

# **Water and Waste Regulatory Office**

## **Water Supply Regulatory Accounting Guidelines and Reporting Requirements**

**Draft 01**

October 2007

**Water and Waste Regulatory Office**  
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**Requirements**

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## **PREAMBLE**

*[Disclaimer: This document is a provisional first draft to be used as a basis for discussion only]*

This first draft of the water supply regulatory accounting guidelines and reporting requirements sets out the WWRO's initial information requirements to meet its tariff determination obligations based upon the draft Water Supply Tariff Procedures.

An important element of the programme includes a model development and testing phase. This requires the co-operation and support of the regional water supply service providers in providing the necessary data (audited or un-audited) to allow such tests to be carried out in such a manner that the results, as close as possible, reflect real costs and sales performances.

Throughout these guidelines there are comments denoted by *[italics in square brackets]*. These comments do not form the content of the guidelines but provide comments on logic applied, areas where decisions need to be reached and assumptions that may have to be made. Such comments may be removed from the final version of the guidelines but are included in this document to facilitate debate and discussion prior to the adoption of a final set of guidelines.

## 1. DEFINITIONS

**Adopted assets:** Fixed assets financed by a developer or user where the ownership is transferred to the utility, the value of which is not added to the regulatory capital value.

**Broad equivalence:** the concept whereby the long run costs of maintenance expenditure are comparable to the long run current cost depreciation charge in a steady state condition.

**Capital asset pricing model:** An economic rationale for determining the risk return relationship and hence the returns expected of specific industry types, e.g. water supply.

**Capital contributions:** Finance provided as a contribution towards an investment by a third party, e.g. infrastructure charges and contributions for activities such as pipeline diversions.

**Capital maintenance:** Planned work carried out by the regional water supply service providers to replace and repair and water supply assets to provide a base service to customers.

**Current cost accounting:** A method of accounting originally designed to deal with the problem of showing the effect of inflation on business profits. Instead of showing assets at their historic cost (i.e. their original purchase price), less depreciation where appropriate, the assets are shown at their current cost (replacement cost) at the time of producing the accounts. This method of accounting is used in the water industry because of the extensive nature of capital assets and the fact that historic costs do not reflect the asset's true worth. *[without detailed replacement costs a surrogate that can be applied in the first instance is actual costs subject to inflation indexation]*

**Current cost depreciation:** Depreciation calculated in accordance with current cost accounting methods. *[For existing assets an alternative method is proposed based upon the debt repayment profile of the regional water supply service providers ]*

**Customer-number-related operating costs:** Operating costs that are related to the number of customers, e.g. meter reading, billing etc.

**Enhanced service levels:** Permanent, identifiable and measurable improvements in service levels that are above the current base level.

**Enhancement:** To enhance and grow the asset base through enhanced service levels and/or system expansion.

**Ex-ante:** A calculation methodology based upon projections of costs and revenues.

**Fixed-costs:** Operating costs that are unrelated to the number of customers and unrelated to the volume of water

**Grants:** Finance provided for investment or the provision of services for which no repayment is required. This includes a grant equivalent of the conversion of concessionary (soft) loans to grant and commercial loan. Infrastructure investment financed by grants is neither added to the infrastructure renewals charge nor the regulatory capital value.

**Indexed:** Costs and revenues adjusted for inflation in accordance with inflation indices

**Infrastructure assets:** Mainly underground assets, such as water mains and also dams and reservoirs that last for a long time. A distinction is drawn between infrastructure and non-infrastructure assets because of the way in which the assets are managed, operated and maintained by the regional water supply service providers.

**Infrastructure charges:** Paid by developers and customers in new properties for either a first time connection of premises for domestic purposes to a public water supply or a public sewer.

**Infrastructure renewals charge:** An annual accounting provision for expenditure on the renewal of infrastructure (i.e. mainly underground) assets charged to the regulatory profit and loss account.

**K factor:** A factor expressed as a percentage) that reflects the real increase or decrease in tariffs before inflation adjustments.

**Non Revenue Water (NRW):** The volume of water treated and entering the system that does not generate income for the regional water supply service providers.

**Non-infrastructure assets:** Mainly surface assets such as water treatment works, pumping stations and company laboratories, depots and workshops.

**Non-recoverable debts:** An allowance for payments due to the regional water supply service providers for which there is no reasonable prospect for receiving payment and would effectively qualify to be written off in accordance with conventional accounting practices.

**Operating costs:** Direct operating costs related to providing the service including: labour; energy; chemicals; consumable materials; overheads; non-recoverable taxes and other recurrent expenditure.

**Real prices:** Costs and revenues expressed in prices as at a set date, e.g. mid 2008.

**Regulatory calendar:** A timetable of activities to be undertaken by the regional water supply service providers, WWRO and others in order to meet their time-bound obligations. The activities include preparation of procedures, consultation, testing, information requirements, tariff submissions, approval, and adoption.

**Regulatory capital value:** The capital base used in setting price limits and is the value of the regional water supply service providers which earns a return on investment. It represents the opening value of the investments made and debt, working capital, government equity [*subject to government policy*], and net new capital expenditure. The capital value is calculated after current cost depreciation.

**Return on capital:** a fair return on the regulatory capital value represented as the annual income and capital growth from an investment, expressed as a percentage of the original investment.

**Revenue requirement:** The annual income requirement necessary to finance the activities of the regional water supply service providers including a return on capital. It includes; operational costs; infrastructure renewals charge; current cost depreciation; return on capital and other costs as appropriate.

**Risk premium:** The return over and above the risk free return that reflects the sector or business risk.

**Smoothing:** The process of adjusting tariff outputs to replacing excessive price fluctuations by equivalent uniform (or near uniform) percentage adjustments, but still maintaining the same net present value of the revenue stream.

**Supply demand balance:** The gap between supply and demand, either through the demand from new customers or increased demand from existing customers, for which additional investment is required to ensure that the demand for services is satisfied.

**Un-indexed:** Costs and revenues that are not adjusted for inflation.

**Volume-related operating costs:** Operating costs that are related to the volume of water, e.g. raw water charges, chemicals for treatment and energy for pumping

**Weighted average cost of capital (WACC):** The weighted average of debt interest and equity investor expectations expressed as a percentage return on total capital.

**Working capital:** The capital required to finance the recurrent costs of the regional water supply service providers. In the context of these procedures the working capital is not necessarily the strict accounting definition but rather one that reflects the actual needs of the regional water supply service providers, e.g. three months turnover.

## **2. GENERAL CONCEPTS**

### **2.1 Regulatory accounting guidelines**

2.1.1 Conventional accounting rules based upon historic costs and conventional depreciation methods are recognised as a legitimate method of financial reporting but have a variety of limitations, in particular in regard to the return on capital earned and real depreciation in capital intensive industries with long asset lives such as the water industry. In the presence of inflation these limitations lead to:

- Understated asset values
- Overstated profit measures, and consequently
- Overstated returns on capital and distorted measures of total costs which persist even if inflation falls to zero

Other failings in the conventional accounting rules with respect to utility services relate to the valuation of the business when financed by grants or 'gifted assets' leading to:

- Depreciation provisions and returns on capital passed through to tariffs on assets not financed by the utility, and consequently
- Tariffs higher than they would otherwise need to be if the utility is only to be rewarded for its financial investments

2.1.2 Regulatory accounting comprises a reassessment of the conventional accounting structures designed to overcome the above failings. It is not an alternative to the established accounting regime but rather seeks additional information and further details than that offered by the existing financial reporting outputs by:

- Determining asset values, and hence depreciation, to reflect their true value to the business and the level of real investment made by the business (through current cost accounting methods), and consequently,
- Determination of a return on capital that fairly reflects the level of investment made by the utility and market expectations.

2.1.3 In addition, regulatory accounting seeks to determine the true income and costs of water supply service provision by:

- The removal of the costs and revenues associated with non-core activities (if any) e.g. the hiring out of construction equipment to private concerns.
- To separately categorise capital investment by purpose (capital maintenance and enhancement, the latter further subdivided into the sub-categories of: improved quality, improved level of service and supply/demand balance).
- Developing an alternative method of passing through the costs of capital maintenance that are reflective of the real costs of asset maintenance rather than depreciation provisions (infrastructure renewals accounting).

### **2.2 Reporting**

2.2.1 The reporting requirements for fall into two categories:

- Historical data comprising past financial and technical records
- Projections of future financial and technical performance

2.2.2 The historical financial reporting data shall comprise financial reports in accordance with the Regulatory Accounting Guidelines as set out in this document.

2.2.3 The historical financial reporting data shall comprise the compilation of technical data as set out in these guidelines and in accordance with currently established technical reporting criteria.

- 2.2.4 The historical data shall be applied as a base level of financial performance and be used as a basis for future financial and technical performance
- 2.2.5 The historical data shall be applied to measure actual performance of the utilities against expectations applied in the tariff determination process, in particular the measurement of level of service performance against expenditure on capital maintenance.
- 2.2.6 Projections of costs and technical performance shall be based upon the submitted business plans subject to the scrutiny of the WWRO.

### 3. ACTIVITIES

#### 3.1 Separation of core and non-core activities

3.1.1 All income and expenditure, including capital investment, operational costs, overheads, cost of capital and non-cash expenditure items for core activities only shall be included in the regulatory accounts.

3.1.2 Core activities for the provision of water supply services are defined in Table 1.

Table 1 – Core / non-core activities

Activity	Core activities	Non-core activities
Water abstraction	The abstraction of water for treatment and delivery into the piped water network	The abstraction of water for other purposes such as irrigation or bulk (unregulated) sales to other users.
Water treatment	The treatment of water prior to its delivery into the piped water network for use by the customers within the service providers' defined service areas.	The treatment of water to be exported to another service provider <sup>1</sup> .
Water storage	The storage of treated and untreated water prior to ultimate delivery to the piped water network for use by the customers within the service providers' defined service areas.	The storage of treated and untreated water prior to export to another service provider.
Water transmission and distribution	The transmission and distribution of water within the network.	The transmission and distribution of water to be exported to other service providers and for bulk (unregulated) sales.
House connections	The installation of new and repair of existing house connections within the defined service areas	Commercial unregulated services to customers, e.g. repairs to plumbing downstream of the point of water sales (meter).
Customer services	Meter reading, billing and revenue collection; public awareness and advertising campaigns insofar as they relate to the piped water system, etc.	Customer service activities for unregulated services.
Other activities		Commercial unregulated activities, e.g. hire of construction equipment.
Overheads	Pro-rata the overhead activities associated with the core-activities	All other overhead activities

*[Insert similar table for wastewater services]*

3.1.3 Where resources are shared between core and non-core activities an appropriate apportionment of the costs attributable to core activities only shall be carried to the regulatory accounts.

