors being the increase in the discount rate of 0.3% and the reduction in the inflation rate of 0.05% (both in absolute terms). The assumptions used are within KPMG Actuary's tolerable benchmark range.

- 5.11 Where there has been a change in the level of contributions within the year, check that management has included a commentary on the difference in the relative amount of contributions being used to fund any deficit. If changes are noted, provide details and the details of supporting documentation that was made available.**
- 5.11.1 The employer contribution rate remained constant during the year at 26.9%. There is currently a pension liability of £5.9m after applying the deferred tax asset on the pension liability of £1.3m (£7.2m before deferred tax).**

## 6 Part D – Income (Tables 23 and 26)

In line with the NIAUR guidance the higher of £20k or 0.1% of turnover (i.e. £367.3m x 0.1% = £367k) has been used as materiality for Part D.

- 6.1 **Read management’s reconciliation and commentary of the amounts billed to the reported turnover. Where there are adjustments, (other than for the measured income accrual), management’s commentary should set out whether these are one-offs for the current year or repeated. Where the adjustments occur annually, management should comment on the size of the adjustment compared to the previous year. Read NI Water’s commentary and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**
  - 6.1.1 Management have reconciled the billed income figure reported in Table 23 to Echo reports for the year, after making manual adjustments for movements in accrued, referred and deferred income and adjustments in respect of miscellaneous movements in provisions. Referred income relates to bills raised and included in Rapid Xtra billing reports, but not accounted for by NI Water as they are currently under investigation. Total turnover, opening and closing accrued/referred income and manual adjustments have been agreed to the Oracle nominal ledger, the remaining billed income figure to Echo reports. We have also verified the arithmetical accuracy of the reconciliation.
  - 6.1.2 The majority of adjustments are non-recurring in nature and relate to movements in provisions and accrued income due to changes in the billing cycle in the current year. Recurring adjustments relate to variances between accrued income and amounts actually billed.
- 6.2 **Based on discussion with management and sight of underlying documentation, describe NI Water’s procedures for monitoring revenue, including who reviews the revenues against PC15 and forecasts, the process for identification of variances and whether any sensitivity analysis takes place. Describe the nature of the underlying documentation observed.**
  - 6.2.1 Measured and unmeasured Water and Sewerage revenue are monitored against the budgetary position on a monthly basis and variances investigated. This process is undertaken by representatives from Financial Accounts, Management Accounts and Customer Services. Monthly variances are also reviewed by the Finance Director and Customer Services Director, who subsequently prepare a report for submission to the Board. The annual budget is based on PC15, after adjusting for a change in revenue mix given the deferral of domestic charges and phasing of subsidy income.
  - 6.2.2 The company uses the ‘actuals report’ for the purpose of providing management with more detailed information in respect of consumption, broken down by customer categories and types, thus enabling the company to more accurately identify trends and fluctuations which in turn allows them to forecast future consumption with more accuracy. The Finance and Customer Services teams meet on a monthly basis to discuss emerging variances with the ‘actuals report’ allowing underlying trends in consumption to be compared to the volumetrics underpinning the forecasted information and can provide logical explanations for under/over achievement in revenue targets. Where subsequent meter readings are at variance with the expected amounts taken from the accrued income report, this is taken into account in estimated forecasted revenue.
- 6.3 **Obtain the commentary given by NI Water on both revenue reported and to explain variances between the actual and forecasted revenue in the PC15. Read**

**NI Water's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

6.3.1 The company have noted in their commentary that total revenue for 2015/16 was £2.3m (0.6%) above budget (including non-appointed revenue). The back-billing and provision releases, largely account for total income being £2.3m over budget for 2015/16; however, specific reasons are:

- Domestic allowance subsidy: more customers applying for the domestic allowance, and increased consumption/impact of back-billing
- [Redacted]
- [Redacted]
- Increase in the provision set aside for future system adjustments of £0.4m (£0.2m for measured water and £0.2m for measured sewerage), to recognise the higher level of outstanding back-billing debtors as at March 2016.
- The releases in income provisions have affected mainly measured sewerage and trade effluent. There has been:
  - A release in the Hospital TE/TE review provision (i.e. an increase in income) against measured sewerage of £1.3m.
  - £2.8m of the Hospital TE/TE review was written back against income (i.e. a reduction in income).

