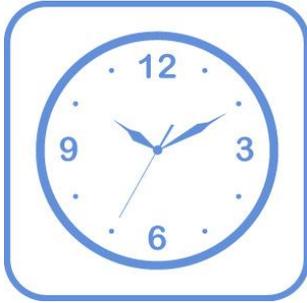




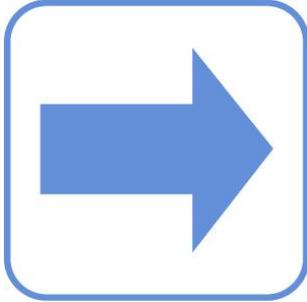
Regulatory reporting workshop

4 November 2014

# Agenda



- 10.00 Coffee – registration
- 10.30 Welcome
- 10.35 **Session 1:** Introduction and overview
- 10.50 **Session 2:** Performance reporting and additional regulatory information
- 11.30 **Session 3:** Company view of proposals
- 12.15 Lunch
- 1.00 **Session 4:** Group feedback, questions and discussion
- 2.15 Break
- 2.30 **Session 5:** Retail – cost allocation/metering
- 3.00 Summary and wrap up
- 3.15 Close



Our emerging vision for the sector is that there should be **trust and confidence** in the services that all companies provide

We have talked previously about a review of the existing regulatory accounts and **future reporting framework**

We recognise that changes are needed to ensure reporting aligns to Ofwat's wider strategy and approach to regulation. We also need to reflect changes arising from the **2014 price review (PR14), including segmental reporting**, the move to **totex**, and also **changes in accounting standards**

The framework should provide include a vehicle for companies to demonstrate **compliance with the price controls**

Our proposals reflect a base level of reporting. They include a **graduated reporting and assurance model**, with **flexibility** for future reporting



Focus on reporting information to all stakeholders on how sector is **delivering for its customers**

Aim to ensure information **adds value**, the approach is **risk based** and provides **flexibility** for future developments (including the Water Act, network+ and PR19)

Due to the regulatory approach, statutory accounts on their own are insufficient. So we have developed proposals for a **single regulatory report**, prepared at the same time as the statutory accounts. This contrasts with the Ofgem approach, which has separate data and stakeholder reporting over a longer period of time

Some minimum prescribed content is required to drive **consistency and comparability** and allow stakeholders ability to analyse both relative as well as absolute performance

# Context of proposals

Section	Description
<b>Regulatory financial report</b>	A baseline level of historical cost financial information that is aligned to the way in which price controls (and associated regulatory performance commitments and incentives) are being set for the next control period
<b>Price control and segmental reporting</b>	Financial information on the wholesale and retail elements of the appointee business, with additional disaggregation of revenues and costs as required
<b>Performance summary</b>	High-level report of performance including outcome delivery and financial results of company
<b>Additional regulatory information</b>	<p>Additional financial and non-financial information, including (but not limited to):</p> <ul style="list-style-type: none"><li>• Additional accounting policies</li><li>• Financeability statement</li><li>• Current cost reporting</li><li>• Detailed outcome and service level reporting</li><li>• Totex analysis</li></ul>



Performance reporting and additional  
regulatory information

# Key features of performance reporting

Our proposals include a base level of performance information

Allows a focus on reporting performance on outcomes and delivery service levels – both narrative and financial data including in year and in period performance

Cost performance – both wholesale totex and retail costs and recognising the importance that cost under or over-performance will be shared with customers at the end of the price control period

Additional regulatory information section provides further flexibility, aligns with the risk-based approach and supports evolution of regulatory framework

# Key benefits of prescribed performance reporting

Consistent reporting across the sector will facilitate relative and absolute performance review by all stakeholders

Presentation allows base level of outcome comparability

Provides transparency to all stakeholders (customers, investors, companies, other regulators, NGOs) to ensure ability to understand performance against price determination

Provides the ability to understand how performance will affect customers and companies in the longer term

# Key challenges

Different approach between IFRS and regulatory accounting – ability to identify, assess and report regulatory assets and liabilities (that is, future rewards and penalties)

Cost implications – though expect that companies will be preparing this information for their own needs and for other communications

We understand that many companies intend to present the majority of this information separately. This might lead to some overlap – how can this be minimised?