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<sup>1</sup> It is debateable as to whether the export of water to another service provider is or is not a core activity. In terms of the WWRO regulation such an export is subject to WWRO regulation. However, the export of water can be regarded as a non-core (but regulated) activity and the costs and revenue should be kept separate from the core business of providing water supply services to the customers within each service providers defined service areas.

3.1.4 Similarly fixed assets values, and their respective depreciation provisions, for the core activities only shall be included in the regulatory accounts subject to the current cost determination of asset values and depreciation provisions as set out in these guidelines (refer Section ?).

3.1.5 Any activity, cost or asset that cannot easily be defined by the service provider as either core or non-core shall be referred to WWRO for definition.

### **3.2 Separation of core activities by tariff structures**

3.2.1 The tariff structures comprise three principal components:

- The volumetric tariff (rate per m<sup>3</sup> of water sold)
- The connection charge to cover the costs of installing a new connection from the network to the property including pipe saddle, small diameter service pipes, valves, meter and other ancillary goods, and
- An infrastructure charge paid by property developers and industrial users as a contribution towards the costs of meeting the additional water demand resulting from their developments.

3.2.2 The regulatory accounts shall comprise a minimum of three profit centres: water sales, connections and infrastructure charges, each one recording the income and costs of each profit centre activity.

3.2.3 Income from the disposal of assets shall be recorded as income for the appropriate profit centre. Where such disposed assets were shared between more than one profit centre the

3.2.4 Overhead and other general costs shall be split between the three profit centres in accordance with an apportionment formula to be agreed with the WWRO.

3.2.5 The infrastructure charge shall be determined on the basis of capital costs only (refer Section ?).

## **4. OPERATING COSTS**

### **4.1 General**

4.1.1 Operational costs shall be recorded in the regulatory accounts and shall, as a minimum, be structured to identify the relevant costs of the three principal sub-categories of:

1. Fixed-cost (meaning operating costs that are unrelated to the number of customers and unrelated to the volume of water)
2. Customer-number-related operating costs
3. Volume-related operating costs (referring to the volume of water)

4.1.2 Operating costs shall be determined net of non-core and/or non-tariff related activities, e.g. the costs of new connections which are assumed to be balanced by connection fee revenues.

4.1.3 Operating cost projections shall be based upon similar sub-divisions.

4.1.4 All operational costs will be treated by the ex-ante method and shall be estimated in real (un-indexed) prices.

4.1.5 Operational costs financed by grants and contributions shall be clearly identified.

*[insert more details on reporting requirements, e.g. business plans]*

## 5. ASSET CATEGORIES

### 5.1 Classification of expenditure

5.1.1 Infrastructure assets generally comprise:

- underground systems of mains and sewers;
- impounding and pumped raw water storage reservoirs;
- dams and canals;
- sludge pipelines; and
- information about infrastructure assets e.g. zonal investigations records.

All other assets, typically above ground, are classified as non-infrastructure.

5.1.2 Non-infrastructure assets are depreciated in line with current accounting conventions, under historic or current cost accounting as appropriate, and the appropriate depreciation charge made to the profit and loss account to represent the economic consumption by the business during the year.

5.1.3 Infrastructure assets are not depreciated. Instead, an infrastructure renewals charge (IRC) is made to the profit and loss account to represent the maintenance of asset value by the business during the year. The IRC should reflect the company's assessment of its long-term capital maintenance needs to maintain infrastructure asset serviceability and operating capacity. The IRC is taken to the balance sheet as a provision (for liabilities and charges) and actual expenditure (IRE) on infrastructure assets is set off against this provision as it occurs. Any difference from year to year between IRC and IRE is accumulated in the balance sheet as a cumulative accrual (IRA) or prepayment as appropriate.

### 5.2 Expenditure categories

5.2.1 Expenditure on each type of assets is categorised by purpose either as:

- **base service provision**, which is required to maintain the current (most recently established base) level of serviceability to customers; or as
- **enhancement** where there is a permanent increase in the current level of serviceability to a new "base" level.

Enhancement is further divided as follows:

- **quality** where expenditure is required to comply with new (i.e. since the base service level was established) legally enforceable quality obligations;
- **enhanced** service level (ESL) where expenditure provides an identifiable, measurable and permanent step change in overall level of service to existing customers above the standard previously provided;
- **supply/demand** balance (SDB) where expenditure provides water and sewerage services for new customers with no net deterioration from the current level of service provided to existing customers; and/or accommodates the increased use of water by existing customers at the current level of service.

5.2.2 Routine maintenance not included in capital expenditure and other maintenance expenditure arising in reactive way on a day to day basis are treated as an operating cost and taken directly to the profit and loss account.

5.2.3 Annex 1 to this guideline classifies the categories of capital expenditure infrastructure / non-infrastructure and by purpose (Base, Qual, ESL, and SDB).

5.2.4 Proportional allocation of capital expenditure is required between purpose categories where appropriate, i.e. base service provision, quality enhance service levels and supply/demand balance. The last three purpose categories represent an enhancement: a permanent increase in aggregate service level to existing customers and/or the provision to new

customers of the current service level. Enhancement projects may serve several purposes and in most cases will involve an element of maintenance works being carried out earlier than otherwise necessary. This advanced maintenance element should be allocated to base service provision.

- 5.2.5 Where enhanced service levels arise from expenditure required for other purpose categories then only the incremental expenditure, if any, should be allocated to ESL. Allocation to ESL should represent expenditure incurred solely for the purpose of achieving an identifiable, measurable and permanent stepped improvement in aggregate service levels.

## 6. ACCOUNTING FOR CAPITAL MAINTENANCE

### 6.1 Current cost depreciation (non-infrastructure assets)

- 6.1.1 On the basis that the existing infrastructure assets are included in the regulatory capital value as the value of as the long term debt held by the operators a substitute for depreciation on these assets is the debt repayment profile where applicable. This shall be recorded in the accounts at their actual costs with no adjustments for inflation.
- 6.1.2 Depreciation on non-infrastructure assets commissioned after *[insert date: suggest 1 Jan 2008]* shall be recorded in the accounts on a current cost basis in accordance with an indexation formula, or, where there is sufficient information available, there Modern Equivalent Asset (MEA) values.
- 6.1.3 For the purposes of regulatory accounting all assets commissioned in the financial year are deemed to have been commissioned at the mid-point of the year, i.e. 30 June.
- 6.1.4 The indexation method of determining annual current cost depreciation (CCD) is:

$$\text{CCD} = \frac{P \times f}{L}$$

Where: P = Original asset purchase price  
f = inflation multiplication factor since mid-point of the year of commissioning  
L = useful life of asset (years)

### 6.2 Definitions

All assets are to be re-valued to their modern equivalent asset (MEA) values. The MEA value is defined as:

$$\text{MEA value} = \frac{P \times f \times (L-Y)}{L}$$

Where: P = Original asset purchase price (kip)  
f = inflation multiplication factor  
Y = age of asset (years)  
L = useful life of asset (years)

The inflation factor is for the revaluation of assets to the end of 2003 is scheduled in Annex 2. These figures are based upon published inflation indices from the Department of Statistics. As inflation statistics before 1988 are not available it is assumed that inflation prior to this date was zero. The impact of this assumption is minimal as the NPSEs had very few assets prior to this date and any inaccuracies as a result of this assumption are considered to make negligible difference in the regulatory process.

Every year WASA will publish a schedule of inflation factors for the determination of MEA values.

#### Example 6.1 – Calculation of MEA values

An NPSE has an asset originally purchased in June 1997 for 150 million kip. The useful life of the asset is 30 years. What is its MEA value at the end of 2003?
MEA = $\frac{150\,000\,000 \text{ kip} \times 7.77 \times 23.5 \text{ years}}{30 \text{ years}}$
= 912 975 000 kip

### 6.3 Requirements

At the end of each fiscal year the NPSEs shall produce a modified asset register with all core assets re-valued to their MEA values in accordance with the above formula.

The modified asset register will exclude all assets that are no longer in use for whatever reason.

Any asset disposed of prior to the expiry of its useful life shall have a written down value of zero and the balance of the asset value (on a current cost basis) shall become a depreciation charge for the year it was disposed of. Any proceeds from the sale of the asset shall be treated as income.

The re-valued assets shall be carried forward the regulatory balance sheets of the NPSEs.

## 7. CURRENT COST DEPRECIATION

### 7.1 Principle

The statutory accounting regulations determine depreciation provisions on the basis of historic cost (original purchase price). Although this process is a legal requirement for the determination of tax obligations it fails to reflect the true state of the NPSEs finances. In particular, historic cost depreciation, if used as a basis for pricing (tariffs), will deliver cash reserves well below capital maintenance requirements (refer following sub-section for definition), especially in a relatively high inflation environment as experienced by the Lao PDR in recent years. Ideally, in a steady state condition the depreciation allowances (in the long-term) should equate to long term capital maintenance expenditure. This concept is known as 'Broad Equivalence'<sup>2</sup>

In accordance with standard commercial accounting practices depreciation must still be calculated on a historic cost basis for taxation calculations but an alternative mechanism, current cost accounting, is generally adopted for pricing purposes and reporting the state of the business to shareholders.

Consequently, as with re-valuing assets to account for inflation, the depreciation allowances also have to be re-valued on a regular basis.

### 7.2 Definitions

Capital maintenance is the replacement of assets at the end of their useful lives. With a large asset base and a steady state condition the annual depreciation charges, as measured on a current cost basis, should approximately equal the capital maintenance costs, thereby maintaining the overall value of the assets.

Although there is some evidence to suggest that the asset lives as defined in the statutory accounting regulations do not always reflect the actual asset lives it is not considered appropriate at this stage to provide an alternative approach for regulatory accounts. In future years, however, and in the light of improved data, WASA may prescribe alternative asset lives for the regulatory accounts.

The current cost depreciation ( $D_{\text{current}}$ ) of an asset is given by:

$$D_{\text{current}} = \frac{P \times f}{L}$$

Where: P = Original asset purchase price (kip)

f = inflation multiplication factor

L = useful life of asset (years)

#### Example 7.1 – Calculation of current cost depreciation

An NPSE has an asset originally purchased in June 1997 for 150 million kip. The useful life of the asset is 30 years. What is the depreciation charge for 2003?
$D_{\text{current}} = \frac{150\,000\,000 \text{ kip} \times 7.77}{30 \text{ years}}$
= 38 850 000 kip /year

### 7.3 Requirements

At the end of each fiscal year the NPSEs shall produce a modified depreciation schedule with all core assets depreciated in accordance with current cost accounting as set out in the above formula.