6.3.2 Actual revenue figures have been agreed to the Oracle nominal ledger. Budget figures are those initiated by the Customer Service Department and agreed with the Finance and Regulation Department. Explanations in respect of turnover variances are those provided by the Customer Service Team.

6.4 **Obtain management’s commentary on the basis of the measured income accrual. Read NI Water’s commentary and agree the accrual and supporting details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

6.4.1 The commentary on the basis of the measured income accrual was reviewed and is consistent with our understanding established during the statutory audit. The level of measured income accrual noted for 2015/16 has been agreed to the Oracle nominal ledger and reconciled to underlying customer billing reports. We note that accrued income has increased by £0.8m from the prior year as a result of the following:

	<b>Impact £m</b>
Release of hospital trade effluent provision	1.5
Reduction in hospital trade effluent accrued income	(0.5)
Other miscellaneous items	(0.2)
<b>Total increase in accrued income</b>	<b>0.8</b>

6.5 **Where management has calculated a retrospective review of the previous year’s accrual compared to the amounts actually billed, agree the amounts reported to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation. Where management are not able to complete a retrospective review of the previous year’s accrual, ensure that NI Water has included an explanation of the reasons for this in their commentary.**

6.5.1 In 2014 management implemented a reconciliation process whereby amounts billed are compared to those previously accrued for both monthly and six monthly customers.

In the current year, a £1.7m (2014/15: £1.6m) system adjustment provision in respect of expected credits to be raised relating to bills previously issued was recognised against trade receivables. This system adjustment provision was created in recognition of the number of adjustments that are made to bills following queries raised by customers. Management have referred to this in their commentary to Table 6A.

6.6 **Check the amounts reported in net revenue movement out of the tariff basket (Water and Sewerage service) agree to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.**

6.6.1 There has been no net revenue movement out of the tariff basket, as stated in the commentary.

## Part E – Bad Debt (Tables 6a, 21 and 22)

In line with the NIAUR guidance the following materiality levels have been used for part E:

- Bad debt charge - movements of +/- 10% of bad debt charge i.e. +/- (10% of £264k) - £26k
- Write offs - movement of +/- 0.1% of turnover i.e. +/- (0.1% of £367.3m) - £367k
- Revenue outstanding - movement of +/- 1% of turnover i.e. +/- (1% of £367.3m) - £3.67m
- We have assumed a materiality threshold of 0.1% of turnover for customer services operating expenditure i.e. (0.1% of £367.3m) - £367k

### General Procedures

7.1 **Obtain NI Water’s commentary on whether the data has been extracted directly from their billing systems or whether numbers have been manually calculated or adjusted in some way, for example to allocate data between households and non-households. Read NI Water’s explanation and agree details of any assumptions or apportionment stated in the basis of preparation to the underlying accounting records or other supporting documentation. Describe the nature of the underlying accounting records or other supporting documentation.**

7.1.1 The data illustrated on lines 29 and 43 of Table 6a summarise revenue outstanding from non-households only. Household billing had not commenced in 15/16 therefore no such income has been recognised and as such there is no outstanding revenue at the year end.

7.1.2 As noted earlier, NI Water has outsourced billing and debt collection to Echo.

7.1.3 The balances on line 29 and line 43 have been extracted directly from the aged debt listing created using information from the Rapid Xtra Billing System provided by Echo on a monthly basis and manually reconciled to the Oracle nominal ledger. The reconciliation is consistent with the reconciliation audited as part of our statutory audit work. Reconciling items have been agreed to supporting documentation, and balances agreed to Oracle nominal ledger.

7.1.4 The nominal ledger figure is £0.1m greater than the figure included in the AIR due to the following adjustments:

	<b>£m</b>
Balance per Nominal Ledger	9.9
Bad debt provision netted off against Table 6a	(2.8)
Credit balances not included in Table 6a, included in Nominal Ledger	2.8
Referred bills	(0.1)
Balance per Table 6a	9.8

7.1.5 The information for revenue written off of £1.32m populated in lines 57a and 58a has been reconciled to the Oracle nominal ledger.

7.1.6 The customer services operating expenditure of £8.27m in line 63 has been agreed as the total of line 13 in Table 21 (£4.22m) and line 12 in Table 22 (£4.05m). This total has been agreed to the Regulatory Accounts.