Alternative models for making this information available – for example, the Ofgem model of reporting

# Key disclosure proposals

## Outcome performance summary

Review of overall progress and performance

Achievement of certain performance commitments

Estimates of the position for actual and expected rewards and penalties

## Current cost fixed assets information

Continued regulatory financial reporting of certain data on a current cost basis will be important for the ongoing regulation of the water sector industry

There are a number of regulatory functions and duties for which current cost information is the most appropriate basis for our regulatory assessments and conclusions

## Number of properties and volumes

Additional information required under the price control and to provide context for performance

## Allowed totex reconciliation

A reconciliation of totex performance in the period, against the allowed totex used in setting the allowed wholesale revenues in final determinations

Stakeholders will be able to assess the company's view on the relative impact of its efficiency or inefficiency at the end of each year in the price control period

## Reporting against price control building blocks

By producing an income statement on an IFRS basis for regulatory reporting purposes, we note that there are some areas which would not be included that stakeholders may find useful, but is not readily available from the previous sections of the report

Provide transparency of performance against the economic basis of setting allowed revenues in the PR14 process



Company view of proposals



Group breakout and feedback

# Group breakout questions



**1. Regulatory financial reporting:** Do you agree that we should require a separate regulatory report to promote consistent and comparable regulatory information? Should this be appended to companies' statutory accounts and should we consider retaining transitional reporting for certain features of regulatory accounting under UK GAAP, including infrastructure renewals expenditure?



**2. Price control and additional segmental reporting:** Do you believe that a full segmental income statement is required, or would a reduced level of reporting, such as a contribution statement before interest and tax (in line with the basis of allowed returns in retail price controls), be a more appropriate format? What are your views on the appropriateness of the services being reported within the segmental reporting cost tables?



**3. Performance summary:** To promote consistency and comparability, we are proposing a base level of reporting which may lead to overlap with other reporting companies choose to produce. How can we best manage the risk of overlaps between the information we require and other information companies may produce for their stakeholders?



**4. Additional regulatory information:** We consider that performance against price determinations is important for stakeholders. To what extent do you think we should prescribe the content and format of such reporting? Do you have any views on how companies should present this information?



**5. Assurance:** All companies are required to obtain third party assurance over their outcome reporting. We welcome views on the most appropriate form, scope and provider of outcome reporting and associated assurance



## Cost allocations



We have tightened up our guidance on cost allocation in response to the introduction of four price controls for PR14 and to prepare for market opening in 2017

In March 2014, we published prescriptive guidance on the allocation of costs between retail and wholesale and between household and non-household

One area where our cost allocation guidance is less prescriptive is the allocation of costs between:

‘Base’ costs to serve unmetered customers

The additional cost to serve metered customers

We consider that there is a need to issue more prescriptive guidance in this area through the regulatory accounting guidelines (RAGS), in particular following representations on the draft determinations about this issue



## **Cost reflectivity**

Allocation of costs needs to be robust and cost reflective to be useful to the users of the accounts and for decision making

## **Regulatory comparison**

Consistent allocation of costs is needed to ensure that regulatory incentives from comparative analysis apply fairly across companies

Lack of prescription in current guidance has led to variable approaches by companies in business plans



### **Monitoring of costs compared with the final determinations**

For PR14 we set a separate efficiency challenge for base ‘unmetered’ costs to serve and additional costs to serve household retail metered customers

Robust information on the cost of serving unmetered and metered customers will allow us to calculate the additional cost to serve metered customers for comparison with the final determinations

Collecting this information over all six customer types will also inform our view of the ‘economies of scope’ for household retail

# Metered/unmetered cost allocation (1)



This guidance should be used to allocate costs between unmetered and metered customers in: Table 2D Historic Cost Retail Opex Analysis of the regulatory accounts

Companies will need to allocate total operating costs (line 25) between six customer groups for household retail:

Metered water only

Metered wastewater only

Metered water and wastewater

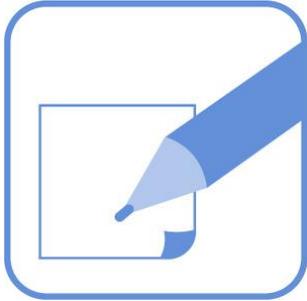
Unmetered water only

Unmetered wastewater only

Unmetered water and wastewater

For non-household, costs will need to be allocated across all customer types

## Metered/unmetered cost allocation (2)



Where possible companies should directly attribute their costs between customer types. But we recognise that it may not be possible to directly attribute some costs

Where this is the case we propose that companies must use a consistent set of prescribed cost drivers to allocate their costs between unmetered customers and the additional cost to serve metered customers

Where possible we have tried to keep these cost drivers consistent with those prescribed for the allocation of costs between household and non-household

# Metered/unmetered cost drivers (1)

Cost	Proposed cost driver
Billing	Number of bills to metered/unmetered customers
Payment handling, remittance and cash handling	Number of payments made by metered/unmetered customers
Vulnerable customer schemes	Number of metered/unmetered customers in vulnerable customer schemes
Non-network customer enquiries and complaints	Number of non-network customer enquiries made by metered/unmetered customers
Other customer services	Number of metered/unmetered customers
Debt management	Debt outstanding for more than 30 days for metered/unmetered customers
Doubtful debts	N/A – directly attributable to metered/unmetered customers
Meter reading	N/A – all metered
Demand-side water efficiency initiatives	Directly attributable where initiatives are specific to metered or unmetered customers; and Number of metered/unmetered customers where initiatives are not specific