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<sup>2</sup> Developed by OFWAT, the water and wastewater regulator for England and Wales.

Depreciation shall not be charged on assets that are no longer in use except for the remaining allowance in their final year of use. Depreciation charges shall not be applied to any asset still in service if it has already exceeded its defined useful life.

The determined current cost depreciation charges are then carried forward to the annual profit and loss account.

- 7.3.1 These procedures set out the detailed proposals for water tariff setting. They are based upon the statutory obligations as set out in *Regulation No 2004/49 on the Activities of Water, Wastewater and Waste Services Providers*. They also adhere to the principles of the WWRO Water Tariff Policy (2007).

## **7.4 Water tariff calculation principles**

- 7.4.1 The determination of water tariffs is based upon the prices set to satisfy a revenue requirement by the regional water supply service providers. This revenue requirement includes for:

Operating costs: labour, energy, consumable materials, chemicals, overheads, non-recoverable taxes, and recurrent expenditure

Capital maintenance: infrastructure renewals charges, depreciation and other appropriate mechanisms

Return on capital: a fair return on the regulatory capital value of the assets financed by the regional water supply service providers.

- 7.4.2 A fundamental principal of these procedures is that the regional water supply service providers shall be entitled to a revenue stream sufficient to finance its activities but at the same time shall ensure that its return on capital is limited to a fair representation of the investments made by the regional water supply service providers, e.g. investments financed through grants shall not qualify as capital upon which a return can be earned.
- 7.4.3 These procedures are based upon a periodic review (3 years).
- 7.4.4 A significant element of the revenue requirement upon which the tariff is calculated is the financing necessary for capital maintenance, upgrading and system refurbishment. These procedures are based upon the assumption that the allowances provided for in the revenue requirement reflect actual expenditure. Where expenditure is above or below such provisions interim adjustments to the prices shall be made. These procedures, therefore, are designed to eliminate, as far as possible, incentives for the postponement of such capital maintenance, upgrading and system refurbishment.

## **7.5 Real prices**

- 7.5.1 All costs determined are to be adjusted to the price level at the mid-point of the year preceding the commencement of the price review period.
- 7.5.2 The tariff for the first year of the tariff review period shall be set on the price base of the mid-point of the preceding year multiplied by the inflation index for the preceding year.
- 7.5.3 Subsequent tariffs shall be adjusted by the preceding year inflation figures.
- 7.5.4 Tariffs shall be subject to the real increases (or decreases) as determined by these procedures [*unsmoothed adjustments or smoothed adjustments depending upon the approach adopted*]

## **7.6 Efficiencies**

- 7.6.1 In this first three year review there is no efficiency savings to be brought forward. However, in the next review the procedures should allow for any efficiency benefits beyond those expected by the WWRO to be retained by the regional water supply service providers for a

defined period *[OFWAT allows efficiency benefits to be retained for five years]* irrespective of when the efficiencies were realised.

## **7.7 Smoothing**

7.7.1 The procedures are designed to smooth prices over the three year review period to limit the adverse impact of price shocks and fluctuations.

## **7.8 Financial statements**

7.8.1 The projected regulatory financial statements for the regional water supply service providers shall be a principal output of these procedures. These statements shall include:

1. Regulatory balance sheet (including regulatory capital value)
2. Regulatory income statement
3. Cash flow

7.8.2 The projected financial statements shall be compared with the actual performance and where appropriate may be used to identify legitimate triggers for extra-ordinary price adjustments.

## 8. MODEL OVERVIEW

### 8.1 Timetable

8.1.1 It is necessary for WWRO to develop a 'regulatory calendar' setting out a strict timeframe for the issuance of draft and final tariff determination procedures (this document) including information requirements, submission of tariff proposals with accompanying data, review of proposals and independent assessment of tariffs, WWRO response to tariff proposals, final deliberations / negotiations, approval of tariffs and adoption. The following timetable for the 2009 – 2011 tariff review period is proposed:

<b>No later than</b>	<b>Activity</b>	<b>Responsible party</b>
31 Dec 2007	Development and issuance of draft Tariff Determination Procedures including information requirements	WWRO
	Commencement of data collection and forecasting activities	Regional water supply service providers
31 Jan 2008	Review of procedures and the regional water supply service providers comments	Regional water supply service providers
28 Feb 2008	Consideration of comments, review and amendment of procedures, and issuance of revised Tariff Determination Procedures	WWRO
30 Apr 2008	Preliminary 'testing' of procedures using preliminary data	WWRO in close collaboration with the regional water supply service providers
31 May 2008	Review of test results, amendment of procedures (if required) and issuance of Final Tariff Determination Procedures	WWRO
30 Jun 2008	Submission of tariff proposals, business plans and supporting information based upon Final Tariff Determination Procedures	Regional water supply service providers
30 Sep 2008	Detailed review of tariff proposals including detailed scrutiny of submitted information and formal response to the regional water supply service providers (including alternative tariff proposals)	WWRO
30 Oct 2008	Approval of tariffs by WWRO and publication	WWRO
1 Jan 2009	Adoption of tariffs	Regional water supply service providers
31 May 2009	Submission of actual 2008 data for comparison against projections submitted in the tariff review	Regional water supply service providers
1 Jan 2010	Adjustment of tariffs in accordance with tariff programme and inflation criteria	Regional water supply service providers
31 May 2010	Submission of actual 2009 data for comparison against projections submitted in the tariff review	Regional water supply service providers
1 Jan 2011	Adjustment of tariffs in accordance with tariff programme and inflation criteria	Regional water supply service providers
31 May 2011	Submission of actual 2010 data for comparison against projections submitted in the tariff review	Regional water supply service providers
30 Jun 2011	Submission of tariff proposals, business plans and supporting information based upon Final Tariff Determination Procedures	Regional water supply service providers

*[The above timetable is based upon an initial assessment only and a revised timetable may be required in the light of additional information. However, it is important at the outset to develop a relatively strict timetable without which it may not be possible to ensure compliance with the desired end result]*

## 8.2 Model platform

8.2.1 The procedures comprise a calculation process comprising a series of MS Excel spreadsheets *[In this preliminary draft the spreadsheets have not yet been developed]*. Each spreadsheet comprises a specific component of the model:

1. Demand and sales model (tariff denominator)
2. Regulatory capital value
3. Revenue requirement (tariff numerator)
  - i. Operational costs
  - ii. Infrastructure renewals charge
  - iii. Depreciation (calculated on a current cost basis)
  - iv. Return on capital
  - v. Other costs *[if required]*
4. Tariff calculation
  - vi. Annual tariffs
  - vii. Smoothed 'adjusted' tariffs

## 8.3 Input data sources

8.3.1 The input data required in the model will be derived from various sources including:

1. Audited (and un-audited) financial statements from the regional water supply service providers, e.g. detailed income statements, asset registers, loan schedules, cost centre records, performance reports etc.
2. Business plans of the regional water supply service providers, e.g. production and sales projections (including NRW assessments), revenue collection projections, operational cost projections investment plans (including backlogs of capital maintenance), expanded service expectations, debt coverage requirements (interest and loan repayments), etc.
3. Government of Kosovo, e.g. cost of capital, policies related to regulatory capital value, etc.
4. Other sources, e.g. inflation statistics, interest rates, income levels etc.

8.3.2 Detailed definitions of the individual data requirements are included in as an annex to these procedures *[not developed in this first draft]*.

*[It may not be possible for the respective parties to collate and provide all the data as set out in these procedures for the determination of tariffs the first three year review, in which case WWRO, in consultation with the regional water supply service providers may be required to make 'best estimates' based upon the best information available to them at the time. This does not give license to the regional water supply service providers to abrogate their information reporting responsibilities but rather that they should improve their information systems to meet the requirements of WWRO. It is expected that during the three year tariff review period (2009 – 2011) improved information reporting systems will allow WWRO to re-evaluate the tariff determinations and, if considered appropriate, adjust tariffs based upon this improved information.]*

## 8.4 Model concept

8.4.1 The model is based upon the determination of tariffs for each year that will provide a revenue stream equivalent to the revenue requirement (including a return on capital where appropriate). The average tariff for each year is the revenue requirement divided by the expected volume of sales for that year.

8.4.2 The revenue requirement is determined on the basis of meeting real cash flow demands and does not necessarily pass through non-cash items (depreciation and asset / liability

revaluation adjustments, e.g. foreign exchange losses) except where such pass through is considered both prudent and acceptable.

- 8.4.3 The revenue requirement includes efficient operational costs, the costs of capital maintenance, and a return on capital. *[Taxation can be added to these costs but for the purposes of the current tariff review it is assumed that the regional water supply service providers do not generate sufficient revenues to be liable for tax, or, has built up a sufficiently large tax shield to offset any potential profits that would otherwise be subject to taxation]*
- 8.4.4 The treatment of capital maintenance depends upon whether such costs are for the maintenance of infrastructure (underground) assets or non-infrastructure assets (refer Sections 12 and 13).
- 8.4.5 The costs of operational activities, including capital maintenance of infrastructure assets, financed through grants are not included in the revenue requirement.
- 8.4.6 Capital investments in infrastructure enhancement that are grant financed are not added to the regulatory capital value.
- 8.4.7 Capital investment in non-infrastructure assets are added to the RCV net of grant contributions and the grants are written off over the life of the assets.
- 8.4.8 The regulatory capital value is based upon an opening value *[to be determined]* and it is increased through new investments (net of grants and capital contributions) and decreased by depreciation calculated on a current cost accounting basis.
- 8.4.9 The return on capital is based upon a 'fair' return that reflects the cost of capital to the regional water service providers (interest rates and equity return expectations).
- 8.4.10 The overall concept of the procedures is illustrated in Figure 1.