- 7.2 Trace the data to NI Water’s accounting records/billing systems. Describe the source of the underlying accounting records or billing systems that data has been agreed to.**
- 7.2.1 The total revenue outstanding detailed in lines 29 and 43 has been reconciled to the Oracle nominal ledger which agrees to the Regulatory Accounts. We have reviewed the reconciliation between the Oracle nominal ledger and the Rapid Xtra billing system as described in 7.1.4 above.**
- 7.3 Obtain NI Water’s commentary on any changes in reporting methodologies (for example, apportionments used in calculating outstanding revenue collection operating expenditure) from year to year and the effect this will have on the data reported in the current, past and/or future years. Read NI Water’s explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**
- 7.3.1 There have been no changes in reporting methodologies since the prior year. The income split by category has been reconciled to the Oracle nominal ledger. Explanations for variances provided by management supports our understanding of the debtors/income process established during the statutory fieldwork.**
- 7.4 For any changes in methodology check that the previous years’ data has been adjusted. If previous years’ data has not been adjusted, discuss with management and state NI Water’s reasons for this.**
- 7.4.1 There have been no changes in methodology that require an adjustment to prior year figures.**

### **Specific procedures – revenue outstanding**

- 7.5 Describe the nature of the revenue outstanding reported in lines 1 to 56 (i.e. confirm that the definition of ‘revenue outstanding’ as set out in NI Water’s reporting requirements had been adhered to) of the Regulatory Table 6a and state where this information has been extracted from.**
- 7.5.1 Domestic billing has been postponed in the current year; hence lines 1-28 remain blank. The revenue outstanding reported in line 29 is that of non-domestic measured Water, measured Sewerage and Trade Effluent billing. This is further broken down in lines 31, 33, 35 and 37. The revenue outstanding per line 43 is that of non-domestic unmeasured Water and Sewerage. This is further broken down in lines 45, 47, 49 and 51. This information has been reconciled to the Oracle nominal ledger. Information is posted into the nominal ledger on a monthly basis from the information pack derived from the Rapid Xtra billing system.**
- 7.6 Check that the revenue outstanding shown in these lines has been aged into the relevant time bands correctly, through agreement to underlying accounting records. Specify the details of the underlying aged debt report or other accounting records that the revenue outstanding has been agreed to and details of sample tested.**
- 7.6.1 The ageing of outstanding debt has been agreed to underlying accounting records and agrees with work performed during the statutory fieldwork. The aged debt report provides totals for measured, unmeasured and Trade Effluent debtor categories aged from 0-30, 30-60 up to 180 days, then from 180-365 days, after which it continues 1-2 years up to 4+ years.**

- 7.7 **Check that NI Water has provided explanations for any material changes (+/-20% between the report year and the previous year) in the “revenue outstanding” lines. Read NI Water’s explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**
- 7.7.1 Revenue outstanding decreased by £1.5m (13%) on prior year. The opening and closing revenue outstanding balances for the year have been agreed to reports generated by the Rapid Xtra Billing system.
- 7.8 **Check that the sum of the total revenue outstanding lines (lines 1, 13, 15, 27, 29, 41, 43 and 55) reconciles to the debt reported on NI Water’s General Ledger. If numbers do not reconcile, test that the reason for the difference in management’s commentary can be agreed to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**
- 7.8.1 The total revenue outstanding per line 29 and line 43 was reconciled to the Oracle nominal ledger.
- 7.9 **Check that the reasons for any adjustments made to revenue outstanding between data extracted from billing or accounting systems and that reported in the Regulatory Table can be supported by the underlying records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**
- 7.9.1 See 7.1.4 for details on adjustments made to revenue outstanding between data extracted from the billing system and that reported in the Regulatory Table.
- 7.10 **Check that ‘non-household revenue outstanding’ has been correctly extracted from NI Water’s underlying accounting records or other supporting documentation. Describe the nature of costs that have been reported.**
- 7.10.1 Line 29 - the total of non-household revenue outstanding has been reconciled to the Oracle nominal ledger.

