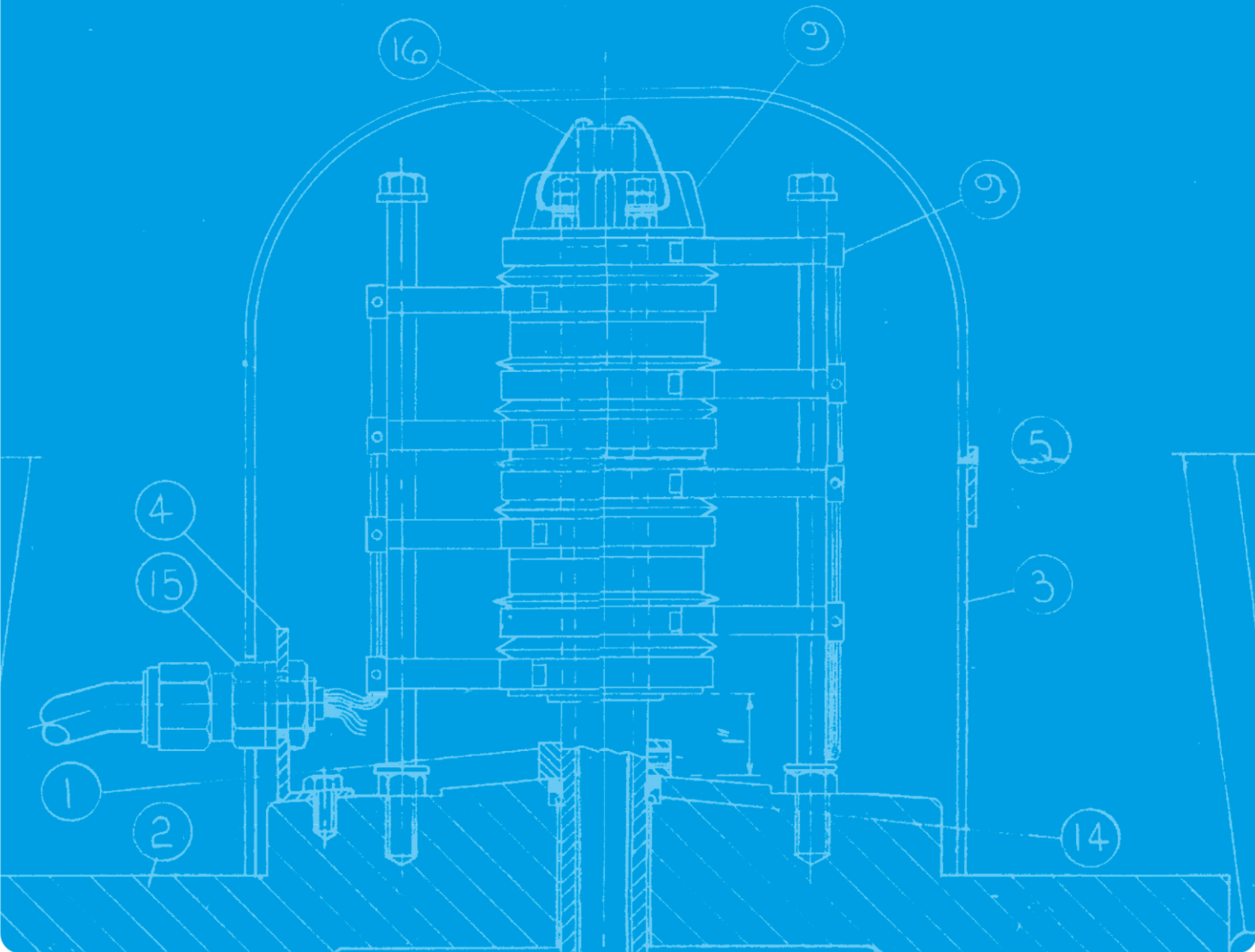


Consultation on regulatory reporting for the 2016-17 reporting year

Author: Rob McPheely
Date: 22nd June 2016



Consultation on regulatory reporting for the 2016-17 reporting year

Summary of our response

We welcome this opportunity to comment on Ofwat's proposals for regulatory reporting for 2016-17.

Overall we consider that the proposals will result in enhanced and more consistent reporting across the sector. We believe that the proposals strike an appropriate balance between achieving consistency of reporting between companies whilst allowing them the flexibility to ensure that their reports are relevant to their stakeholders and appropriately reflect their performance.

We understand that Ofwat wishes to publish revised finalised RAGs well in advance of the 2016-17 year end and we welcome this objective. However, we have not yet completed and submitted our Annual Performance Report for 2015-16. Our response reflects our experience to date but we have not yet performed a comprehensive review of the process and identified lessons learned. Consequently our response may not include all those points that might have been identified had the response date been scheduled after this year's submission.

We note Ofwat's comment in the consultation that the changes to the wording of the RAGs are small but even so, the impact of them could be significant in monetary terms. In these circumstances we believe that it would have been helpful for the link to the revised RAGs to provide a change marked version of the new documents so that changes could be easily identified.

Our response to the consultation is attached in the accompanying template.