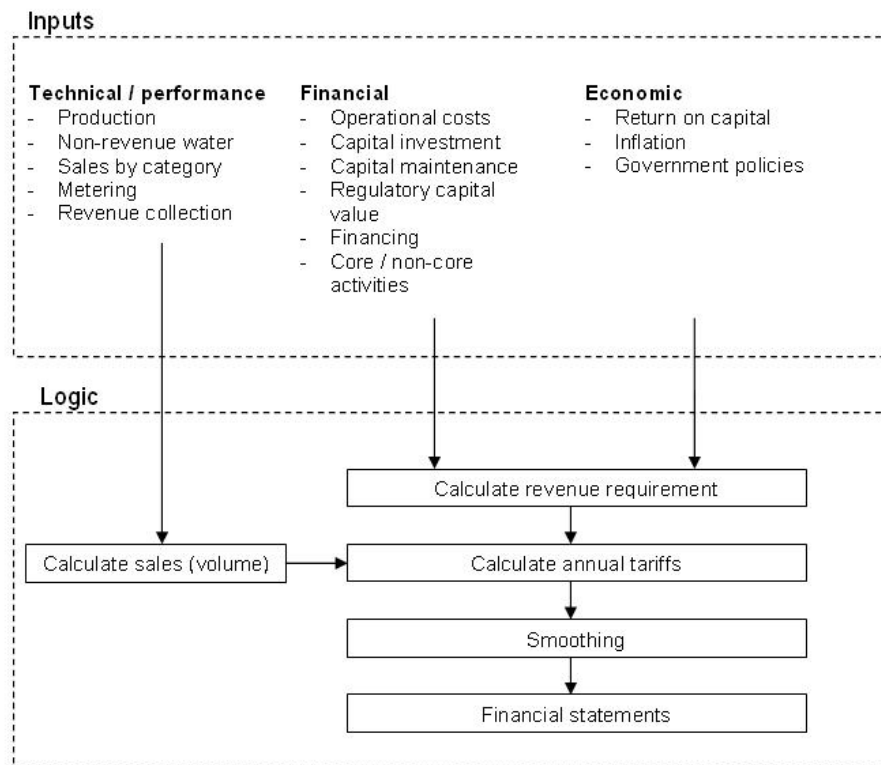


Figure 1 – Model overview

## 9. SALES CALCULATION

### 9.1 Logic

- 9.1.1 The overall sales projections are based upon the business plans of the regional water supply service providers but subject to regulatory scrutiny and, where appropriate, adjustment to reflect WWRO expectations of improved performance.
- 9.1.2 The expected total annual water sales (m<sup>3</sup>) are determined on the basis of:  
Sales in year = Previous year sales + increase in production<sup>3</sup> + reduction in NRW
- 9.1.3 The increases in production shall reflect any investment in service enhancement (supply demand balance and level of service) expectations, notably service expansion. The regional water supply service providers shall provide supporting data where required.
- 9.1.4 Water sales projections shall be broken down into customer categories, e.g. domestic, non-domestic etc. The regional water supply service providers shall provide sufficient information to ascertain reasonable estimates of such projections by category.
- 9.1.5 The projected number of customers (by category) for each year is required to determine the basis upon which connection fee revenue is determined and to be removed from the revenue requirement for the determination of the tariff. Similarly, the costs associated with the installation of connections are required to be estimated and excluded from the revenue requirement on the basis that such costs are matched by connection fees.
- 9.1.6 The projected volumes of water sales based upon estimates, due to faulty meters or meters not installed, by category is required to determine the degree to which the revenue may be affected by the metering programme and whether the impact exceeds pre-defined boundaries that may trigger an interim adjustment.
- 9.1.7 Water sales projections by category shall be adjusted to reflect non-recoverable debts (non-payment). The adjustments for non-recoverable debts shall be subject to the scrutiny of the WWRO in determining an appropriate level of non-recoverable debt<sup>4</sup>.

### 9.2 Information requirements

- 9.2.1 The principal information requirements for this component of the model include:

Ref	Item	Unit	Source	Remarks
	Estimated water sales projections by category	m <sup>3</sup> per year	Regional water supply service providers' business plan	Sales to be identified on the basis of customer type, e.g. domestic/ non-domestic etc.
	Production projections	m <sup>3</sup> per year	Regional water supply service providers' business plan	Required to determine volume related costs, e.g. energy
	NRW projections	m <sup>3</sup> per year	Regional water supply service providers' business plans	NRW required for water balance. Reductions in NRW should equate to increased sales and/or reduced production.
	Existing and projected numbers of customers by category	No by year	Regional water supply service providers' business plans	For simplicity take average of each year

<sup>3</sup> This is estimated production output and is not to be confused with production capacity.

<sup>4</sup> The level of non-recoverable debt shall not include provisions for late payment. Non-recoverable debts are defined as those for which there is no real prospect of payment, e.g. commercial customers that have become insolvent, domestic customers who have been disconnected and show no willingness to be reconnected, customers whereby there is no willingness to pay and the sanction of disconnection cannot be applied, etc. Non-recoverable debts are those that qualify to be written off as bad debts.

<b>Ref</b>	<b>Item</b>	<b>Unit</b>	<b>Source</b>	<b>Remarks</b>
	Projected volumes metered and un-metered	m <sup>3</sup> per year	the regional water supply service providers business plans	This may be required to evaluate interim tariff adjustments if the metering programme deviates from expectations resulting in either excessive windfall gains or losses
	Revenue collection performance expectations by category	% by category and year	the regional water supply service providers business plans	Required to determine the degree to which tariffs are required to cover non-payment.

## 10. REVENUE REQUIREMENT OVERVIEW

- 10.1.1 The revenue requirement represents the income required by the regional water supply service providers in order for it to meet the cost of running its business and to fund its investment programme. It is calculated on an annual basis in real terms. The main components of the revenue requirement are operating costs, capital maintenance and a return on capital.
- 10.1.2 Operating costs comprise the costs of operating the system as it stands in that year. This includes base service operating costs and net changes in operating costs associated with quality enhancements, service expansion and changes to the level of service.
- 10.1.3 Capital maintenance comprises the long-run cost of maintaining the asset systems. This is made up from the Infrastructure Renewals Charge (IRC) on below ground (infrastructure) assets and a depreciation charge<sup>5</sup> for above ground (non-infrastructure) assets.
- 10.1.4 Return on capital is the return on the regulatory capital value (RCV). The RCV consists of an initial value *[to be determined and relies on a WWRO and/or government policy decision]* and subsequent capital expenditure net of depreciation and grants and contributions.
- 10.1.5 The rate of return on the RCV is determined on the basis of *[subject to WWRO and/or government policy decision]*.
- 10.1.6 For this first review there is no provision for incentive allowances to be retained for five years as there has been no prior incentive based tariff review for such incentive allowances to pass through from. Future five year reviews shall provide for the retention of savings due to operating and capital out-performance.

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<sup>5</sup> Strictly speaking the depreciation needs to be determined on a current cost accounting (CCA) basis. However, it is unlikely that regional water supply service providers will have their accounting records established to provide a comprehensive assessment of CC depreciation and a simple indexation approach may be more appropriate.

## **11. OPERATING COSTS**

### **11.1 General**

11.1.1 This chapter sets out the various components of the operating costs forecast for the review period. The determined operating costs shall be included in the revenue requirement and will be used to determine the allowed revenue in each year of the review period.

*[The provisions relating to the business plan and how the forecasts are determined are not within the scope of these procedures]*

11.1.2 Operating costs are classified into three categories. The value of operating costs that must be included in the revenue requirement and that will be used to determine the allowed revenue in each of the years of the review period (before any adjustments and corrections) is equal to the sum of the three values that correspond with the categories. The three categories are as follows:

4. Fixed-cost (meaning operating costs that are unrelated to the number of customers and unrelated to the volume of water)
5. Customer-number-related operating costs
6. Volume-related operating costs (referring to the volume of water)

11.1.3 Operating costs shall be determined net of non-core and/or non-tariff related activities, e.g. the costs of new connections which are assumed to be balanced by connection fee revenues.

11.1.4 All operational costs will be treated by the ex-ante method and shall be estimated in real (un-indexed) prices.

### **11.2 Fixed-cost operational costs**

11.2.1 Fixed operational costs financed by grants and contributions shall not be added to the revenue requirement.

11.2.2 No adjustment will be made to the annual allowed revenue in subsequent review periods based on whether the regional water supply service providers' expenditures are greater or less than the amounts included in the revenue requirement except for:

1. To the extent that a regional water supply service provider does not carry out activities required by its own O&M manual, e.g. routine maintenance carried out less frequently than specified in the manual *[subject to verification by the technical auditor]*, at the next price review the WWRO may deduct the amount of the costs thereby saved by the regional water supply service providers (based on best estimates) from the revenue requirement for the review period following the next price review.
2. To the extent that the regional water supply service providers can generate real efficiency gains the benefits of such gains shall be retained for a period of five years. Such 'pass through' gains shall be added to subsequent review period revenue requirements.

### **11.3 Customer-number-related operational costs**

11.3.1 Customer number related operational costs include those costs that are driven by the number of customer connections, e.g. meter reading, billing and collection.

11.3.2 The customer number related operational costs shall be determined on the basis of existing financial records to determine a cost per customer. This shall then be extrapolated to the projected number of customers for each year in the review period.

11.3.3 The customer number related operational costs per customer shall be subject to adjustment to reflect expectations of improved efficiency in customer services activities resulting in improved utilisation of resources, e.g. quarterly meter reading, and improved technology. The efficiency expectations shall be subject to scrutiny by the WWRO resulting in an expectation of costs per customer to fall in real terms over time.

## 11.4 Volume-related operational costs

11.4.1 The volume related operational costs include

1. The costs of electricity used in treatment and pumping
2. The costs of chemicals used in treatment (including tertiary chlorine dosing)
3. The costs of raw water

11.4.2 Notation:

$V_t$  Variable costs per cubic meter of water sold and paid for, used for the revenue requirement for year t

$Q_t$  Forecast quantity of water sold for year t

$EL_t$  Forecast cost of electricity for pumping per cubic meter of water pumped, for year t

$CH_t$  Forecast cost of chemicals per cubic meter of water treated for year t

$RW_t$  Forecast raw water or abstraction charge per cubic meter of water purchased or abstracted for year t

$\Psi$  A forecast or stipulated coefficient equal to:

$$\frac{\text{Quantity pumped, treated, or produced (as the case may be)}}{\text{Quantity sold (i.e. billed)}}$$

$\Psi_{ELt}$  Relating to water pumped in year

$\Psi_{CHt}$  Relating to water treated in year t

$\Psi_{RWt}$  Relating to raw water purchased or produced (i.e. water entering the distribution system) in year t water treated in year t

$CE_t$  Stipulated collection efficiency for year t, equal to:

$$\text{revenue collected} / \text{revenue billed}$$

11.4.3  $V_t$  is determined as follows:

$$V_t = \frac{(EL_t \times \Psi_{ELt}) + (CH_t \times \Psi_{CHt}) + (RW_t \times \Psi_{RWt})}{CE_t}$$

11.4.4 The value  $V_t \times Q_t$  is included in the revenue requirement for year t of the review period.

## 11.5 Information requirements

11.5.1 The principal information requirements for this component of the model include:

Ref	Item	Unit	Source	Remarks
	Fixed operational cost projections (unrelated to the number of customers of volume of water produced or sold), e.g. labour, overheads, routine maintenance etc.	EUR	Regional water supply service providers' financial records and business plans	Based upon existing costs + or – any expected deviations, e.g. salary uplifts etc. Ensure that costs related to non-core or alternatively financed activities, e.g. new connections are excluded. Identify and separate out any costs funded by grants or other sources.
	Customer related operational costs, e.g. meter reading, billing and collection.	EUR	the regional water supply service providers' financial records business plans	Based upon existing costs + or – any expected deviations, e.g. salary uplifts etc. Identify and separate out any costs funded by grants or other sources.

