

RD 16/00

**TO REGULATORY DIRECTORS OF ALL
WATER AND SEWERAGE COMPANIES AND
WATER ONLY COMPANIES**

22 June 2000

Dear Regulatory Director

**INFORMATION REQUIREMENTS FOR NOTIFIED ITEMS FOR BAD DEBT AND
THE ADMINISTRATIVE COSTS OF PROVISION FOR VULNERABLE
CUSTOMERS – CONCLUSIONS**

In RD7/00 Ofwat consulted on the data required to provide basic comparative information to inform Ofwat's consideration of the cost implications of any interim determinations involving notified items on bad debt and vulnerable groups.

Responses were received from all the water and sewerage companies, from ten water only companies and from Water UK. While a number of companies felt the proposed requirements were broadly acceptable, others expressed concern at the additional burden on companies and suggested data should only be required when an interim determination was triggered or that each company should have individual information requirements specific to their circumstances.

Information requirements

In the light of companies' comments some changes have been made to reduce the information burden. However, Ofwat considers that it is necessary to collect basic comparative information from all companies to monitor both the impact of the Water Industry Act 1999 on bad debt levels, and the cost of administering the regulations on vulnerable groups. Any interim determination would have to be informed by benchmark information from other companies, although this does not mean that local factors may not also have to be taken into account. To agree separate, different information requirements with each individual company would be impractical and would make comparisons between companies impossible.

It is important to note that the purpose of these information requirements is to provide basic comparative information for all companies. In the event of an interim determination, further supporting information may be required from the applicant. However, it would be inappropriate to require all companies, regardless of whether they intend to use the notified item mechanism, to submit the level of information that would be necessary to justify additional costs under the notified items.

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Details of revisions to the proposals in RD 7/00, and of companies' comments on these proposals are given in Appendix 1. Revised tables and line definitions are given in Appendix 2. Information from 1998-99 and 1999-2000 for the bad debt notified item is to be collected by 1 September 2000, accompanied by auditors' and reporters' reports.

How the information is to be used

In their responses to RD 7/00, many companies raised issues relating to how the information collected on bad debt would be used, and requested clarification of the process Ofwat would use to judge whether any increase in costs was justified. A particular concern was the use of benchmarking, with many companies arguing that external factors should be taken into account as well as unit costs.

Appendix 3 sets out an outline of the proposed process that would be used in the event of an interim determination for the notified item on bad debt. There are some issues that require further consultation with companies, as discussed in Appendix 3.

One of these issues is which, if any, external factors should be taken into account when assessing companies' relative performance in collecting outstanding revenue. Views are invited on this issue (and on the outline process as a whole).

Responses should be submitted no later than Friday 21 July 2000, to Rob Wesley at Ofwat.

Yours sincerely,

M Saunders
Head of Consumer Affairs and Tariffs

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APPENDIX 1

INFORMATION REQUIREMENTS FOR NOTIFIED ITEMS FOR BAD DEBT AND THE ADMINISTRATIVE COSTS OF PROVISION FOR VULNERABLE CUSTOMERS - CONCLUSIONS

1. Information for the bad debt notified item

The basic structure of the information requirements for this notified item is similar to that proposed in RD 7/00, but the information is to be collected at a company level, reducing the overall information burden of the proposals. It is proposed to collect information about 1998-99 and 1999-2000 by 1 September 2000 so that preliminary analysis of the data can be carried out in advance of potential reference notice submissions this autumn. A capture system will be sent to companies in July; practical arrangements will be discussed shortly. The table will then be included in the Annual Return from 2001, as described in *Annual Return 2001-05: A consultation paper on monitoring companies' performance*. Revisions to the proposals in RD 7/00 are discussed below, as are companies' responses to the proposals. The revised structure of the table, and detailed line definitions, are given in Appendix 2.

a) Revenue lost due to bad debt

Bands for the age of outstanding revenue

As in RD 7/00, information is to be collected on the amount of revenue outstanding from household customers at the end of the financial year, and the amount outstanding for various periods of time. However, it is proposed to remove the first time band, with the new bands being revenue that has been outstanding for less than 12 months, for 12 to 24 months, and for 24 to 48 months. The lines for total revenue outstanding have been amended to the total revenue outstanding for less than 48 months.