Appendix – Ofwat questions

Questions relating to 2016-17 reporting

Q1. What are your views on the content and format of the proposed tables in Appendix 1?

We have attached to this response a summary of our observations from completing the tables for APR 2016. As at the date of this response we have not completed our APR reporting for 2015/16, but we include some comments based on communications with Ofwat during this process and revised tables provided which have been updated since the consultation was published.

Q2. Do you have any views on the revised guidance in RAG1 which is intended to assist completion of pro forma table 4G?

We concur with the revised guidance and are supportive of the aim of reducing the administrative burden on companies.

Q3. RAG2 consists of a mixture of high level principles and detailed guidance for cost reporting;

- Q3a Is the balance of principles and rules appropriate?
- Q3b Are there areas where more principles should be provided?
- Q3c Are there areas where more guidance should be provided?

We have a number of detailed comments on the tables and definitions which we have attached to this response.

In particular we disagree with the definition for FTEs that is set out in RAG 2. The definition includes staff employed by a third party providing an out-sourced service to the appointee. In such arrangements the charge for the service will include an amount for the third party's general and support costs. Part of the benefit of such arrangements for the appointee is that they reduce the appointee's staffing levels and hence reduce the level of general and support costs that are FTE related (e.g. HR costs). In our view the inclusion of these FTEs in the allocation of costs results in an over allocation of FTE related costs to these areas to the benefit of in-sourced activities. As such we consider that this guidance is not helpful in ensuring that allocations are cost reflective.

Q4. RAG2 suggests that a common method for calculating returned sludge liquors should be implemented. Do you have any observations on the approach suggested and any suggestions for a common formula?

We agree that a common method for allocating the costs relating to returned sludge liquors should be implemented. We consider that ammonia load is the most significant of the proposed cost drivers for this. We consider that the Sludge Working Group is the appropriate forum to discuss and agree the method.

Q5. In RAG2 we have set out how energy costs and savings from sludge processes should be treated – do you have any views on this approach?

We consider that it could be argued that part of the cost savings from energy generation from sludge could be allocated to the sewage treatment service. However, we acknowledge that any allocation methodology would be arbitrary and hence we concur with the proposed approach which will ensure consistency across the industry.

Cost savings may be derived from self consumption of energy generated or by export to the grid. In our view it would be helpful for the RAG to specify where the savings from self consumption should be recorded and in our opinion they should be on the same line as savings from exported energy.

[Q6. In RAG2 we have set out how imported potable bulk supplies should be treated – do you have any views on this approach?](#)

We note that the draft RAG proposes that companies should “either use the costs of the exporting company as a guide” but does not provide an alternative proposal. We believe that this may be a typographical error in the draft RAG.

In our view there is no satisfactory method to allocate costs of bulk imports of potable water between water treatment and water resources as:

- up to date cost information from the exporting company would not be readily available; and
- the available information would be at a company level and would not necessarily be representative of the costs of the bulk import.

In our view it would be more appropriate to include bulk supplies for potable water under water treatment and bulk supplies of non-potable water under raw water abstraction.

The draft RAG refers to the water resources upstream service. In our view it would be helpful to confirm whether this refers to both the abstraction licences and raw water abstraction services.

[Q7. In RAG3 we have clarified our expectations for reporting transactions with associates and the non-appointed business. Do you have any comments on these?](#)

We concur with the proposals for reporting transactions with associates.

[Q8. Our intention is to include the metrics for the Financial monitoring framework and site data for the Abstraction Incentive Mechanism \(AIM\) in the Annual Performance Report. Do you agree with this approach?](#)

We support the use of incentive mechanisms to encourage abstraction reduction where it is having an environmental impact. We also support the objective of greater transparency for stakeholders through the publication of meaningful, robust and accurate information. The suitability of abstraction points for inclusion in AIM are dependent on the site specific conditions and the maturity of the company’s ongoing restoring sustainable abstraction programme. We therefore believe companies should not publish AIM performance in a raw or un-contextualised way. Stakeholders should be provided with fuller information on progress against environmental objectives. AIM would be part of this, alongside information on other innovative incentives companies may have.

Questions relating to future reporting

Q9. Should the Annual Performance Report contain more transparency over metering assets and installation and maintenance costs from 2017?

We understand Ofwat's desire for more transparency in this area. We would like to see specific proposals before commenting in detail.

Q10. Ofwat is working with the sector to develop new charging rules covering activities such as connection charges, infrastructure charges and other contributions from third parties. Should the Annual Performance Report contain more detailed cost information on new connections and other costs associated with these charges?

We note Ofwat's recent publication of their emerging thinking relating to new connections charging. We believe that any changes arising from that work should be agreed and implemented before any new reporting in this area is designed.

We also consider that any new reporting should take into consideration the following:

- the materiality of these charges in relation to appointees' businesses;
- certain of the activities under consideration in this area may be contestable and hence cost information in these areas is likely to be commercially sensitive.

Other points we would like to raise

We attach a summary of issues that we have noted in completing the APR tables for 2015/16.