<b>Ref</b>	<b>Item</b>	<b>Unit</b>	<b>Source</b>	<b>Remarks</b>
	Volume related operational costs and projections	EUR	the regional water supply service providers' financial records business plans	To include the costs as set out in section 11.4, e.g. electricity, chemicals, raw water purchase etc. Identify and separate out any costs funded by grants or other sources.

## 12. CURRENT COST DEPRECIATION

### 12.1 General

- 12.1.1 The fixed assets of the regional water supply service providers are broadly divided into two categories - underground (or infrastructure) assets and surface (or non-infrastructure) assets. The underground assets are not depreciated but expenditure to maintain the serviceability to customers of the network is included in the infrastructure renewals charge (IRC).
- 12.1.2 The revenue requirement includes an element for the replacement cost of depreciable assets spread over the economic life of the asset. This is the current cost depreciation charge (CCD).

### 12.2 CCD on existing non-infrastructure assets

- 12.2.1 The conventional approach is that CCD on existing assets at the beginning of the base year is an input to the model.

*[Determining the value of CCD on existing assets is likely to prove very problematic due to various factors including: not knowing what the real Modern Equivalent Asset (MEA) values are and the resulting CCD provisions, not knowing how such assets were financed, e.g. grants, loans or equity investment, not knowing what the impacts of any debt relief are intended to provide etc. Rather than undertake a detailed and comprehensive analysis of assets and depreciation provisions, the answer to which may be little more than educated guesswork an alternative approach is presented in these procedures as follows:]*

#### Variant A

- 12.2.2 Consider depreciation as a 'return of capital'. In this case the financial obligations for the return of capital are effectively the repayment of long term debt obligations. An opening value of CCD can therefore be determined on the basis of a Net Present Value of a repayment stream of the existing (but not subsequent) debts. This could then be transposed to a smoothed (uniform or gradually rising or falling) level of CCD to be applied over a specified period, say 10 to 20 years.

#### Variant B

- 12.2.3 A variant of the above approach could be to input debt repayment into the revenue requirement on an annualised basis, i.e. no smoothing based upon NPV. This ensures sufficient cash flow to meet repayment obligations year on year. On this basis the CCD on existing non-infrastructure assets will decline over time as debts are progressively paid off. Similarly the RCV of the original asset base will also decline but the overall RCV will increase as new investments come on stream.
- 12.2.4 Using either of the above this component of the revenue requirement *is / is not [debateable see note at end of paragraph]* subject to inflation indexation. *[It can be argued that as the repayment obligations of loans in EUR remain constant irrespective of inflation there is no requirement to allow for inflation adjustments (although any repayment obligations in foreign currencies may still need to be indexed against exchange rate movements). It can be counter-argued that this component should, in fact, be subject to indexation as the repayment of loans is the employment of earned returns which should be protected against the adverse impacts of inflation. By allowing for this to be indexed the tariff calculation does become significantly simpler as there is no need to separate indexed from non-indexed elements of the RCV and CCD.]*

*[It can be argued that a significant portion of the long term loans held by the water supply service providers may have been for investment in the infrastructure (underground) assets for which no depreciation should be charged and therefore an apportionment of debt between infrastructure and non-infrastructure assets is required. However, if this approach was adopted it would effectively demand that a portion of the allowance for infrastructure renewals would have to be spent on debt repayment and re-borrowing would be necessary to meet the level of renewals expected. It may be unlikely that the regional water supply service providers would be able to borrow for infrastructure renewals activities, at least not*

*in the short term, and it is therefore prudent to consider all debt repayment obligations to be substituted for CCD on existing assets.]*

## 12.3 CCD on new non-infrastructure assets

12.3.1 CCD on new investment is calculated on a straight line basis in accordance with their respective asset lives. Similarly grants and contributions on above ground assets are written off over the life of the asset.

*[The financing of investment in Kosovo is sometimes through concessionary (soft) loans with very low interest rates and generous grace periods and repayment provisions. It is debateable as to whether the regional water supply service providers should be entitled to a full return on capital for investments financed on such terms. It is suggested that any projects financed by such concessionary loans are analysed and recalculated (for tariff setting purposes only) to a combination of grant and commercial loan equivalent whereby the difference between the value of the loan and the NPV of the loan repayment profile, including interest (discounted on a commercial lending rate) is, in effect, the value of the grant equivalent. On this basis the determined grant component is treated as any other grant according to these procedures.]*

12.3.2 The proportions of capital investment in each asset life category are input separately for maintenance, quality enhancement, supply demand balance and enhanced service levels expenditure. The apportionment of grants and capital contributions received between the asset life categories are also inputs to the model.

12.3.3 If the service capability of a pool of non-infrastructure assets is in a steady state and the accounting life of the assets is equivalent to their service life, then in the long run the capital maintenance expenditure to renew and replace the asset base (maintenance non-infrastructure (MNI) expenditure) and the current cost depreciation charge for those assets should be comparable (concept of *Broad Equivalence*). The steady state condition for broad equivalence is not expected in the review period and the investment necessary to enhance and upgrade the non-infrastructure assets to the required service levels over a prolonged period will result in increasing levels of CCD over and above the allowance for CCD on the existing assets (determined on the basis of loan repayment obligations).

## 12.4 Information requirements

12.4.1 The principal information requirements for this component of the model include:

Ref	Item	Unit	Source	Remarks
	Existing long term debt obligations (repayment of principal profile)	EUR per year	Regional water supply service providers' financial records and business plans	Identify and separate repayment obligations in foreign currency.
	Capital maintenance plans for non-infrastructure assets.	EUR per year	the regional water supply service providers investment plans and business plan	Judgement required to determine whether investments are for CM or enhancement. Tariff impact is negligible (if any) and therefore accuracy in judgement is not too much of a concern. Identify and separate out any investment funded by grants or other sources.
	Investment in non-infrastructure enhancement separated by activity, e.g. quality, I o s, expansion etc.	EUR per year	the regional water supply service providers financial records business plans	Identify and separate out any investment funded by grants or other sources.
	Asset useful lives	Years	the regional water supply service providers policy	WWRO to be satisfied that the asset lives used reflect real expectations of asset life.

Ref	Item	Unit	Source	Remarks
	Investment financing details, e.g. interest etc.	Schedule	the regional water supply service providers investment plans	Policy decision required with respect to conversion of concessionary loans to grant and loan equivalents.

## 13. INFRASTRUCTURE RENEWALS CHARGE

### 13.1 Concept

13.1.1 Infrastructure renewals accounting is used for underground assets rather than conventional depreciation. An infrastructure renewals charge (IRC) is made each year and included in the revenue requirement. The IRC reflects the average of infrastructure renewals expenditure (IRE) over a period of time.

13.1.2 The IRC is determined on the basis of the expenditure necessary to maintain base levels of service and excludes expenditure on infrastructure enhancement which is added to the RCV. Infrastructure enhancement includes the expenditure made to improve water quality, levels of service and meeting supply / demand balance (including service expansion).

*[It is recognised that there may be a significant backlog of infrastructure renewals that is required to raise quality and levels of service to the required levels. It is unlikely that the proposed infrastructure renewals programme will be able to clearly identify the breakdown in order to separate backlog from that required to maintain the current low levels of service. A degree of regulatory discretion is required in this instance to determine an estimate of the amounts to be financed by the IRC and that to be added to the RCV. Furthermore, it becomes more complicated in that the IRC would need to be increased progressively in order to deliver improving levels of service. A simple, albeit crude, methodology is to estimate the IRC necessary to maintain the existing low level of service and that required to meet the ultimate level of service and progressively increase the IRC on a straight line basis over the period by which the ultimate level of service is achieved. The balance of the spend on infrastructure can effectively be added to the RCV. This problem is simplified where infrastructure investment is financed through grants as, in accordance with the IRC concept, grant financed expenditure on infrastructure (renewals and enhancement) is neither added to the RCV nor included in the IRC.]*

13.1.3 Capital grants and contributions attributable to infrastructure renewals are not included in the revenue requirement.

*[If concessionary loans are employed the grant equivalent component should not be added to the revenue requirement.]*

### 13.2 Information requirements

13.2.1 The principal information requirements for this component of the model include:

Ref	Item	Unit	Source	Remarks
	Infrastructure renewals expenditure programme	EUR per year	Regional water supply service providers' business plans	Judgement required to separate normal renewals from backlog, the latter to be considered as service enhancement and to be added to the regulatory capital value. Identify and separate out any costs funded by grants or other sources.
	Increased demand projections	Schedule	Regional water supply service providers' investment plans	Policy decision required with respect to conversion of concessionary loans to grant and loan equivalents.

## **14. INFRASTRUCTURE CHARGES AND CONTRIBUTIONS**

### **14.1 Infrastructure charges**

- 14.1.1 Infrastructure charges are paid by developers and customers in new properties for either a first-time connection of premises for domestic purposes to a public water supply or a public sewer. The charge is to cover the cost of improving the distribution network to meet the demand created by the connection of new premises over time.
- 14.1.2 Infrastructure charges shall be confined to the costs of enhancing the network, including pumping stations and storage facilities but not including water source works and water treatment facilities.
- 14.1.3 The infrastructure charges shall be determined on the basis of the long run marginal costs of new investment per dwelling with a discount rate set at the same rate as the regulatory return on capital.
- 14.1.4 The model for determining the infrastructure charges shall be for a minimum of 15 years but longer run models shall be developed where appropriate.
- 14.1.5 The regulatory capital value shall be the cost of the investment net of infrastructure charges.
- 14.1.6 Without detailed investment plans the utilities shall employ an estimated value of infrastructure charges to be determined by the WWRO, the value of which shall not be added to the regulatory capital value.

### **14.2 Capital contributions**

- 14.2.1 Capital contributions are paid by developers and customers for the development of infrastructure specific to the needs of the developer or customer, e.g. a new pipeline to a factory, and to cover the cost of improving the distribution network to meet the additional demand.
- 14.2.2 As for infrastructure charges the capital contributions shall be confined to the costs of any dedicated infrastructure and enhancement of the network, including pumping stations and storage facilities but not including water source works and water treatment facilities. *[There is an argument in favour of a contribution towards new treatment facilities and water source works when the expected increase in demand is high. This should be examined further].*
- 14.2.3 The capital contributions shall be determined based upon the real costs of meeting the additional demand or determined on the basis of the long run marginal costs of new investment per m<sup>3</sup> of water expected to be supplied with a discount rate set at the same rate as the regulatory return on capital whichever is most appropriate<sup>6</sup>.
- 14.2.4 The regulatory capital value shall be the cost of the investment net of any contributions.