### **Specific procedures – Customer Service Operating Expenditure**

- 7.11 **Obtain NI Water’s commentary on the basis of allocating customer services operating expenditure (between lines 59 to 63). Check that this is consistent with the underlying accounting records and other supporting documentation.**
- 7.11.1 Customer services operating expenditure has been allocated to line 59 only due to there being no household billing in 15/16 and hence there are no associated costs in respect of the collection of household debt. Similarly there have been no donations to charitable trusts assisting customers in debt nor any operating expenditure incurred due to vulnerable household customers. The allocation of this customer services operating expenditure follows the same methodology as detailed in the commentary to Tables 21 and 22. Further work has been performed on the allocation methodology in section B - Activity Costing Analysis including walkthroughs of a sample of expense items to confirm that the allocation is being carried out as described in the methodology included in the commentary to Tables 21 and 22 - no issues were noted.
- 7.12 **Check that NI Water has provided an explanation for any material changes (+/-30% between report year and previous year) in data reported in the ‘customer service operating expenditure’ lines. Read NI Water’s explanation and agree details set out in the commentary to the underlying accounting records or other**

**supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.12.1 Total customer services operating expenditure has decreased by approximately £0.3m (3%) compared to AIR15. This is made up of various movements in each direction, with no individual movement +/- 30%, explanations for these movements are included in the commentary to Tables 21 and 22 and are consistent with our understanding of debt collection and movements observed during statutory fieldwork. None of the variances are material, as per the definition (i.e. +/- 30%).

7.13 **Describe the basis of allocating outstanding revenue collection operating expenditure in line 60a.**

7.13.1 As domestic billing has been postponed, there is no operating expenditure incurred in relation to households. No balance has been reported in line 60. Expenditure in relation to line 60a has been allocated on the basis set out in 7.14.1.

7.14 **Check that reported numbers for household and non-household costs for outstanding revenue collection operating expenditure in line 60a can be agreed to the underlying accounting records or other supporting documentation. Obtain NI Water's commentary and check that NI Water has provided reasons for any material differences (+/-30% between the report year and the previous year) in each element. Read NI Water's explanation and agree details set out in the commentary to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.14.1 Line 60 - Not applicable as there was no domestic billing in 15/16 therefore no outstanding domestic revenue at the year end.

Line 60a - Operating expenditure has been disclosed as £1.934m (2015: £2.242m). This is based on a number of key assumptions and management disclose the following in their commentary:

[Redacted]. In addition, an estimate of some internal NI Water collection costs was included. There is a confidence grading of DX, as there was no formal system in place to gather these costs."

The internal costs referred to include NI Water staff costs based on an estimate of grading but does not include the costs of billing, staff costs in respect of dealing with complaints or queries, NI Water overhead costs, bad debt costs or management review costs.

We recommend that further analysis of this figure is carried out in future years to ensure that all relevant costs have been included in line 60a.

7.15 **Where NI Water has commented on a change to the methodology used to compile line 60a auditors should agree this to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**

7.15.1 There has been no change in the methodology used to compile line 60a.

- 7.16 **Trace line 63 to the sum of Table 21 line 13 and Table 22 line 12. If they are not in accordance, check that reasons for any difference can be agreed to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**
- 7.16.1 The total figure in line 63 (£8.27m) has been agreed to the total of line 13 in Table 21 (£4.22m) plus the total of line 12 in Table 22 (£4.05m).
- 7.17 **Where NI Water has included an explanation of any significant exceptional capital costs associated directly with outstanding revenue collection or provision for vulnerable customers, agree these to the underlying accounting records or other supporting documentation. Where applicable, describe the nature of the underlying accounting records or other supporting documentation.**
- 7.17.1 No significant exceptional capital costs have been described in the Company's commentary.

## Specific procedures – interaction between charge, provision and outstanding revenue

- 7.18 Obtain a commentary from management on the bad debt provisioning policy, particularly where this has changed from the prior year. Where a change has been reported to have taken place, check that this is consistent with the Regulatory Accounts and the underlying accounting records.
- 7.18.1 The bad debt provisioning policy has been included in the commentary to Table 6a. This is consistent with the prior year policy. The methodology for calculating the bad debt provision is based on an analysis of industry specific bad debt which banded specific industry types as high, medium or low risk in terms of collectability of debt. Percentages were then applied in terms of bad debt provision. Percentages for 'high risk' were set at an increased level and percentages for 'low risk' at a reduced level. The company view this methodology as providing an appropriate estimate of the provisioning required and reflects the current economic climate. NI Water's bad debt provision is calculated as follows:

