Dee Valley WATER

Financial Monitoring Framework Response
Ofwat, City Centre Tower
7 Hill Street
Birmingham
B5 4UA

Dear Sir/ Madam

Consultation on financial monitoring framework

We welcome the opportunity to respond to your proposals on the proposed financial monitoring framework.

Overview

Whilst we agree with the aims of the proposed financial reporting framework (as outlined on page 4 of the consultation paper), notably the need to monitor the financial stability of regulated businesses and identify financial and structural risks, we believe that it is possible to achieve these aims using the financial reporting information that is already publically available.

This information includes both the regulatory and statutory accounts, which already reference certain of the KPI measures contained in Appendix 1 of the consultation paper, and provide sufficient information to enable a user of the accounts to calculate many of the other measures that are included in the proposed financial monitoring report. Indeed, we note that key financial stakeholders, such as the credit rating agencies, already perform similar analysis prior to issuing their credit rating. This rating is published in the Annual Report for the information of shareholders and other stakeholders.

In preparing publically available financial reporting, Dee Valley Water ('the Company') complies with Company Law, International and UK Financial Reporting Standards and also the Regulatory Accounting Guidelines which specify clear guidelines on financeability and matters such as Going Concern. Such matters are also included with the Governance framework of the Company and form part of the Directors' fiduciary duties.

We therefore challenge whether the data included in the financial monitoring report will provide any further value to stakeholders. It will of course add an additional reporting burden on companies that are already complying with extensive regulatory and statutory reporting requirements and publishing large volumes of financial information. Furthermore, for smaller companies such as ourselves, increased reporting and potential external assurance can have a disproportionate impact.

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With regard to the requirement to stress test business plans, and to publish metrics based on a series of sensitivities, we again understand the rationale of this requirement but disagree with the publication of sensitised data.

Such sensitivity analysis is already performed on the business plan prior to the approval of the financial statements, to allow the Company's directors to conclude on their going concern assessment as mentioned above. Comprehensive disclosures in respect of this going concern assessment are included in the financial statements, confirming the financial stability of the business at the date of approval and giving stakeholders comfort that:

- The Company remains profitable and cash-generative in a range of scenarios, including similar circumstances to those set out in section 7 of the consultation paper, for a period extending to at least 18 months after the date of approval of the financial statements;
- Sufficient headroom is maintained over the existing financial covenants using sensitised forecasts.

This going concern assessment is both approved by the Board and audited by our external auditors. We therefore argue that this assessment, and the associated disclosures in the financial statements, provide compelling evidence as to the financial stability of the Company. We consider publication of the sensitised metrics themselves to be unnecessary, commercially inappropriate and, given the varying capital structures of the regulated companies, unlikely to provide a meaningful comparison across the sector.

Further comments on consultation queries

Our overall views on the financial monitoring proposals are set out above. Where appropriate, we have commented further on the individual consultation queries below:

Consultation queries 1, 2 and 3

See above for summary comments covering questions 1, 2 and 3 of the consultation. Whilst the list of metrics in Appendix 1 seems comprehensive and sensible from 'Regulatory Gearing' onwards, we argue that these metrics are either already publically available or can be derived by an interested stakeholder using the financial information that is already published (as the credit rating agencies already do).

More specifically, the comparatives to final determination seem out-of-place in this analysis, providing little value to external stakeholders other than Ofwat.

The Company monitoring category (page 26, Appendix 1) has no relevance to this analysis and should be removed.

Consultation query 4

We believe that such metrics, if published, should reflect the existing regulatory and statutory requirements and be published annually. Many of the measures rely on figures that are finalised at the financial year-end (e.g. RCV, dividends) and therefore cannot be meaningfully updated on a more frequent basis.

Consultation queries 5 and 6

The proposed requirement to incorporate holding companies and other controlling parties into the scope of the financial monitoring framework would not have a material impact on Dee Valley Water. As noted on page 16 of the consultation paper, any such requirement would necessitate a review of existing company licences and should be consulted on separately.

Consultation queries 7 and 8

Our view on the proposed stress testing is set out above. We do not believe that the suggested requirement to publish sensitised data is appropriate, and question both the value of this and the ultimate comparability of the data that would be published.

In the event that you have any queries on the above responses we look forward to hearing from you, and can provide further detail as required.

Yours Faithfully,

Andrew Bickerton
Finance Director