Form and content of proposed tables

Area	Type	Note
Section 1	Sign convention	We consider that the sign convention for some of the tables in the APR may lead to users of accounts mis-interpreting subtotals unless they are presented with the accounts in an excel form. Non appointed adjustments in section 1 have been presented as positive numbers. We propose that these are entered as negative amounts and the total adjustments column be adjusted to the sum of statutory and RAG differences and non-appointed
2B, 4D, 4E	Sign convention	Grants & contributions are presented as positive numbers and deducted from calculations to arrive at the totex totals. We propose that these are entered as negative numbers and added to calculations to arrive at the totex total
4H	Sign convention	Expenditure funded by Wholesale is presented as a positive number, again we propose these to be presented as negative numbers
2A	Formula	Line 1 in table 2A currently requires manual input. It would be useful if these cells could be linked to Table 2I to avoid the risk of errors
2G/2H	Formula	Line 20 sums the total of customer numbers. However customer numbers may be duplicated in the lines above if they are provided more than one water or wastewater service (e.g. for wastewater, customers can receive sewerage, surface water drainage & trade effluent in some instances), resulting in customer numbers being overstated. We would propose that the subtotal for customer numbers is not automatically calculated but to be input manually
2D	Definitions	In light of the recent changes in to the tables, it would be useful for the title of table 2D to include 'Tangible' and also have a validation check to table 1C line 1

RAG 2 high level principles and detailed guidance

Area	Type	Note
2.10	Clarification	Clarify which class of assets are included in the cumulo rates allocation approach (infra, non infra or both)
2.12	Clarification	Clarify if power cost savings resulting from energy generation should be netted against power costs or classed as negative opex
2.13	Clarification	Clarify which class of assets are included in the local authority rates allocation approach (infra, non infra or both)

RAG 4 definitions

Area	Type	Note
1C	Definitions	The cash & cash equivalents definition states that overdraft balances should not be netted off as it should be included separately in 'Trade & other payables'. We believe that overdraft balances should be disclosed in borrowings especially where there is a right of set-off
2B, 4D, 4E	Definitions	Grants & contributions are disclosed in line 17 of 2B, 4D and 4E. The guidance states that this is equal to the sum of lines 2E.1, 2E.2 & 2E.3 for water and 2E.7 & 2E.8 for wastewater. We consider this to be an error in the definition as all grants and contributions should be included in totex performance
4E	Definitions	Table 4E requires BOD volumes to be disclosed for imported sludge liquor treatment. We consider the volume of ammonia treated to be more appropriate to use in the calculation of unit cost information as BOD is not used in the sludge liquor treatment process.
2I	Definitions	Both the WRFIM model and table 2I currently do not allow the adjustment of the allowed or recovered revenues for in-period ODIs. Whilst this does not affect us until 2017/18, we consider that it is useful to raise this so that future releases of the tables and the WRFIM model address the current omission.
4B	Definitions	<p>We have already raised in an email to Rob Lee on 10 May a query on whether the totex reported in line 8 of the 2015-16 version of the table should be allowed totex or baseline totex as the line title in the table suggested 'allowed' but the line definition states 'baseline' and whether excluded costs from the menu should be included or not.</p> <p>We have reviewed the suggested table for 2016-17 forwarded to Mandip Bhangal in an email by Rob Lee on 16 June 2016 and agree that the revised table addresses the definition issues raised in our query above and is now consistent with the intention of the PR14 rule book where actual totex (excluding pensions and exclusions) is compared to allowed totex (excluding pensions and exclusions).</p> <p>We have the following queries with the line definitions set out in Rob's email:</p> <ul style="list-style-type: none"> Line 4B.4 – Other 'Rule book' adjustments – states transition expenditure should be reported in this line and therefore treated as an exclusion. We do not consider that this is correct as transition expenditure relates to costs that have been allowed in the menu but spent during 2014-15. The costs should only be reported in line 4B.6 – Transition expenditure of the table. Line 4B.9 – Allowed totex (final menu choice) – base year prices – states the final menu choice totex for PR14 is set out in line 4 of the 'Wholesale water / wastewater allowed expenditure' tables in chapters A2 (water) and A3 (wastewater) of 'Final price control determination notice: company-specific appendix'. We think the reference is incorrect as line 4 refers to 'Company's view of menu costs' and it should be line 6 – 'Allowed expenditure from menu'.
4C	Definitions	We have already queried in an email to Rob Lee on 20 May, two issues with the definition of line 2. These related to whether the calculation should use allowed or baseline totex and whether the annual FD PAYG rate or the weighted average PAYG should be used. As with table 4B, we have reviewed the suggested table for 2016-17 forwarded to Mandip Bhangal by Rob Lee on 16 June 2016 and agree that it addresses the issues raised in our earlier email.

Other items

Area	Type	Note
Consultation document	Methodology statement	The consultation document refers to the Accounting Separation methodology statement and the requirement to disclose a breakdown of the recharges paid to and received from other business units for the use of fixed assets. Whilst we agree with the importance of the methodology statement in order to enable users to understand how companies have approached accounting separation, as a principle we consider that any financial information should be disclosed in the APR and narrative information on processes, systems and assumptions to be included in the methodology statement. Our view is that if we require further information on recharges we should look to include this in the APR.