Definition of outstanding revenue

Several companies raised points about the precise definition of outstanding revenue. For the purposes of these information requirements, outstanding revenue means revenue that has been billed and is due, but has not yet been collected at the end of the financial year in question. This will include revenue that will eventually be paid late (but has not yet been paid), as well as revenue that will not be paid at all.

As different companies may have different policies on writing off bad debt, to ensure consistency all revenue that is due but has not yet been collected should be included, regardless of whether the company has written off the revenue in question. The lines for revenue written off should be the actual amount of revenue written off by a company (under their own policy) in the relevant financial year, not the provision for bad debt. This amount should be net of any revenue collected during the financial year that had been previously written off.

Treatment of instalments

Customers who have an agreement with the company to pay by instalments present several complications for this definition. If such an agreement is for the current year's charges as a normal payment option, then "outstanding revenue" should only include instalments that are due, but have not yet been paid. Instalments that are not yet due should not be included as outstanding revenue. With the removal of the six-month age band, the time bands for reporting outstanding revenue are now for complete financial years. For companies whose charging year is the same as the financial year this will mean that for unmeasured customers who are not in debt all instalments will be due at the point of reporting, the end of the financial year.

As several companies pointed out, the situation is different if the instalments are agreed as a means of clearing outstanding debt from previous years. In this case these instalments should be regarded as revenue outstanding from the financial year in which it was originally due – the age of the debt should not be reset each time an instalment plan is renegotiated. Instalments that are not yet due, but are to pay historic outstanding charges, should be included as outstanding revenue, from the financial year for which the charge was originally due. If instalments are partly to pay current charges and partly to pay historic outstanding charges, then only the amount that is for the historic outstanding charges should be included as outstanding revenue. Some degree of apportionment may be necessary to split instalments in this manner.

Issues related to the collection of historic data

A number of companies said they would have difficulty providing data on outstanding revenue for 1998-99 and 1999-2000 in the level of detail specified in RD 7/00. It is inevitable that it will be easier to put systems in place to analyse data for future years than to retrospectively carry out the same level of analysis for past years. It is accepted that some degree of apportionment might be required in order to allocate outstanding revenue to the specified categories. This should be subject to audit scrutiny and the basis of any allocations should be clearly explained in the commentary.

Separation of household outstanding revenue

In RD 7/00, it was proposed that the information on outstanding revenue should be collected for household customers only, as most non-households are unaffected by the legislative changes relevant to the notified item. A few companies responded that they were currently unable to split household and non-household bad debt. As the notified item is specifically for additional costs due to loss of the power to disconnect household customers as a result of the Water Industry Act 1999, it is essential that the information to be used for the notified item should be for household customers. If, particularly for historic data, some degree of apportionment is necessary, the basis of this should be clearly explained in companies' commentaries.

Reporting by number of households

A few companies commented that they would have difficulties in reporting the number of households with outstanding revenue as their systems were based on the number of accounts rather than the number of customers, and a new account was opened for each debt for which legal action was taken. All companies should report data based on numbers of households; if this data is based on information on numbers of accounts the link between the two should be explained in companies' commentaries.

b) Information on customer services costs

As in RD 7/00, information on customer services costs is to be based on a subdivision of the "operating expenditure – customer services" lines of the annual return. Following comments from the companies, the subdivisions will now be:

- general customer services expenditure excluding the items below;
- costs of collection of outstanding revenue from household customers;
- donations to charitable trusts for the purpose of assisting household customers in debt; and
- costs of administering provision for vulnerable customers.

Cost of collection of outstanding revenue from household customers

As the separate line for legal and other costs recovered from customers has been removed, the line for costs of collection of outstanding revenue should now include any court and legal fees incurred in collecting outstanding revenue, net of any costs recovered from customers.