### **14.3 Information requirements**

- 14.3.1 The principal information requirements for this component of the model include:

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<sup>6</sup> Where new investment is specific to an individual customer or developer the determination of the capital contribution is straightforward. Where an investment is made to cater for several potential customers or developers at different times or shared with existing customers a more complex discounted cash flow approach is needed to determine the relative apportionments of the contributions.

Ref	Item	Unit	Source	Remarks
	Infrastructure expenditure to meet supply demand balance	EUR per year	Regional water supply service providers' investment plans	To be separated to identify that required to satisfy increased domestic demand attributable to new connections, i.e. excluding increased demand due to rising per capita consumption, and that required to meet increase demand attributable to specific developers / customers for the determination of capital contributions. Investment schedule to separate infrastructure from non-infrastructure activities.
	Projected new connections (domestic and small commercial)	Schedule	Regional water supply service providers' business plans	Annualised programme necessary for the determination of long run marginal costs.
	Infrastructure expenditure to meet specific customer needs for capital contributions	EUR per year	Regional water supply service providers' investment plans	For investments required for more than one developer / customer the expenditure needs to be broken down on an annualised basis for the determination of long run marginal costs.
	Projected increased water demand	Schedule	Regional water supply service providers' business plans	To clearly separate increased demand attributable to new connections, i.e. excluding increased demand due to rising per capita consumption, and that required to meet increase demand attributable to specific developers / customers for the determination of capital contributions.

## 15. REGULATORY CAPITAL VALUE

### 15.1 Concept

- 15.1.1 The regulatory capital value (RCV) represents the capital base upon which the regional water supply service providers are entitled to a return. It represents the level of investment made in the regional water supply service providers by investors and lenders (equity and debt).
- 15.1.2 The opening value of the RCV in the base year is an input to the financial model.
- 15.1.3 Capital expenditure to enhance and maintain the network is added to the RCV. Any capital grants or contributions towards the cost of the new assets are deducted. Current cost depreciation is deducted from the RCV each year.
- 15.1.4 Infrastructure renewals expenditure (IRE) is not added to the RCV.

### 15.2 Opening regulatory capital value

*[The opening regulatory capital value is a major issue requiring a policy decision from both government and the WWRO. The principal positions for the government and the WWRO to decide upon include: the value the municipal equity (related to which is the municipalities' expected return on equity), provisions for working capital, and the treatment of debt. There are several variants to consider as follows:]*

#### Variant A

- 15.2.1 The RCV of the each regional water supply service providers is the value of long term debt<sup>7</sup> plus an allowance for working capital. The debt component of RCV shall not be subject to indexation at the periodic review as the level of debt does not change with inflation. Adjustments to the RCV shall be made to reflect exchange rate fluctuations on debts held in foreign currency. The repayment of debt shall result in a fall in the RCV but shall be compensated with subsequent investment in infrastructure enhancement and non-infrastructure assets. *[Alternatively, the RCV can be subject to indexation reflecting the employment of capital irrespective of whether it is used to repay loans or undertake further investment. This alternative approach delivers a slightly higher tariff but the calculation process becomes significantly simpler].*

*[The principal advantage with this option is that it delivers the lowest tariff but it will progressively rise as new investments are made resulting in increased returns on capital and CCD. The disadvantage is that the municipalities are effectively valuing their equity stake as zero.]*

#### Variant B

- 15.2.2 The RCV of the regional water supply service providers is the value of long term debt plus a nominal amount of municipal equity *[to be determined]* plus an allowance for working capital. The value of municipal equity and working capital shall be subject to indexation at the periodic review. *[see above, all RCV could be subject to indexation.]*

*[This option delivers a higher tariff that includes a return on municipal equity. The regulatory value of municipal equity can be determined arbitrarily and does not need to reflect asset valuation.]*

#### Variant C

- 15.2.3 The RCV of the regional water supply service providers is the net current cost value of the assets of the regional water supply service providers including working capital. The total RCV shall be subject to indexation at periodic reviews.

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<sup>7</sup> The value of debt may be adjusted to reflect the impact of concessionary loans, i.e. to convert the current level of debt to a grant and commercial loan equivalent and only the latter is treated as RCV.

*[This option delivers the highest tariff. It is questionable as to whether such an option is appropriate when many assets may have been gifted, or financed by grants and concessionary loans. It may result in excessive positive cash flows to the regional water supply service providers and may not promote financial and economic efficiency. This variant is not recommended]*

- 15.2.4 The provision for initial working capital shall reflect the finances necessary for the day-to-day activities of the regional water supply service providers (and may exclude the accounts receivable). The value of working capital within the RCV shall be subject to indexation at the periodic review. *[The level of initial working capital could be made arbitrarily, e.g. 3 months turnover].*
- 15.2.5 No future adjustments to working capital other than through indexation of total RCV shall be made.

### 15.3 Information requirements

15.3.1 The principal information requirements for this component of the model include:

Ref	Item	Unit	Source	Remarks
	Opening regulatory capital value including working capital.	EUR	Regional water supply service providers' financial records and government policy	Government / regulatory policy decision required with respect to municipal equity. Policy decision required to determine opening working capital requirement.
	Backlog infrastructure renewals and infrastructure enhancement programme	EUR per year	Regional water supply service providers' financial records and business plans	Identify and separate out any costs funded by grants or other sources.
	Non-infrastructure CM and enhancement programme	EUR per year	Regional water supply service providers' financial records business plans	Identify and separate out any costs funded by grants or other sources.
	Investment financing details, e.g. interest etc.	Schedule	Regional water supply service providers' investment plans	Policy decision required with respect to conversion of concessionary loans to grant and loan equivalents.

## 16. RETURN ON CAPITAL

### 16.1 Concept

16.1.1 The return on RCV is the real return, i.e. adjusted for inflation.

*[As with the determination of the value of RCV the return on capital is a matter for debate and government policy. Should the regional water supply service providers earn a return equivalent to commercial returns for similar risk businesses in Kosovo or elsewhere, recognising that it is a state-owned enterprise? Should the return on capital be set on the basis of existing debt obligations? Should the return on capital be set according to a government determined interest rate, etc.? Recognising that the options for determining the level of the RCV may, in fact, result in quite a low RCV relative to overall assets the impact that the return on RCV may have on the tariff may be minimal, at least in the early years. However, on the basis that future concessionary loans may be converted to an equivalent NPV combination of grants and commercial loans the return on RCV should at least be comparable to commercial borrowing rates. Extending this argument further, the government's desire for greater private sector investment in the sector will demand returns on RCV (at least that element financed by the private sector) to be comparable with the expectations of similar risk returns. It may be unrealistic, however, in the very short term to set the return on RCV to suit private sector expectations until there is a firm commitment to attract private sector financing. Consequently, these procedures present several variants for setting the return on RCV as follows:]*

#### Variant A

16.1.2 Set the return on RCV to reflect the commercial cost of borrowing (net of inflation) for an organisation such as a regional water supply service provider plus *[optional]* a small premium *[to be determined]* to reflect equity expectations of returns.

*[This is the simplest approach and aside from the small premium it is easily justifiable. However, it may not satisfy the expectations of future private sector investment.]*

#### Variant B

16.1.3 Set the return on RCV on the basis of a weighted average cost of capital (WACC) where the debt component reflects the interest payable on the initial RCV debt whereas the equity element reflects the return on any additional RCV (irrespective of whether the financing is through borrowing or equity) at a commercial rate of return (net of inflation).

*[The net result of this variant is an increasing return on capital as the ratio of initial RCV to new RCV changes with new investment although it may be possible to determine an average equivalent. The calculation of the return on RCV does, however, become complex.]*

#### Variant C

16.1.4 Set the return on RCV using the Capital Asset Pricing Model (CAPM) whereby the return is the sum of the 'risk-free' real interest rate plus the industry risk premium. *[It is recognised that the market information in Kosovo is not sophisticated enough to facilitate a detailed CAPM analysis. As an alternative it may be possible to employ the results of the OFWAT tariff determinations in England / Wales, i.e. use the risk premium determined by OFWAT for the water industry. This may not necessarily be a true reflection of Kosovo water industry risk (excluding country political risk) but may be considered to be an acceptable surrogate.]*

16.1.5 The 'risk-free' real interest rate can be based upon Euro-zone government treasury bonds (adjusted for inflation). *[This variant is effectively sets the scene for attracting private investment in the sector whereby the returns on offer for new investment are comparable to private sector expectations. The only missing element is a provision for country risk without which external investment may not be forthcoming. Many governments in the Euro-zone issue treasury bonds which can provide an appropriate measure of risk free return. Country risk in within the Euro-zone is reflected by the variance in the rates – although the degree of variance is generally quite small. As Kosovo is not in the Euro-zone the country risk may be higher than the highest within the zone. WWRO should consult with the Kosovo central bank to determine an appropriate level of country risk premium.]*

## 16.2 Information requirements

16.2.1 The principal information requirements (depending upon which variant is selected) for this component of the model include:

Ref	Item	Unit	Source	Remarks
	Risk free real returns	Rate	Euro-zone government treasury bond yields adjusted for inflation and Kosovo country risk	This depends upon the degree of sophistication in the market for government bonds and the measurement of yields. It may include country risk but not necessarily investor perceptions of country risk.
	Industry risk premium	Rate	OFWAT determinations (or other suitable surrogate)	The use of the OFWAT data is possibly the only viable alternative although the industry risk premium for the regional water supply service providers may be perceived as being considerably higher than that determined by OFWAT for England/Wales.
	Actual cost of debt	Rate	Regional water supply service providers' financial records	Applicable to embedded debt only and excludes new financial obligations.

16.2.2 In all cases policy decisions are required to determine the most appropriate return on regulatory capital value.

## 17. TARIFF CALCULATION

### 17.1 Concept

- 17.1.1 Tariffs per m<sup>3</sup> of water are determined on the basis of the sum of operational and capital maintenance costs and the return on regulatory capital divided by the expectations of the volumes of water sold and paid for.
- 17.1.2 Tariffs can be set on the basis of either smoothed or unsmoothed tariffs.
- 17.1.3 For the unsmoothed option the resulting tariffs are determined on a year on year basis expressed in real terms. This will result in annual increases or decreases in the tariff in real terms (K factors). The resulting unsmoothed tariffs will be adjusted annually by the rate of inflation as determined by the retail price index (RPI) plus a factor K.
- 17.1.4 For the smoothed tariffs a uniform (constant) K value is determined that delivers the same NPV that of the unsmoothed tariffs. For this there are several variants available. It is not appropriate to state in these procedures the precise method to be adopted but rather to undertake the analysis on an unsmoothed basis and then examine the implications of smoothing first before reaching a decision. Regardless of what smoothing option is adopted the calculation must deliver the same NPV as the unsmoothed option.