Provision	0-30 Days	31-60 Days	61-90 Days	91-120 Days	121- 150	151- 180	181- 365	1-2 years	2-3 years	3-4 years	4 years +
High	5%	5%	10%	10%	35%	65%	80%	100%	100%	100%	100%
Medium	2%	2%	2%	2%	20%	35%	65%	100%	100%	100%	100%
Low	1%	1%	1%	1%	10%	20%	30%	50%	75%	100%	100%
Test Meters	75%	75%	75%	75%	75%	75%	75%	100%	100%	100%	100%

The following is a summary of the bad debt provision at 31 March 2016 and 31 March 2015:

	2016	2015
	£m	£m
Measured Water & Sewerage	2.160	3.887
Unmeasured Water & Sewerage	0.115	0.114
Trade Effluent	0.575	0.387
<b>Total</b>	<b>2.850</b>	<b>4.388</b>

The bad debt policy applied is consistent with the policy that has been applied in deriving the bad debt provision in the Statutory Accounts and Regulatory Accounts.

- 7.19 Provide in a Table the level of consistency over time between the bad debt charge (from Tables 21 and 22), and revenue outstanding (Lines, 1, 13, 15, 27, 29, 41, 43 and 55 of Table 6a). Through discussions with management, explain any large movements.
- 7.19.1 The level of revenue outstanding has decreased in the year due to the influences outlined in 7.7.1 above.

Table	Line		AIR 2016 £m	AIR 2015 £m	AIR 2014 £m	AIR 2013 £m	Variance from AIR 2015 to AIR 2016 £m
21	18	Doubtful debts	0.302	0.554	0.521	0.327	(0.252)
22	17	Doubtful debts	(0.566)	0.282	0.233	0.037	(0.848)
6a	1	Total revenue outstanding < 48 months (measured households)	-	-	-	-	-
6a	13	Revenue outstanding > 48 months (measured households)	-	-	-	-	-
6a	15	Total revenue outstanding < 48 months (unmeasured households)	-	-	-	-	-
6a	27	Revenue outstanding > 48 months (unmeasured households)	-	-	-	-	-
6a	29	Total revenue outstanding < 48 months (measured non-households)	7.220	8.739	8.260	7.972	(1.519)
6a	41	Total revenue outstanding > 48 months (measured non-households)	-	-	-	-	-
6a	43	Total revenue outstanding < 48 months (unmeasured non-households)	2.604	2.566	2.627	0.402	0.038
6a	55	Total revenue outstanding > 48 months (unmeasured non-households)	-	-	-	-	-

- 7.19.2 Of the £264k current year total bad debt credit, a £302k bad debt charge can be directly allocated to Table 21 (Water) and £566k bad debt credit can be directly allocated to Table 22 (Sewerage). The current year bad debt charge relates to £1,333k of FY16 bad debts written off and a £1,597k release of provisions.
- 7.19.3 We note that there are limitations when reviewing the consistency over time of the bad debt charge and revenue outstanding in a company that is continuing to grow and develop due to the following factors:
- Revisions to bad debt provisioning policies in light of experience
  - Improvements in empirical evidence of system adjustments
  - Economic factors outside of the control of the company
- 7.19.4 Line 29 of Table 6a representing measured non household debt has decreased by £1.519m from the prior year.
- 7.19.5 Line 43 of Table 6a representing unmeasured non household debt less than 48 months old has remained largely consistent with only a small increase of £0.038m from the prior year.
- 7.19.6 Lines 1, 13, 15 and 27 above relate to domestic debt and as such are not applicable for the company.
- 7.19.7 Lines 41 and 55 above relate to non-domestic debt greater than 48 months old. These debts are fully provided for and as such are included at nil value.
- 7.20 **For the effect of changes in the provisioning policy (set out in management's commentary), obtain an assessment of the impact of the change and agree to supporting documentation. Describe the nature of the supporting documentation.**
- 7.20.1 The Company's provisioning policy is consistent with the prior year.

**8 Part F – Taxation (Tables 18a and 18b)**

[Part F – Taxation has been redacted]



## 9 Part G – Accounting Charges (Table 33 & 34)

### Current cost Depreciation (CCD) - Table 33

9.1 **Check that any amounts reported by NI Water for assets fully depreciated still in use and assets written off or replaced in the year which were not fully depreciated can be agreed to the underlying accounting records.**

9.1.1 During our statutory audit work we noted that management recognised impairment losses/accelerated depreciation in respect of sites that were classified as assets held for sale in the current year. As a result impairment losses/accelerated depreciation totalling £105k (historic cost), £130k (current cost), was recognised in both the statutory and regulatory financial statements.

