Anglian Water
Services Limited
Lancaster House
Lancaster Way
Ermine Business Park
Huntingdon
Cambs PE29 6YJ

Tel 01480 323550
Fax 01480 311057

Our ref

Your ref

Regulatory Reporting Consultation Response
Ofwat
City Centre Tower
7 Hill Street
Birmingham
B5 4UA

Regulatory.accounts@ofwat.gsi.gov.uk

22nd June 2016

Dear Regulatory Reporting Team

Consultation on Regulatory Reporting (March 2016)

We welcome the opportunity to respond on Ofwat's proposed changes to regulatory reporting. We have provided our answers to the specific questions raised in the consultation document below, followed by some more general queries and comments.

We would be pleased to discuss in more detail any of the points in our response.

Yours sincerely

Andrew Snelson
Economic Regulation Manager

Registered Office
Anglian Water Services Ltd
Lancaster House, Lancaster Way,
Ermine Business Park, Huntingdon,
Cambridgeshire. PE29 6YJ
Registered in England
No. 2366656.
an AWG Company

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

Table 2D – Historical cost analysis of fixed assets

Currently this table is intended to exclude intangible fixed assets. However, we believe intangible fixed assets should be included for the following reasons:

- Intangible assets such as IT software and asset studies/plans form part of our overall investment programme and the overall depreciation charge for the year. We therefore believe they should also form part of reporting on total fixed assets in table 2D.
- The capital spend reported in tables 4D and 4E includes intangible assets and therefore it is consistent to do likewise in table 2D.
- By including intangible fixed asset depreciation in 2D, the total depreciation charge in 2D will align with the depreciation charge included in operating costs in 1A and the retail depreciation in 2C.
- Historically in the regulatory accounts we have always reported intangible and tangible assets together as one class of fixed asset and we see no benefit in now separating out intangible assets when reporting capital expenditure.

Table 2E – analysis of capital contributions and land sales – wholesale

In Table 2E Ofwat refers to grants and contributions as being "capitalised and amortised against depreciation" and later "capitalised in the year". This is the old UKGAAP treatment of G&C. Under IFRS, we treat G&C as deferred income and subsequently release the income to the P&L over the life of the associated assets. There is currently no column in the table to reflect this treatment.

Table 4B – Wholesale totex analysis

We do not believe this table provides the correct totex variance as it is currently configured. On 2 June we communicated this issue to Gayle Webb at Ofwat. The content of the email is paraphrased below:

In Anglian Water's case (and possibly other companies too), we incurred significant AMP6 transition spend in 2014/15 and this table does not enable the reader to work out the relevant variance between actual totex and allowed totex taking into account these timing differences. This is because the formulae in the table do not make the appropriate adjustment for transition spend, nor the two lines excluded from the menu. In our published accounts, we intend to include an additional table underneath table 4B (see below) to make it easier for the reader to understand the totex variance.

	2015/16 price base			2012/13 price base		
	Water	**Wastewater**	**Total**	**Water**	**Wastewater**	**Total**
Reported totex (lines 6 and 7 in Ofwat table 4B)	316.6	408.3	724.9	298.6	385.1	683.7
Less items excluded from the menu:						
Pension deficit payments (line 2 in Ofwat table 4B)	(3.7)	(5.3)	(9.0)	(3.5)	(5.1)	(8.6)
Third-party services (line 3 in Ofwat table 4B)	(6.2)	(0.8)	(7.0)	(5.9)	(0.7)	(6.6)
Reported menu totex	**306.7**	**402.2**	**708.9**	**289.2**	**379.3**	**668.5**
Early start AMP6 transition programme (line 4 in Ofwat table 4B)	26.8	28.6	55.4	25.3	27.0	52.3
Adjusted reported totex (line 1 in Ofwat table 4B)	**333.5**	**430.8**	**764.3**	**314.5**	**406.3**	**720.8**
Allowed menu totex (line 8 in Ofwat table 4B)	365.0	462.1	827.1	344.2	435.8	780.0

Allowed menu totex (line 8 in Ofwat table 4B)	365.0	462.1	827.1	344.2	435.8	780.0
Totex variance	**31.5**	**31.3**	**62.8**	**29.7**	**29.5**	**59.2**

In addition we suggest a line should be included in the table for programme deferrals (until later in the AMP). This would give a more accurate picture of efficiencies over the AMP, as ignoring deferrals leads to an overstated outperformance position.