Treatment of telephone contacts

Several companies commented that receiving telephone calls from customers regarding outstanding debts is a legitimate cost of collecting outstanding revenue. This point is accepted, and the costs of all telephone contact with household customers relating to specific outstanding debts should be regarded as costs of collecting outstanding revenue. This should be subject to audit scrutiny and the basis of any allocations should be clearly explained in the commentary. Otherwise, the line for the cost of collection of outstanding revenue from household customers is unchanged from RD 7/00.

Issues related to the collection of historic data

As with the outstanding revenue lines, a significant number of companies said they would have difficulty providing data on outstanding revenue collection costs for 1998-99 and 1999-2000 in the level of detail specified in RD 7/00. A particular concern was the separation of the costs of collecting outstanding revenue from households and non-households.

The comments above on the collection of historic data on outstanding revenue also apply for historic data on customer services costs. It is accepted that some degree of

apportionment might be required; again, this should be subject to audit scrutiny and the basis of any allocations should be clearly explained in the commentary.

Treatment of capital expenditure

Several companies commented that essential capital costs associated with new reporting systems should be included as legitimate additional costs for the purpose of the notified items. It does not seem appropriate to have a separate line in the standard information requirements for this capital expenditure, but should a company use the notified item mechanism, then such capital costs could be considered. The Director will, however, need to be satisfied that the expenditure would not have arisen but for the change in law. If a company incurs significant exceptional capital costs associated with outstanding revenue collection or provision for vulnerable customers, then they could include this in their commentary in the Annual Return.

2. Information for the vulnerable customers notified item

Many companies commented that the proposals in RD 7/00 for information for the vulnerable customers notified item were too detailed. These proposals have been revised to reduce the information burden on companies; as for the bad debt notified item, information will now be collected on a company basis. The revised structure of the table, and detailed line definitions, are given in Appendix 2. The table will be included in the Annual Return from 2001, as described in *Annual Return 2001-05: A consultation paper on monitoring companies' performance*.

A specific concern of many companies was that it would not be necessary for the purposes of the notified item to collection information on the number of applicants for each individual medical condition. This point is accepted, and applications for vulnerable customer status on the grounds of having one of the relevant medical conditions are now not to be subdivided into the individual medical conditions. This will significantly reduce the information burden on companies.

For the purposes of this table, the suggestion that "application" should be defined as "the submission of a completed application form" is accepted. For clarity the line definitions have been amended to include references to the need for someone in the household to be in receipt of one of the benefits or tax credits specified in the Regulations.

The implementation of the Vulnerable Groups Regulations will be reviewed separately in conjunction with DETR. This table is to be included in the Annual Return from 2001, as described in *Annual Return 2001-05: A consultation paper on monitoring companies' performance*.

APPENDIX 2

1. Revised table and line definitions for information on outstanding revenue and breakdown of customer services operating expenditure

Outstanding revenue and breakdown of customer services operating expenditure

Description	Units	1998-99	1999-2000
Revenue outstanding - measured households			
1 Total revenue outstanding < 48 months (measured h'holds)	£m		
2 Nr of measured h'holds with outstanding revenue < 48 months	nr		
3 Revenue outstanding < 12 months (measured h'holds)	£m		
4 Nr of measured h'holds with outstanding revenue < 12 months	nr		
5 Revenue outstanding 12-24 months (measured h'holds)	£m		
6 Nr of measured h'holds with outstanding revenue 12-24 months	nr		
7 Revenue outstanding 24-48 months (measured h'holds)	£m		
8 Nr of measured h'holds with outstanding revenue 24-48 months	nr		
Revenue outstanding - unmeasured households			
9 Total revenue outstanding < 48 months (unmeasured h'holds)	£m		
10 Nr of unmeasured h'holds with outstanding revenue < 48 months	nr		
11 Revenue outstanding < 12 months (unmeasured h'holds)	£m		
12 Nr of unmeasured h'holds with outstanding revenue < 12 months	nr		
13 Revenue outstanding 12-24 months (unmeasured h'holds)	£m		
14 Nr of unmeasured h'holds with outstanding revenue 12-24 months	nr		
15 Revenue outstanding 24-48 months (unmeasured h'holds)	£m		
16 Nr of unmeasured h'holds with outstanding revenue 24-48 months	nr		
Revenue written off			
17 Amount of revenue written off from measured households	£m		
18 Amount of revenue written off from unmeasured households	£m		
Customer services operating expenditure			
19 General customer services operating expenditure	£m		
20 Outstanding revenue collection operating expenditure (h'hold)	£m		
21 Donations to charitable trusts assisting customers in debt (h'hold)	£m		
22 Operating expenditure due to vulnerable h'hold customers	£m		
23 Total customer services operating expenditure	£m		

