CAMBRIDGE
WATER
COMPANY

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Rob Lee,
Finance and Networks,
OFWAT,
Centre City Tower,
7, Hill Street,
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31 October 2012

Dear Rob,

Re: Consultation on changes to the Regulatory Accounting Guidelines (RAGs)

Please find below our responses to the listed questions in the above consultation (no response is given for question 7 as this is not applicable to ourselves, being a water only company).

Q1. Are there areas where we could reduce disclosure further? Have we reduced the requirements too far in other areas? Are there any additional requirements we need?

We note that although the requirement for the drafting of certain proforma tables have been removed, the requirement to maintain the underlying detail and therefore the workload remains.

We note the development of the form of the accounting separation methodology statement will involve significant review for inclusion as part of our regulatory accounts, and may be disproportionate in length relative to the total size of the accounts and the number of accounting separation tables contained therein. We recommend that a summary note be contained within the regulatory accounts with reference to a separately published full accounting separation methodology such as was provided for the 2011/12 regulatory accounting year.

With reference to the provision of non-financial information used to operate the Revenue Correction Mechanism, such as property numbers and consumption; as this same information is captured within the Principal Statement why also include in the regulatory accounts?

Q2. A statement on the link between directors' pay and standards of performance is required by the Water Act 2003. RAG3 currently specifies including the statement in the regulatory accounts. If we removed this requirement in from RAG3, this would enable companies to decide where best to publish this statement to make sure it is easily accessible for their stakeholders. Should we remove the disclosure requirement from RAG3?

The removal of this requirement would provide welcome flexibility as to how we satisfy our obligation under the Water Act, even though the end result may still be published in the regulatory accounts.

Q3. Although RAG3 requires annual provision of debt information, in practice we have only collected detailed information on debt at the base year for price setting. We propose to keep the annual provision requirement in RAG3, but then use the yearly update letter to exempt the requirement for years that it is not needed. Is this an acceptable approach?

Conceptually, we note that the provision of comparative annual data is a general standard in presenting accounts, regulatory or otherwise. As this proposal appears to conflict with such practice we would challenge Ofwat to move the collection requirement of this information to another channel, such as when collecting Price Review information.

Q4. We suggest that companies may wish to use a common format to publish the regulatory accounts electronically. This would mean that stakeholders could use the data more easily. What is the most appropriate common electronic format for regulatory accounts?

We would support a least cost, most accessible format, such as the 'pdf' format that we presently use to publish financial data on the Company's web-site.

Q5. We propose to provide companies with the principles and business unit summaries in appendix 4 to use when allocating their costs, rather than publishing prescriptive guidance. Do you agree with this approach? If not, please provide details of an alternative approach you think we should adopt.

In developing Accounting Separation reporting, the prescriptive guidance provided was a fundamental driver. Whilst the principles and business unit summaries contained within appendix 4 offer direction, we are concerned that the interpretive burden will not support consistent year on year treatments and therefore reduce the benefit to a user of published information.

A potential compromise could be a standard Ofwat prescribed model that participants could adopt by default, specifying by note when they have adopted a different basis. Such a methodology would highlight those areas of difference within the industry.

Q6. Do you think there are areas of expenditure that are at high risk of companies classifying incorrectly? If yes, please provide evidence and advise how we could mitigate this risk in a proportionate way.

Through size and scale of operation, there is a fundamental risk that WASCs may allocate costs differently in comparison to WOCs. This is another major argument for retaining prescriptive guidance on allocating costs.

Following on from our compromise recommendation in Q5 above, through the use of an auditor, exceptions to adoption of a prescribed standard form could be reported on, better facilitating a comparison between participants, and hopefully reducing the requirement for further clarification during Price reviews.

Q8. We are proposing that all fixed assets should be recorded in the business unit of principle use. Do you agree with this approach? For some asset categories such as general and support (G&S) that have no natural business unit should we allow them to be allocated or should we require the approach described above for fixed assets?

We are concerned that any benefits arising from a change in approach be balanced against the cost of reanalysis of thousands of individual assets, and the specific identification of the business unit of principle use for each asset. Subsequent modelling and system design costs will also be required to allow for a recalculation of Current Cost Depreciation and cross charging of the same.

Given the scale of change, we would recommend that such a change in requirement be phased to co-ordinated with any request for revaluation of assets for all companies, which might be made during the forthcoming Price Review.

If a revaluation is not to be a requirement of the forthcoming price review, we would hope a time limit may be applied to restrict the burden to assets acquired after the date of the last Price Review.

Without the provision of prescriptive guidance, we are concerned that allocation of G&S assets will prove to be inconsistent, and require further narrative for clarification.

Q9. We are proposing to trial the allocation of operating costs to services as detailed in appendix 6. As well as the service definitions in appendix 6, what information would companies need in order to report costs by these services? What incremental costs do you expect companies would incur in order to report operating costs by the proposed services to same level of assurance as the regulatory accounts? What are the implementation options available to companies to report operating costs by these services?

Through participation in the Regulatory Accounts Working Group we consider that the information in appendix 6 is sufficient, albeit we consider that the burden of data analysis for the present year suggests that adoption of such classification will initially require more management judgement, until data capture systems are adjusted to analyse at source.

As the proposed changes referred to in Q8 above may have a direct impact on the allocation of Current Cost Depreciation, we note that the burden of analytical work required will be extended to accommodate additional units of principle use.

Yours sincerely,

David Jenkins

David Jenkins ACMA
Financial Controller
Cambridge Water PLC