Tables 1A to 1D: Currently column I (total adjustments) equals columns G (differences between statutory and RAG definitions) minus column H (non-appointed). However, since column I is intended to be the total adjustments to the statutory accounts we suggest it is more logical for column I to equal the sum of columns G and H.

Table 4H

On 16 June we highlighted to Ofwat an anomaly in the way Funds from Operations (FFO) is calculated (line 12). The formula in the cell (F20) makes no adjustment for interest received on group loans to holding companies, and as a consequence our FFO is overstated by the intragroup interest received. In our case we have a substantial intragroup interest receivable which is exactly matched by an internal dividend paid to a holding company to finance interest on an intragroup loan. This also affects the calculated cells in lines 15, 17 and 18.

We note that in other cells (such as dividend yield in row 6) an adjustment is correctly made for the internal dividend to a holding company solely to enable that company to pay interest on an intragroup loan from the appointee, so it would be consistent to adjust the intragroup interest where appropriate.

We recommend that the formula is removed from the FFO cell to allow companies to adjust for interest received on intragroup loans where appropriate. Cells in lines 15, 17 and 18 would then pick up the correct FFO figure so would retain their current formulae.

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

We can see in paragraph 2.1.5 the definition of the capital maintenance charge that appears in table 4G has been tightened up from the previous version. However, we note the definition is still quite ambiguous and open to different interpretations, which leads us to conclude this table can have little value in assessing relative performance across the industry. Our view is that the table should either be removed, or the definition of the capital maintenance charge further tightened to ensure consistent reporting across the industry.

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 are broadly supportive of the principles and guidance set out in RAG2. However, one area that appears to be open to different interpretations is on the calculation of FTEs (section 5.1). Companies have many different forms of contracting and outsourcing arrangements in place and the definition provided may not reflect the burden of cost across services

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?

The wording suggests this formula will apply only to liquors returned directly to the STW, however whilst we have a number of sludge treatment centres (STCs) that separately treat the high strength post-digestion dewatering liquor, the effluent from these liquor treatment units still requires further treatment in the STW so the formula will need to account for these liquors as well. It should also be noted where we have separate liquor treatment plants these only treat the high strength liquors; other liquors from thickening return directly to the STW.

We believe this is a complicated area that requires more detailed discussion with technical experts in the industry and an area of operations that may well be 'over generalised' as a result of relying purely on consultation responses. We would be happy to discuss this matter further with Ofwat.

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 currently adopt the approach being proposed

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

We agree with the proposed approach

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?

No

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?

Financial Monitoring Framework –

Financial metrics – we question the value of the financial metrics in table 4H, in particular the FFO based ratios on lines 12 to 15 which Ofwat acknowledges are different from those used by credit rating agencies. We continue to believe that by publishing these metrics we cause confusion amongst our stakeholders as they use different measures.

We contacted Ofwat on 26 May to highlight that certain companies had not followed Owfat's guidance on calculating the financing element of RORE (line 5) that they reported in their preliminary results announcements. This resulted in those companies reporting a RORE which is higher than the figure we expect them to report in their APR in July. This is another area of confusion and we recommend that Ofwat tighten the RORE calculation instructions to remove any ambiguity, or remove the requirement to publish this metric.