Revenue outstanding means the amount of revenue at the end of the financial year in question that has been billed and is due, but has not been collected. Revenue that has been written off should be included in this amount. The information about revenue outstanding is to be split between measured households and unmeasured households, on the basis of whether the household is charged on a metered basis at the end of the financial year. All monetary values are to be given in outturn prices.

Line definitions

Revenue outstanding - measured households

1	Total revenue outstanding < 48 months (measured households)	£m (3dp)
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Definition: The total amount of revenue that, at the end of the financial year, has been outstanding from measured households for less than 48 months from the date on which the amount became due.

2	Number of measured households with outstanding revenue < 48 months	000 (3dp)
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Definition: Number of billed measured households at the end of the financial year with revenue that has been outstanding for less than 48 months.

3	Revenue outstanding < 12 months (measured households)	£m (3dp)
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Definition: The amount of revenue that, at the end of the financial year, has been outstanding from measured households for less than 12 months from the date on which the amount became due.

4	Number of measured households with outstanding revenue < 12 months	000 (3dp)
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Definition: Number of billed measured households at the end of the financial year with revenue that has been outstanding for less than 12 months.

5	Revenue outstanding 12-24 months (measured households)	£m (3dp)
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Definition: The amount of revenue that, at the end of the financial year, has been outstanding from measured households for at least 12 months, but less than 24 months, from the date on which the amount became due.

6	Number of measured households with outstanding revenue 12-24 months	000 (3dp)
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Definition: Number of billed measured households at the end of the financial year with revenue that has been outstanding for at least 12 months but less than 24 months.

7	Revenue outstanding 24-48 months (measured households)	£m (3dp)
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Definition: The amount of revenue that, at the end of the financial year, has been outstanding from measured households for at least 24 months, but less than 48 months, from the date on which the amount became due.

8	Number of measured households with outstanding revenue 24-48 months	000 (3dp)
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Definition: Number of billed measured households at the end of the financial year with revenue that has been outstanding for at least 24 months but less than 48 months.

Revenue outstanding - unmeasured households

Lines 9-16 follow the format of lines 1-8, but for revenue outstanding from households that are not charged on a metered basis at the end of the financial year.

9	Total revenue outstanding <48 months (unmeasured households)	£m (3dp)
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Definition: The total amount of revenue that, at the end of the financial year, has been outstanding from unmeasured households for less than 48 months from the date on which the amount became due.

10	Number of unmeasured households with outstanding revenue <48 months	000 (3dp)
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Definition: Number of billed unmeasured households at the end of the financial year with revenue that has been outstanding for less than 48 months.

11	Revenue outstanding < 12 months (unmeasured households)	£m (3dp)
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Definition: The amount of revenue that, at the end of the financial year, has been outstanding from unmeasured households for less than 12 months from the date on which the amount became due.

12	Number of unmeasured households with outstanding revenue < 12 months	000 (3dp)
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Definition: Number of billed unmeasured households at the end of the financial year with revenue that has been outstanding for less than 12 months.

13	Revenue outstanding 12-24 months (unmeasured households)	£m (3dp)
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Definition: The amount of revenue that, at the end of the financial year, has been outstanding from unmeasured households for at least 12 months, but less than 24 months, from the date on which the amount became due.