#### Variant A

- 17.1.5 The tariff is determined with a K value of zero, i.e. the resulting tariff for the review period is uniform in real terms throughout the period and is only allowed to increase by the rate of inflation.

#### Variant B

- 17.1.6 The tariff is determined with a uniform K starting from the current existing tariff prior to the review, i.e. the tariff increases (or decreases) annually including the initial adjustment are uniform in percentage terms. This avoids the possibility of a first year tariff shock. However, this may result in cash flow shortages for the regional water supply service providers in the early years if the existing tariff is substantially below that determined on an unsmoothed basis. *[It is questionable as to whether the regional water supply service providers enjoy sufficient lines of credit to facilitate such short term cash flow requirements and if not the regional water supply service providers may not be able to meet its planned programme of capital maintenance]*

#### Variant C

- 17.1.7 The tariff is determined on the basis of the year 1 tariff set at the unsmoothed level for year 1 with a uniform K for the following two yearly adjustments. This may result in a first year price shock (followed by uniform adjustments) but protects the regional water supply service providers against adverse cash flow shortfalls.

### 17.2 Unsmoothed tariff and calculation of individual year K factors

- 17.2.1 The resulting average tariff ( $T_{ave}$ ) for each year (t) is calculated as:

$$T_{ave(t)} = \frac{\text{Operating expenditure}_{(t)} + \text{Capital Maintenance}_{(t)} + \text{Return on RCV}_{(t)}}{\text{Quantity of water sold}_{(t)} \times \text{Collection efficiency}_{(t)}}$$

Where:

**Operating expenditure =**

Fixed-costs + customer number related costs + volume related operational costs

**Capital Maintenance =**

IRC + CCD (existing non-inf. assets) + CCD (new non-inf. assets)

**Return on RCV =** Rate of return on RCV x RCV

**Quantity of water sold =** Total volume (m<sup>3</sup>) billed for each year, and

### Collection efficiency =

(billed amounts – non-recoverable billings) received / billed amounts

- 17.2.2 If the relative prices (ratios) for the various tariff categories are to change over the review period (including the ratio between the lifeline and normal domestic tariff) it is necessary to determine the individual tariff for each category.
- 17.2.3 For the determination of individual category tariffs the above formula is applied but the quantity of water sold is adjusted to the domestic equivalent tariff ( $T_D$ ) and the collection efficiency is determined on the basis of weighted collection efficiency for each category. The subsequent tariff categories are determined by multiplying the determined lifeline equivalent rate by the respective ratios, i.e.

$$T_{D(t)} = \frac{\text{Operating expenditure}_{(t)} + \text{Capital Maintenance}_{(t)} + \text{Return on RCV}_{(t)}}{[Q_{D(t)} \times CE_{D(t)}] + \sum \text{Weighting}_{X(t)} \times (Q_{X(t)} \times CE_{X(t)})}$$

Where:

$Q_D$  = Volume of water sold at the domestic rate,

$CE_D$  = Collection efficiency of domestic sales

$\text{Weighting}_X$  = Tariff for customer category X / Domestic tariff

$Q_X$  = Volume of water sold to customer category X

$CE_X$  = Collection efficiency for customer category X

- 17.2.4 The resulting tariffs, average and by category, are broken down into their constituent components of operating costs, capital maintenance return on capital expressed as EUR per  $m^3$  for illustrative and analysis purposes.
- 17.2.5 The result for each year will identify the opening (year 1) tariff and the real percentage increase or decrease for subsequent years, known as the K values, calculated as:

$$K_t = [\text{Un-indexed Tariff}_t / \text{Un-indexed tariff}_{t-1}] - 1$$

Where:

$K_t$  = K factor for year t

- 17.2.6 Where the ratios of the various category tariffs change over the review period (including the ratio between lifeline and the normal domestic tariff) it shall be necessary to determine individual un-indexed prices and an individual K factor for each tariff component, e.g. if the policy was to close the gap between the domestic and the non-domestic tariffs the K factor for the domestic tariff will be greater than the K factor for the non-domestic tariff.

## 17.3 Smoothing

- 17.3.1 The smoothing calculation will depend upon which variant is selected.
- 17.3.2 The basis of the calculation is to determine a uniform K factor for the review period that will delivers a Net Present Value (NPV) of the total income stream equal to the NPV of the unsmoothed income stream.
- 17.3.3 The discount rate to use is the determined return on regulatory capital value.

*[The calculation methodology for this is relatively simple. The revenue stream of the unsmoothed income is equal to revenue requirement, therefore the NPV of the revenue stream less the revenue requirement is zero. First set the year one tariff and an arbitrary value of K which then sets the following year tariffs and determine the net revenue stream based upon sales for each year multiplied by their respective tariffs less the revenue requirement. Using the MS Excel 'goalseek' function determine the value of K that results in*

*an overall net NPV equal to zero. In the case of setting K to zero use 'goalseek' to determine opening (constant) value of the tariff<sup>8</sup>]*

#### **17.4 Financial statements and indicators**

- 17.4.1 The outcomes of the unsmoothed and smoothed tariff analyses shall determine pre-indexation forecast financial statements: income (profit loss), balance sheet and cash flow.
- 17.4.2 The accounting statements should reflect the regulatory accounting guidelines, notably regulatory capital value.
- 17.4.3 The cash flow statement is the principal financial statement. It is necessary to ensure that the regional water supply service providers operate at or near positive cash flows recognising its limited ability to obtain short term financing of negative shortfalls.

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<sup>8</sup> For a uniform constant tariff an alternative method is to divide the NPV of the revenue requirement by the NPV of the volume of sales.

## 18. INDEXATION

### 18.1 Concept

- 18.1.1 All costs determined in these procedures are set at mid-year price level of the year preceding the commencement of the tariff review period.
- 18.1.2 The opening tariff shall be set on the basis mid-year price level of the year preceding the commencement of the tariff review period 2008 price basis multiplied by the inflation index for that year.
- 18.1.3 Subsequent tariffs shall be adjusted by the preceding year inflation figures, i.e. 200X tariff adjusted by inflation index for the year (200X – 1).
- 18.1.4 Tariffs shall be allowed to accommodate the impacts of inflation based upon an overall retail price index, or, if considered appropriate, broken down into constituent inflation components.

*[It is not recommended to break the tariff component down into many different components. At the most it is recommended to break the tariff into three elements: that component (if any) that should not be subject to indexation; the energy component and the non-energy component (on the basis that energy can be considered to be a special item, the level of consumption in the water sector quite possibly being greater than that reflected on the overall retail price inflation statistics). Furthermore, breaking the tariff down into different components presents an added complication in that the proportion of the tariff for each component will not be constant and annual adjustments to the proportions will be necessary, e.g. if the price of energy rises by more than the rate of general inflation then its proportion of overall costs will increase]*

### 18.2 Method

- 18.2.1 For the first year (200X) the determined initial tariff at mid 200X-1 prices is multiplied by rate of inflation between 1 Jan and 31 Dec 200X-1 to arrive at a mid-200X price base<sup>9</sup>
- 18.2.2 The unsmoothed tariff shall be set at the Year 1 tariff and shall be adjusted annually as:

$$\text{Tariff}_t = \text{Tariff}_{t-1} \times (1 + \text{RPI}_{t-1}) \times (1 + K_t)$$

Where:

**RPI<sub>t</sub>** = retail price index for year t

**K<sub>t</sub>** = [Un-indexed Tariff<sub>t</sub>/ Un-indexed tariff<sub>t-1</sub>] - 1

#### Example:

Calculated un-indexed (mid 200X prices) tariffs:

200X+1 = EUR 0.60, and  
200X+2 = EUR 0.65

Inflation rates:

200X = 7%, and  
200X+1 = 8%

Calculation:

$$\text{Tariff}_{200X+1} = 0.60 \times (1 + 7\%) = \text{EUR } 0.642$$

$$K_{200X+2} = 0.65/0.60 - 1 = 8.33\%$$

$$\text{Tariff}_{2010} = 0.642 \times (1 + 8\%) \times (1 + 8.33\%) = \text{EUR } 0.751$$

- 18.2.3 If the procedures adopt any of the variants that exclude parts of the tariff from indexation then the above formula should be adjusted accordingly. Similarly, if elements of the tariff are required to be indexed separately, e.g. the energy cost component, the remaining elements

<sup>9</sup> Inflation indices for the previous 12 months are used on the basis of the best historical information

of the tariff shall be indexed by the general inflation index that excludes the specific indexation elements, e.g. all items excluding energy. Not doing so will result in double counting of inflation components.

### **18.3 Future tariff reviews and regulatory capital value**

- 18.3.1 The indexation process effectively provides a post inflation return on the regulatory capital value. This return is equivalent to the real rate of return multiplied by an indexed regulatory capital value. No adjustment to the regulatory capital value within the review period is necessary.
- 18.3.2 For future review periods the regulatory capital value shall to be adjusted for inflation, e.g. to mid-2011 prices for the determination of tariffs for the 2012 – 2014 period.
- 18.3.3 The opening regulatory capital value is indexed by inflation over the whole review period less the amounts deducted (CC depreciation or equivalent) indexed from the time that the deductions were made. Any other additions or deductions against the regulatory capital value shall be indexed from the time they were incurred.

## **ANNEX 1 – CLASSIFICATION OF CAPITAL EXPENDITURE BY ASSET TYPE AND PURPOSE**

This schedule sets out the classification of capital investment between infrastructure and non-infrastructure assets by purpose, either base service or improved quality. The service enhancement categories of 'enhanced level of service' (ELS) and 'supply demand balance' (SDB) can apply across all categories.