AIM

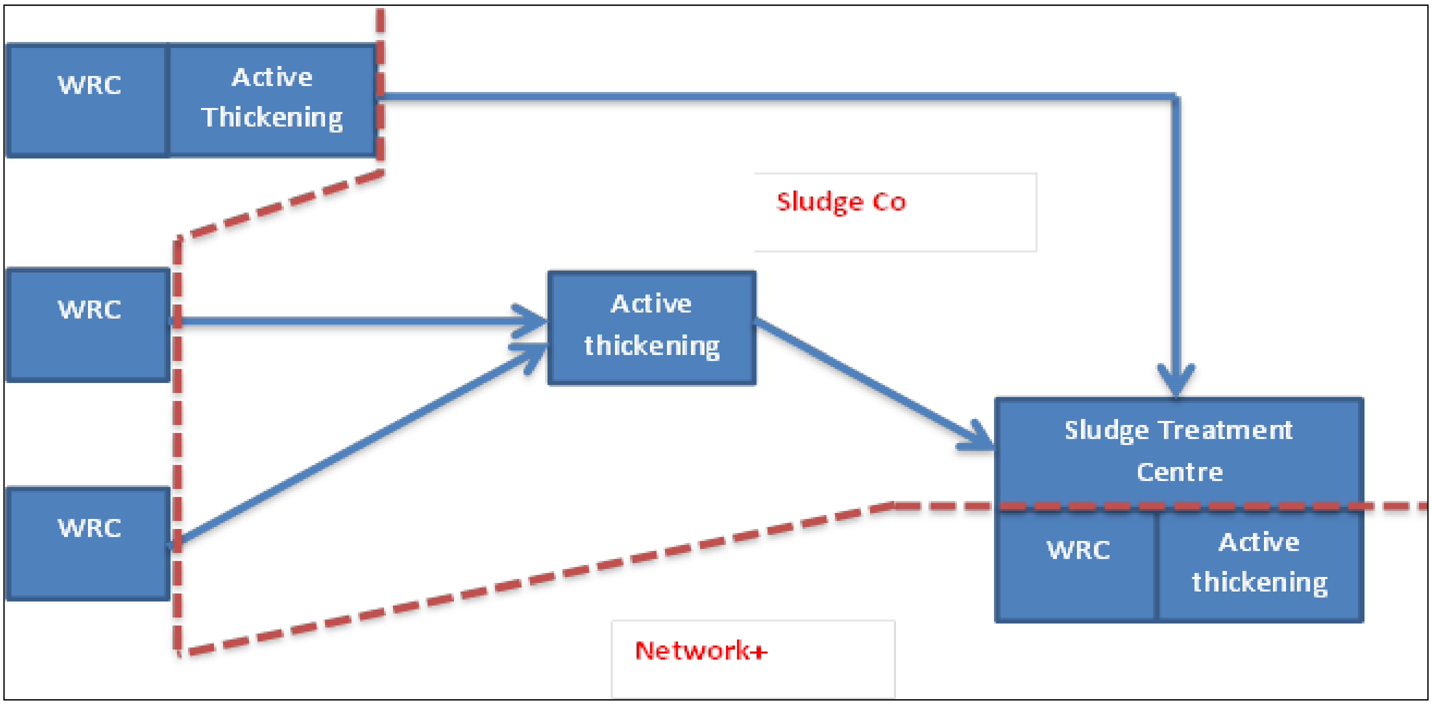
In principle we have no objection to providing site data for AIM sites. We are interested to know what site data Ofwat is proposing.

Q9 Should the Annual Performance Report contain more transparency over metering assets and installation and maintenance costs from 2017?
In principle, we have no objection to providing more detail on metering costs provided that reported data is not commercially sensitive. We believe that if further reporting of these costs is introduced, it will be essential for Ofwat to be very prescriptive on the costing and reporting methodologies to ensure that performance between companies is comparable, particularly when this may lead to accredited entities being able to provide these services.
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 support initiatives to increase the transparency around the costs that make up these charges. As stated above for metering costs, Ofwat must ensure that reported costs are comparable.

Further general comments on the consultation

Sludge boundary

We agree that passive and basic mechanical thickening processes should remain part of sewage treatment. However, we think sewage treatment should also include <u>all</u> thickening processes at a sewage treatment works (including active thickening) which precede transportation to another site, where the STW receives no imports from another site. Under our proposal only the remaining active thickening sites, where sludge from many sites is combined, would become part of the sludge treatment process. The schematic below illustrates our proposal.



We recognise that under our proposal similar assets might be included within different services according to where they are located. However, we do not foresee that this creates a problem. It has the substantial benefit of reducing regulatory burden, by reducing the number of sites where cost allocation is required – in our case from around 100 sites to about 15.

We would be happy to work with Ofwat to develop a common approach across the industry

Paragraph 5.5 Data for cost assessment

We strongly support the need to reinstate the regular collection of data to enable robust cost assessment. We have been active supporters of the cost assessment working group, helping to define the reporting requirements for this year's data collection exercise. We also recognise that further modifications to the reporting requirements may be required after this year's exercise.

RAG2 – Paragraph 2.8 Allocation of operating costs and capital costs for imported tankered waste

For clarity, we suggest the following re-wording of the second paragraph: "Where this is the case then the non-appointed business should be recharged for costs of both the sewage treatment and sludge treatment activities."

RAG 4.06, page 48 - definitions of non-appointed activities

We are not convinced about the treatment of car parks as a non-appointed activity. There is a presumption in the Water Industry Act that appointees will make their land accessible for informal recreation, where appropriate. We view that activities carried out by appointees to enable this should therefore be regarded as appointed activities. Car parks at our reservoirs are used primarily by individuals using the reservoirs for informal recreation and are essential to enable safe access to visitors. We therefore view the provision of car parking, and the costs associated with that provision, as appointed.