14	Number of unmeasured households with outstanding revenue 12-24 months	000 (3dp)
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Definition: Number of billed unmeasured households at the end of the financial year with revenue that has been outstanding for at least 12 months but less than 24 months.

15	Revenue outstanding 24-48 months (unmeasured households)	£m (3dp)
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Definition: The amount of revenue that, at the end of the financial year, has been outstanding from unmeasured households for at least 24 months, but less than 48 months, from the date on which the amount became due.

16	Number of unmeasured households with outstanding revenue 24-48 months	000 (3dp)
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Definition: Number of billed unmeasured households at the end of the financial year with revenue that has been outstanding for at least 24 months but less than 48 months.

Revenue written off

17	Amount of revenue written off from measured households	£m (3dp)
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Definition: The amount of revenue outstanding from measured households that has been written off in the financial year, net of any revenue collected from measured households during the financial year that had previously been written off.

18	Amount of revenue written off from unmeasured households	£m (3dp)
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Definition: The amount of revenue outstanding from unmeasured households that has been written off in the financial year, net of any revenue collected from unmeasured households during the financial year that had previously been written off.

Customer services operating expenditure

19	General customer services operating expenditure	£m (3dp)
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Definition: Total costs directly associated with customer services, except for current cost depreciation and costs directly associated with outstanding revenue collection or administering provisions for vulnerable customers.

Include the costs of customer accounting, the reading of meters, customer enquiries relating to tariff matters and charging or billing, and complaints handling. Costs of initial bills should be included, including purchased billing services, but not costs of subsequent reminders bills. (The costs incurred within the water distribution and sewerage activities in dealing with complaints other than those related to tariff changes should not be included.) Costs of services provided to third parties should not be included.

20	Outstanding revenue collection operating expenditure	£m (3dp)
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Definition: Total costs directly associated with outstanding revenue collection, except for current cost depreciation.

Include the costs of reminder bills and of debt recovery. The cost of outstanding revenue collection services purchased and of commission payments to third parties contracted for billing services should be included. Relevant costs could include costs of dedicated debt handling or revenue collection teams, court and legal fees (net of any amount recovered from customers) and subsidies to Citizen's Advice Bureaux, but donations to charitable trusts assisting customers in debt should not be included.

21	Donations to charitable trusts assisting customers in debt	£m (3dp)
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Definition: Donations to charitable trusts assisting customers in debt.

22	Operating expenditure due to vulnerable customers	£m (3dp)
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Definition: Total costs directly associated with the administration of provision for vulnerable customers, except for current cost depreciation.

23	Total customer services operating expenditure	£m (3dp)
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Definition: Total costs directly associated with customer services, except for current cost depreciation, as defined in line 13, Table 21 (for the water service) and line 14, Table 22 (for the sewerage service) of June Return.

Processing rules: Calculated field. Sum of lines 23, 24, 26 and 27, minus line 25. This line should equal the sum of line 13, Table 21 and line 14, Table 22 of the June Return for the relevant year.

2. Revised table and line definitions for information on applications for vulnerable customer status

Applications for vulnerable customer status

	Description	Units	2000-01
1	Applications: large families	nr	
2	Successful applications - large families	nr	
3	Applications: medical conditions	nr	
4	Successful applications - medical conditions	nr	
5	Total number of applications	nr	
6	Total number of successful applications	nr	

Application is defined as the submission of a completed application form to the company.

Relevant benefit or tax credit is defined as one of the benefits or tax credits specified in The Water Industry (Charges) (Vulnerable Groups) Regulations 1999.

Relevant medical condition is defined as one of the medical conditions specified in The Water Industry (Charges) (Vulnerable Groups) Regulations 1999.

Line definitions

1	Applications: large families	nr (0dp)
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Definition: The number of applications for vulnerable customer status in the financial year on the basis of receipt of a relevant benefit or tax credit and large family size.