The current cost net book value of assets fully depreciated but still in use, has been agreed to the fixed asset register. At 31 March 2016, there are fixed assets with total gross current cost of £374.29m (2014/15: £340.04m) with a Net Current Replacement Cost (NCRC) of zero still in use. These have been agreed to the current cost fixed asset register at the year end.

9.1.2 We note that accelerated depreciation has increased from the prior year (£124k to £8.4m).

9.1.3 We noted during our audit work that the current cost valuation of fixed assets was not based on a Modern Equivalent Asset Value (“MEAV”) basis as is required in regulatory accounting guidelines. This fact was disclosed by management in the Regulatory Accounts and we have drawn this to the attention of the reader of the accounts in our audit opinion.

9.2 **NB. Include any specific procedures required by the Reporter in addition to 9.1 above.**

9.2.1 There were no specific procedures required by the Reporter in addition to 9.1 above in the current year.

### Infrastructure Renewals Charge (IRC) - Table 33

9.3 **Check that the Infrastructure Renewals Charge is based on an operational assessment of activity needed to maintain the serviceability of the underground infrastructure over a reasonably long period using the definitions within RAG 1.04.**

9.3.1 The calculation of the infrastructure renewals charge has been reviewed. It is based on the final determination arriving from PC15. Management note in their commentary to Table 33 that the Regulator determined that the IRC and IRE will be the same for the six year period of PC15. The PC15 determination is based on an operational assessment of activity needed to maintain the serviceability of the underground infrastructure using

the definitions within RAG 1.04. We note that the cumulative difference between IRE and IRC at 31 March 2016 is £5.844m (Water prepayment of £9.4m and Sewerage accrual of £15.244m). Whilst we recognise that differences will inevitably arise due to timing of planned work, we recommend that management review their longer term maintenance plans to ensure that the IRC is representative of the actual renewals expenditure over the longer term.

**9.4 Check that NI Water's explanation for the difference between the IRC reported in the Regulatory Accounts and the Statutory Accounts can be agreed to underlying accounting records.**

**9.4.1 The Statutory Accounts are prepared under International Financial Reporting Standards as adopted by the EU. These standards prohibit the use of renewals accounting and accordingly there is no value for IRC in the Statutory Accounts.**

## 10 **Part H – Land Sales (Table 39)**

[Part H – Land Sales has been redacted]

## 11 Part I – Analysis of borrowing (Table 19a)

- 11.1 **Confirm that the total carrying value of all instruments reconciles back to the appropriate line in Table 19 as required by the reporting requirements of Table 19a.**
  - 11.1.1 The carrying value of £983.56m has been agreed to Table 19 line 20.
- 11.2 **Confirm that each instrument has been included within the correct category (A, B, C) in accordance with the definitions of FRS 26 (or other relevant standard).**
  - 11.2.1 Each instrument has been included in the correct category (A - C) in accordance with the definitions of FRS 26. The capital loan notes have been classified as a fixed rate instrument under other borrowings (C).
- 11.3 **Agree the interest rates recorded in Table 19a back to loan documents and other supporting documentation.**
  - 11.3.1 The interest rates recorded for the capital loan notes have been agreed to the individual Fixed Coupon Unsecured Loan notes.
  - 11.3.2 We note that the interest rate of 5.25% relates to loan notes issued before 31 March 2010. Any loan notes issued after this date are subject to interest rates based on a margin of 0.85% above the reference gilt rate published by UK HM Government Debt Management Office on the date of the issue of the loan note. This amendment to interest rates has also been agreed to the loan note agreement and has been noted in the Company's commentary to Table 19a.
- 11.4 **Agree the hedging strategy (if applicable) to supporting documentation. Describe the nature of the supporting documentation.**
  - 11.4.1 As per the Statutory Accounts, the Company does not adopt a hedging strategy.
- 11.5 **Review NI Water's commentary on any significant borrowings that mature in less than one year and agree the details back to supporting documentation.**
  - 11.5.1 The Company does not have any significant borrowings which mature in less than one year.
  - 11.5.2 [Section 11.5.2 has been redacted]