## Metered/unmetered cost drivers (2)

Cost	Preferred cost driver
Customer-side leaks	Number of customer-side leaks in metered/unmetered properties
Developer services	N/A – all metered
Disconnections and reconnections	Number of disconnections and reconnections made to metered/unmetered customers
Charitable trust donations	Number of metered/unmetered customers
Other operating costs	
Other direct costs	
Local authority rates (including cumulo rates)	
General and support costs (excluding motor vehicle costs)	
General and support costs: Motor vehicle costs	

## Metered/unmetered cost drivers (3)

Cost	Preferred cost driver
Depreciation	Directly attributable to metered for vans used for meter reading and IT used for meter reading Allocation of other assets dependent on the nature of the asset, for example: Billing system based on the number of bills raised to metered/unmetered customers



We recognise that there is variation in companies' business plan allocations due to a lack of prescription in the existing guidance

We will have to set final determinations for unmetered cost to serve and the additional cost to serve metered customers before we introduce more prescriptive guidance

We will set final determinations based on companies' business plan allocations where we can see that companies have complied with the existing guidance for metered and unmetered allocations

# Clarification on other cost allocation areas



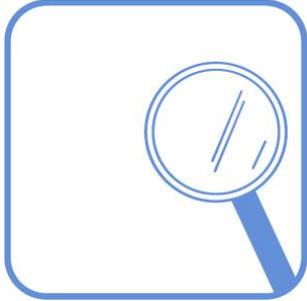
In our regulatory accounting guidelines we intend to clarify the guidance that we issued in March 2014 in the following three areas:

Allocation of doubtful debts between household and non-household

Allocation of investigatory visits between wholesale and retail

Allocation of capital costs and depreciation in line with principal use guidance

# Allocation of doubtful debts



In our March guidance we stated that “customer doubtful debts should be directly attributable on a customer specific basis”

We will be clarifying this as follows in the RAGs guidance:

Doubtful debts charges due to write-offs should be directly attributed on a customer specific (meaning individual customer) basis

Doubtful debts charges due to the increase in the provision for doubtful debts should be allocated on a customer-type (meaning household or non-household) basis

Companies need to have the systems in place to allocate their doubtful debts charge as prescribed above for 2015-16



**We intend to use the business plan guidance (set out in our September 2013 and April 2014 workshop slides) for the RAGs**

Where the cause of the investigation was a network issue the cost should be included in wholesale

Where the cause of the investigation was not a network issue the cost should be included in retail

## **What does this mean in practice?**

Jobs associated with a fault arising on the customer's property up to the emergency stop tap should be classified as retail

Jobs relating to network issues or requiring follow on work should be classified as wholesale



## **We intend to follow the business plan guidance for allocation of capital costs and depreciation in the business plans for the RAGs**

Where possible, capital expenditure and associated depreciation should be directly attributed between the retail and wholesale price controls

Where an asset is used in more than one price control it should be recorded in the price control of principal use with recharges made to other price controls that use the asset

Recharges should reflect the proportion used by each asset

The basis of the recharge should relate to the asset, for example:

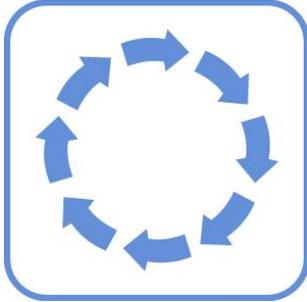
Finance software allocated based on number of licences

Leasehold and freehold property allocated based on floor space

Land allocated on based on use/area



Recap and next steps



We propose the regulatory reporting framework should:

- Focus on value-added reporting
- Be risk-based, practical and targeted
- Provide flexibility for the future

We presented proposals for a single, annual regulatory report

The report will be the primary vehicle that companies use to demonstrate compliance with the separate price controls

Stakeholders will benefit from consistent reporting across the sector to support comparability; this is the key purpose of the regulatory report

The report will allow a tailored nature of reporting and assurance, providing flexibility and risk focus

# Timetable and next steps

**11 November  
2014**

Consultation  
closes

**November  
2014**

Consideration of  
stakeholder  
feedback

**12 December  
2014**

Final  
determinations

Graduated  
reporting  
assessment

Initial  
implications of  
assessment

**December  
2014**

Finalisation of  
proposals

**January 2015**

Publication of  
reporting  
requirements  
and guidance