### **Water service areas**

Water resource facilities  
Water treatment works  
Water distribution mains  
Service reservoirs and water towers  
Booster pumping stations  
Management and general – water service

### **Sewerage service areas**

Sewerage  
Headworks  
Sewage treatment works  
Sludge treatment  
Sludge disposal  
In-line pumping stations  
Terminal pumping stations  
Management and general – sewerage service

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Ref	Infrastructure or non infrastructure	Water service – all areas	Expenditure purpose
	Infra or Non-infra	Element of works solely to achieve an identifiable, measurable and permanent stepped improvement in service levels above the most recently established base service level.	ELS
	Infra or Non-infra	Element of works required solely to meet demand from new customers and/or increased demand from existing customers.	SDB

Ref	Infrastructure or non infrastructure	Water resource facilities	Expenditure purpose
		All dams and impounding reservoirs holding raw water; all pumping stations in raw water systems including in-line transfer pumping, river intakes, boreholes and wells requiring simple disinfection prior to forwarding into the supply system; and all mains or aqueducts associated with the transfer of raw water either between sources or from source to treatment.	
	Non-infra	RESOURCE DEVELOPMENT Refurbishment of boreholes, river intakes and related facilities.	Base
	Infra	RESERVOIR MAINTENANCE INCLUDING SAFETY Repointing and repair of dam/spillway, extending height of dam wall and freeboard, extending/widening spillway, rehabilitation work.	Base
	Non-infra	PUMPING STATIONS New/renewal of/other work to pumping stations size for size element and/or rationalisation	Base
	Infra	AQUEDUCT REFURBISHMENT Size for size/equivalent metric size element of mains replacement irrespective of material.	Base Base
	Infra	Scraping and lining/relining to address condition/pressure/flow /interruption problems.	Base
	Infra	Relining arising solely from need for final water supplied to meet the terms of the EU or Kosovo Water Quality Regulations and resulting in a pipe capable of delivering water to an appropriately increased standard. Note: Subsequent scraping and lining would be maintenance and therefore Base.	Qual
	Infra	General preservation of the network including repointing, scouring, pipe bursting size for size and investigation of aqueduct condition.	Base
	Infra	Refurbishment/replacement of pipe bridges, tunnels, canals, valves and chambers.	Base
	Infra	Works to secure/provide alternative supplies in order to maintain base service provision.	Base
	Infra	Size for size element of diversions.	Base
	Infra Non-infra	GENERAL Works to comply with health and safety legislation: - below ground; - above ground.	Base
	Infra Non-infra	Works to improve efficiency e.g. energy conservation: - below ground; - above ground.	Base

Ref	Infrastructure or non infrastructure	Water treatment works	Expenditure purpose
		All water treatment works, but excluding both simple disinfection associated with groundwater boreholes/wells and also secondary disinfection included with the distribution system.	
	Non-infra	Size for size element of additional/enhanced treatment facilities, renewals of existing works including instrumentation control and automation.	Base
	Non-infra	New instrumentation control and automation to improve operational efficiency even if it improves treatment quality.	Base
	Non-infra	Element of additional/enhanced treatment facilities arising solely to comply with legal quality obligations for the current works aggregate capacity and resulting in treatment works capable of supplying water to an appropriately increased quality standard.	Qual
	Non-infra	Works to comply with health and safety legislation.	Base
	Non-infra	Works to improve efficiency e.g. energy conservation	Base

Ref	Infrastructure or non infrastructure	Water distribution mains	Expenditure purpose
		All mains associated with the supply of water for industrial and domestic uses including associated pipe bridges, tunnels/conduits, service tunnels, culverts, valves, chambers and system ancillaries.	
		MAINS	Base
		Diversion, duplication, new, relining, requisitioned, replacement, reinforcement, scraping and lining:	
	Infra	- size for size/equivalent metric size element, irrespective of material to maintain base service provision;	Base
	Infra	- element arising solely from the need for current capacity to comply with legal quality obligations	Qual
	Infra	Renewal of pipe bridges, tunnels, conduits, valves and chambers.	Base
		CUSTOMER ANCILLARIES	
	Non-infra	Renewal/replacement of flow/pressure meters and chambers.	Base
	Infra	Replacement/enhancement of communication/service pipes:	Base
		OTHER WORK	
	Infra	Zonal investigations.	Base
	Non-infra	Pressure and flow monitoring (incl. portable loggers)	Base
	Non-infra	Secondary disinfection.	Base
		Works to comply with health and safety legislation.	Base
	Infra	- below ground;	
	Non-infra	- above ground.	
		Works to improve efficiency e.g. energy conservation	Base
	Infra	- below ground;	
	Non-infra	- above ground	

Ref	Infrastructure or non infrastructure	Service reservoirs and water towers	Expenditure purpose
		All treated water service reservoirs and towers within the water supply system and water treatment works and secondary disinfection plant on reservoir sites. Include break pressure tanks.	
	Non-infra	Renewal of/other work to service reservoirs and water towers.	Base
	Non-infra	Works to comply with health and safety legislation.	Base
	Non-infra	Works to improve efficiency e.g. energy conservation	Base

Ref	Infrastructure or non infrastructure	Pumping stations – treated water	Expenditure purpose
		Pumping stations drawing on treated water storage. Note: Pumping stations in raw water systems are included under Water Resource Facilities and interstage pumping stations at water treatment works under Water Treatment.	
	Non-infra	New/renewal of/other work to pumping stations size for size element and/or rationalisation.	Base
	Non-infra	Works to comply with health and safety legislation.	Base
	Non-infra	Works to improve efficiency e.g. energy conservation	Base

Ref	Infrastructure or non infrastructure	Management and general – water service	Expenditure purpose
	Infra	General mapping and updating of network records and associated improvements in efficiency.	Base
	Non-infra	New/extensions to existing land, buildings, laboratories, depots and workshops.	Base
	Non-infra	New/renewal of telemetry/communications systems, leakage control/monitoring equipment, analytical/sampling plant and equipment, land, buildings, laboratories, depots and workshops.	Base
	Non-infra	New/renewal of computers (including software), vehicles and mobile plant.	Base
	Non-infra	Recreation/conservation.	Base
	Non-infra	Site security.	Base
	Non-infra	Works to comply with health and safety legislation.	Base
	Non-infra	Works to improve efficiency e.g. energy conservation	Base

Ref	Infrastructure or non infrastructure	Sewerage services – all areas	Expenditure purpose
	Infra or non-infra	Element of works solely to achieve an identifiable, measurable and permanent stepped improvement in service levels above the most recently established base service level.	ELS
	Infra or non-infra	Element of works required solely to meet demand from new customers and/or increased demand from existing customers.	SDB

Ref	Infrastructure or non infrastructure	Sewerage	Expenditure purpose
		All foul water, combined, relevant surface water and sewers including interceptor sewers, manholes, overflows, sewage pumping mains, syphons, tank and transfer sewers.	
	Infra	Diversion/duplication/new /renewal/replacement/requisitioning of sewers, interceptor sewers, storm overflows, storage capacity and step irons/manhole covers; drainage area investigations including flow surveys and catchment specific records upgrading.	
	Infra	- size for size/equivalent metric size element, rationalisation;	Base
	Infra	- element required solely either to improve unsatisfactory overflows or to comply with new discharge consents and regulations.	Qual
	Infra	Works to comply with health and safety legislation	Base
	Infra	Works to improve efficiency e.g. energy conservation	Base

Ref	Infrastructure or non infrastructure	Headworks	Expenditure purpose
	Non-infra	Renewal/refurbishment/size for size element of other works/rationalisation;	Base
	Non-infra	Elements required solely to comply with legal quality obligations that result in headworks of current capacity capable of treating effluent to the required quality standards.	Qual
	Non-infra	Renewal/new instrumentation control and automation even if it improves treatment quality.	Base
	Infra	Works to comply with health and safety legislation	Base
	Non-infra	- below ground; - above ground.	
	Infra	Works to improve efficiency e.g. energy conservation	Base
	Non-infra	- below ground; - above ground.	

Ref	Infrastructure or non infrastructure	Sewage treatment works	Expenditure purpose
		Include all sewage treatment works with one or more treatment stages, interstage pumping facilities and sludge holding tanks with provision for dewatering.	
	Non-infra	New treatment works/work carried out to existing works to increase treatment facilities/capacity	Base
	Non-infra	- size for size element and rationalisation;	Qual
	Non-infra	- element required solely to comply with legal quality obligations.	Base
		New instrumentation control and automation to improve operational efficiency even if it improves treatment quality, renewals of existing treatment works and instrumentation control and automation size for size element of other work carried out to existing works to improve treatment facilities/capacity.	
	Non-infra	Works to comply with health and safety legislation.	Base
	Non-infra	Works to improve efficiency e.g. energy conservation	Base

Ref	Infrastructure or non infrastructure	Sludge treatment	Expenditure purpose
		All sludge treatment plant which changes the nature of the raw sludge prior to its final disposal. Sludge holding tanks are included under Sewage Treatment Works.	
		New/enhanced treatment/storage facilities, renewal of existing sludge treatment works, pumping stations:	
	Non-infra	- size for size element and rationalisation;	Base
	Non-infra	- element required solely to comply with new legal quality obligations either on the disposal of existing amounts of sludge or for the increased amounts of sludge resulting from more exacting effluent quality standards.	Qual
		New instrumentation control and automation to improve operational efficiency even if improves capacity.	Base
	Non-infra	Works to comply with health and safety legislation.	Base
	Non-infra	Works to improve efficiency e.g. energy conservation.	Base

Ref	Infrastructure or non infrastructure	Sludge disposal (excluding vehicles)	Expenditure purpose
		Include all plant and transfer arrangements associated with the final disposal of treated sludge. Sludge disposal vehicles are included under Management and General.	
	Infra	Maintenance of sludge pipelines.	Base
	Non-infra	Maintenance of existing headworks, sludge disposal plant.	Base
		.Works to comply with health and safety legislation	Base
	Infra	- below ground;	
	Non-infra	- above ground.	
		Works to improve efficiency e.g. energy conservation	Base
	Infra	- below ground;	
	Non-infra	- above ground	

<b>Ref</b>	<b>Infrastructure or non infrastructure</b>	<b>Pumping stations</b>	<b>Expenditure purpose</b>
	Non-infra	All pumping stations associated with the sewer system and terminal pumping stations.	Base
	Non-infra	Renewal/rationalisation of structures, mechanical, electrical and telemetry equipment.	Base
	Non-infra	Works to comply with health and safety legislation.	Base
	Non-infra	Works to improve efficiency e.g. energy conservation	Base

<b>Ref</b>	<b>Infrastructure or non infrastructure</b>	<b>Management and general – sewerage service</b>	<b>Expenditure purpose</b>
	Infra	General mapping and updating of network records and associated improvements in efficiency.	Base
	Non-infra	New/extensions to existing land, buildings, laboratories, depots and workshops.	Base
	Non-infra	New/renewal of telemetry/communications systems, leakage control/monitoring equipment, analytical/sampling plant and equipment, land, buildings, laboratories, depots and workshops.	Base
	Non-infra	New/renewal of computers (including software), vehicles and mobile plant.	Base
	Non-infra	Recreation/conservation.	Base
	Non-infra	Site security.	Base
	Non-infra	Works to comply with Health and Safety legislation.	Base
	Non-infra	Works to improve efficiency e.g. energy conservation	Base