## 12 Part J – General (Tables 42 and 43)

- 12.1 **Ensure that amounts recorded in Tables 42 and 43 of the AIR16, as appropriate, are calculated in accordance with the terms of the relevant PPP contract and with Generally Accepted Accounting Practice (UK GAAP). Also review the audit trail for payment to PPP contractors and the checking of underlying evidence in support of these payments.**
- 12.1.1 The Company has three PPP contracts in place. For Statutory Accounts purposes all PPP contracts (Alpha, Omega and Kinnegar) are treated as “on” balance sheet. “On” balance sheet classification results in the fixed assets used in the contract being recognised on the balance sheet of NI Water with an associated PPP creditor being recognised. An element of the unitary charge relates to the repayment of this PPP creditor balance. “Off” balance sheet classification results in the fixed assets used in the contract not being recognised on the balance sheet of NI Water.
- 12.1.2 There is a difference between the Statutory Accounts and the Regulatory Accounts in terms of the “on/off” balance sheet classification of the PPP contracts. The Statutory Accounts are prepared under International Financial Reporting Standards as adopted by the EU whereas the Regulatory Accounts are prepared under the regulatory guidelines and UK GAAP. As such the Regulatory Accounts treat the Kinnegar and Omega contracts as “off” balance sheet.
- 12.1.3 The amounts recognised in the current year in respect of PPP contracts are in accordance with GAAP. Samples of payments were agreed, as part of our statutory audit procedures, to invoices from the PPP contractor and bank statements.
- 12.1.4 The payments to the contractor appear consistent with our overall knowledge of the PPP contracts. The PPP contract, or any amendments to it, has not been reviewed as part of our audit testing as this would not be necessary to agree amounts recorded in the nominal ledger. The amounts included in the Tables have been agreed, on a sample basis, to invoices provided by the PPP contractor.
- 12.2 **Details of any major internal control weaknesses identified from the review of PPP.**  
[Sections 12.2.1 and 12.2.2 have been redacted]
- 12.3 **Confirm values included in Tables 42 and 43 are consistent with those in the Statutory Accounts and note any deviations.**  
[Section 12.3.1 has been redacted]
- 12.4 **Review supporting commentary to Table 42 with regard to NI Water statement on total PPP unitary charge. Review commentary to ensure consistency with underlying accounting records and the applicability of any assumptions made.**  
[Section 12.4.1 has been redacted]
- 12.5 **Ensure that the amounts recorded in line 9 (Opex Deductions) of Table 42 have been calculated and charged appropriately, promptly and accurately and are additionally consistent with the terms of the PPP contract between NI Water and the Concessionaire Company.**  
[Section 12.5.1 has been redacted]
- 12.6 **Ensure that any disputed amounts between NI Water and the Concessionaire Company have been treated and recorded appropriately in accordance with GAAP and the Regulatory Accounting Guidelines.**  
[Section 12.6.1 and 12.6.2 have been redacted]

- 12.7 **Check that any relevant efficiency gains recorded in line 11 of Table 42 have been calculated accurately and applied consistently in accordance with the terms of the relevant PPP contracts.**  
[Section 12.7.1 and 12.7.2 have been redacted]
- 12.8 **Additionally check the status of all efficiency audits and/reports on PPP operations and report on their implementation, where appropriate. Should implementation be outstanding report on the explanations provided by NI Water of any failure or delay in implementing such audits/reports.**  
[Section 12.8.1 has been redacted]
- 12.9 **Ensure that amounts recorded in lines 10 and 16 of Table 42 for atypical expenditure and payments capitalised have been appropriately authorised and supported by information which supports the payments made.**  
[Section 12.9.1 has been redacted]
- 12.10 **Confirm that all payments reviewed have been made in accordance with the terms of the relevant PPP contract or if such payments have been made outside the terms of the contract, that they have been appropriately authorised.**
- 12.10.1 We have agreed a sample of payments to bank statements and reconciled these to individual invoices provided by the contractor which have been checked and certified for payment by the Company.
- 12.11 **Confirm that all payments reviewed have been appropriately recorded and follow GAAP.**
- 12.11.1 All payments reviewed in relation to the PPP contracts have been appropriately recorded and follow GAAP.
- 12.12 **Check and report on the consistency of the total amount recorded in Table 42 line 20 and Table 43 line 4 with the respective totals recorded in line 21a of Table 21 and line 20a of Table 22.**  
[Section 12.12.1 has been redacted]
- 12.13 **Check and report on the consistency of the total amount recorded in Table 43 line 5 with the total in line 22a of Table 21 and line 21a of Table 22.**  
[Section 12.13.1 has been redacted]