

C2 COST BASE, BENCHMARKING AND EFFICIENCY STUDIES

REPORTER GUIDANCE

Introduction

Reporters should refer to the cost base information requirements for a general introduction to the cost base submission, the cost base objectives, the methodology and the format of submissions including the cost breakdown structure (CBS).

Role of reporters

Reporters are required to give the company cost base submission focused scrutiny and comment on aspects that are material to the cost base objectives (see section 1 of the information requirements).

Reporters are required to answer specific questions on each standard cost in the input cells provided for them in the CBS and to provide a general commentary. Where the answer is lengthy, or the same answer applies to several standard costs, the reporters' comments in the CBS may refer to sections / paragraphs in the general commentary. Section 2 of the information requirements describes the CBS and includes examples (one for infrastructure and one for non-infrastructure) of completed CBS spreadsheets, showing company data and reporter comments.

Reporter input to the CBS

The CBS is divided into blocks, and there is one input cell for reporters in each. The text in bold below is the question posed in the CBS. The remaining bulleted text provides further explanation and guidance. Where the answer to any of the questions is 'no', the reporter should estimate the adjustment required to make the submitted standard costs compliant.

1. General information: Check reference. Is proposed solution the company's normal practice? Is it the lowest whole life cost solution?

- Check the reference to standard practice documents / generic solutions or completed similar projects and confirm or otherwise whether the proposed solution is the company's normal practice. For example, is this the process design the company would typically choose?
- Comment on the suitability of process choice eg is it likely to work, and on whether it is the least whole life cost solution.

2a. Direct costs: Does the cost data represent the company's typical costs? Comment on the link between the data used in the cost base and that being used to develop the draft business plan.

- Where the company has not been able to extract direct costs from its cost capture system, examine and comment on the company's method for estimating these costs.

2b. Adjustments and exclusions: Are the items included, assumptions and methods consistent with standard cost definition and table guidance? Are adjustments typical / representative?

- Check whether direct cost adjustments or exclusions have been derived in accordance with the methodology described in section 2 of the information requirements and the specific guidance on each sub-service in sections 4 to 7.
- Comment on factors the company cannot control that affect costs, eg being limited to sub-optimal lengths for pipe / sewer laying. Are these material and do they mean that standard costs do not comply with the definitions?

3. Indirect costs: Are the indirect costs representative? Are comparable costs being used to develop the draft business plan?

- Where the company has not been able to extract indirect costs from its cost capture system, examine and comment on the company's method for estimating these costs.
- Confirm whether the company has used a suitable averaging method (eg across water infrastructure or water non-infrastructure) for indirect costs such as asset management, design, supervision and commissioning costs. Check and confirm that the company has not adjusted indirect costs based on the argument that the standard costs represent 'easy' projects.
- Where costs are based on tender data, confirm whether a tender to outturn adjustment factor has been applied, based on the average tender to outturn ratio.
- Where costs are based on outturn costs, confirm whether the company has allowed for the typical level of risk eg by including an appropriate contingency allowance.
- Examine how risk allowances in standard costs align with risk allowances in business plan estimates.
- Confirm whether where applicable a pain / gain adjustment has been made at project and programme levels.

4. Corporate overheads: Have all corporate overheads been allocated? Are the same overheads being used to develop the draft business plan?

- Verify and confirm whether percentage allowances for overheads in the standard costs include all capitalised overheads eg non-project staff, buildings, vehicles etc.
- Check and confirm that the company has not reduced the percentage on the grounds that projects used to derive standard costs are 'straightforward'.

5. Confidence grades: Reporter assessment

- Reporters should confirm the confidence grades provided by the company or, where they do not agree, submit their own assessments. Refer to table 2 in section 2 of the information requirements.

General commentary in written report

The reporter should provide general commentary under the following headings:

Sources of data and methodology

- Confirm or otherwise whether the data sources, unit cost data, estimating systems and procedures used to derive all standard costs are consistent with those being used for providing the capital expenditure estimates in developing the company's draft business plan.
- Verify and confirm whether the company has completed the CBS in line with the information requirements. Where the company's cost breakdown does not align with the CBS, check and confirm or otherwise whether the company has clearly explained where the costs are included.
- Verify and confirm whether the company has completed only those standard costs that represent 2% or more of planned expenditure for the sub-service. Where the company has not completed such a standard cost, confirm or otherwise whether the reasons given by the company for non completion are in line with the information requirements.

Company-specific special factors

Where the company claims that special factors affect the comparability of standard costs, review these claims critically. The company itself should not make any adjustments to standard costs to reflect company special factor claims; check whether this is the case.

Independence of company estimates

Confirm or otherwise that the company has compiled its standard cost submissions largely independently of other water and sewerage companies. Where there have been exchanges of technical information between companies on design and processes, identify whether amendments to standard costs are also reflected in the investment projections submitted by the company. Identify whether this transfer of information has resulted in lower unit costs assumptions in capital expenditure projections than would otherwise have been the case.

Comparison with 2004 standard cost estimates

Provide an assessment of the change in the level of standard cost estimates submitted in tables C2.9 and C2.10, and the reasons for the differences between current estimates and those submitted in 2004. Confirm the extent to which the company has updated its costing methodology for unit costs to take account of technological and other efficiencies since PR04. Where there are significant differences between unit costs for projects based on AMP4 guidance and similar unit costs for projects based on current guidance, comment on the reasons for the differences and whether there is any evidence of savings being made. **Significant** means an increase of at least 10% or a reduction of at least 25%.

Where answers to questions in the CBS are lengthy, or the same answer applies to several standard costs, reporters may find it convenient to include the answer in the written report.

Balance of workload

Reporters should focus on those standard costs that represent a larger proportion of the company's capital programme and on those aspects of the methodology and those company-specific special factors that are the most material.

Reporters should balance their workload on the cost base report as follows:

Sources of data and methodology	60%
Company-specific special factors	10%
Confidence grades	15%
Independence of company estimates	5%
Comparison with 2004 standard cost estimates	10%

Following company and reporter submissions, we expect to raise queries to ensure comparability across the industry. This will require additional input from reporters, and they should allow for this in their plans.

In addition we expect each reporter to attend a training workshop to explain the cost base information requirements in late November 2007 and a comparability / horizontal review workshop to give feedback on our analysis including comparisons across companies in May 2008.