2	Successful applications – large families	nr (0dp)
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Definition: The number of successful applications for vulnerable customer status in the financial year on the basis of receipt of a relevant benefit or tax credit and large family size.

3	Applications: medical conditions	nr (0dp)
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Definition: The number of applications for vulnerable customer status in the financial year on the basis of receipt of a relevant benefit or tax credit and of being affected by one of the relevant medical conditions.

4	Successful applications – medical conditions	nr (0dp)
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Definition: The number of successful applications for vulnerable customer status in the financial year on the basis of receipt of a relevant benefit or tax credit and of being affected by one of the relevant medical conditions.

5	Total number of applications	nr (0dp)
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Definition: The total number of applications for vulnerable customer status in the financial year.

6	Total number of successful applications	nr (0dp)
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Definition: The total number of successful applications for vulnerable customer status in the financial year.

APPENDIX 3

OUTLINE PROCESS FOR AN INTERIM DETERMINATION UNDER THE NOTIFIED ITEM FOR BAD DEBT

In this appendix, an outline process is suggested for use in the event of an interim determination under the notified item for bad debt. At this stage it is not practical to set out exactly how the notified item would operate, but this appendix sets out the principles which would be used.

The process would have two stages. Firstly an annual amount reasonably attributable to the impact of the ban on disconnections would be determined. This would have the following components:

- loss of revenue due to increased non-payment
- increased operating costs of collecting outstanding revenue
- increased annualised capital costs directly attributable to outstanding revenue collection

For each component, it would be the change between the base year (1998-99) and the latest year for which information was available at the time that a reference notice was submitted that would be considered.

To determine the revenue loss component, the change in the amount of outstanding revenue in each of the three specified time bands would be considered. Due to the potential for variability between different companies' write off policies, the notified item could not be based on companies' individual levels of written off revenue. Instead standardised assumptions on the proportion of outstanding revenue in each time band that is likely never to be collected would be applied to each company's data, to give a value for the change in lost revenue due to non-payment.

Companies are requested to provide details of their write off policies in order to inform assumptions on the proportions of revenue that is likely never to be collected. This information would be regarded as being commercial in confidence.

If a company supplied evidence that there was a material loss due to the cash flow effects of increased late payment, then this would also be considered.

The additional revenue loss would be added to the change in outstanding revenue collection costs and any additional justifiable annualised capital costs to give an annual total amount that could be attributed to the ban on disconnections.

The second stage of the process would be to determine whether all of this increase was due to the external factor of the ban on disconnections, or whether part of the increase was due to other factors, such as relative inefficiency on the part of the company.

This would be done by assessing companies' relative efficiency in collecting outstanding revenue, in the year of the notified item. The total costs (revenue losses,

operating costs and capital costs) would be compared on a unit cost basis and related to relevant external factors.

Various industry wide factors, which will impact on all companies (albeit to different levels), could be relevant in determining efficient levels of revenue collection costs and of write offs. These could include factors related to the socio-economic characteristics of the customer base, such as numbers of customers in receipt of benefit or in social housing, or a measure of the rate of change of occupancy. Views are invited on which factors would be relevant, and how these are best measured. As well as industry wide factors affecting performance, company specific factors could also be considered, but the onus would be on the company to demonstrate their significance.

Explanatory factors must be outside of management control, and should be factors for which comparative data of reasonable quality is readily available and can be related to individual companies' operating regions.

In assessing a reference notice under the notified item, the Director's aim would be to ensure that incentives to efficiently collect outstanding revenue were maintained, by avoiding excessive costs being passed through to customers. Costs would be judged against a benchmark level; the choice of benchmark would need to take account of the robustness of the analysis of companies' costs and of the data on which it is based.

For a company with costs at or below the benchmark level, increased costs as defined above would be regarded as wholly due the legislative change. For a company with costs higher than the benchmark level, part of any increase in costs would be regarded as being due to other factors.

This process would then result in the annual total amount for an efficient company that was attributable to the ban on disconnections. This would be compared with the materiality criteria in the same manner as described in *RD 14/00 Notified item for meter optants*.