Northumbrian Water response to Ofwat's consultation on changes to the regulatory accounting guidelines (RAGs)

Regulatory accounts format and requirements

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

We support the overall aim to reduce disclosure requirements to those necessary for regulatory purposes. We also support the general desire to 'tidy up' the RAGs and reduce duplication.

We feel there are areas for further reduction of disclosure requirements. In our view, a review of the Regulatory Accounts should have the primary aim to remove data that is not necessary for regulatory analysis of information. All other current requirements should in our view be removed. The HC pro formas (A1 to A4), in our view, do not appear to be necessary for regulatory purposes. We do not see what value would be lost if pro formas A1 to A4 were deleted.

We welcome the reduction of pro forma tables from 18 to 14 and we further note the revised accounts proforma list (RAG3, Appendix 1 page 19). An area of ambiguity for us is that the turnover analysis pro forma seems to have been incorporated into pro forma A5, we presume it will be made clear whether this should be part of the CC P&L or as a more detailed note.

For additional requirements, we note that Ofwat has recently requested industry data on the numbers of customers for average cost to serve analysis, whilst there is a fair case to include some high level standard physical data (customer numbers, length of mains & sewers, volumes) in the annual regulatory accounts rather than request it on an ad-hoc basis, such additions should be kept to a minimum, (say 10-20 data items), as we do not wish to reproduce the Annual Return. However, we accept that it is often more efficient to report this data on an annual basis than to respond to ad-hoc requests that are inevitable to inform interested stakeholders for example.

The requirement for current cost accounting is the most significant regulatory reporting burden on the company in our view. It is also little understood outside the industry. We have made clear our desire in the long term to move away from current cost accounting. Whilst this does not affect our support for this consultation, we do feel a longer term aim for all concerned should be to find a practical and workable alternative and it may be that the introduction of a totex approach now provides an opportunity to do so.

Q2 A statement on the links 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 the requirement 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?

Given the long established requirements of the Water Act 2003, we feel that the statement is best kept in the Regulatory Accounts. Our Regulatory Accounts are an established form of communication and are accessible for stakeholders. Allowing it to be moved to a different publication may well make it less accessible - different companies may put the statement in different and less prominent places, making industry comparisons more difficult for stakeholders.

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 annual update letter to exempt the requirement for years that it is not needed. Is this an acceptable approach?

We agree that there will be some data that will only be required for price setting and not annually. The proposed approach appears reasonable.

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 have suggested to Ofwat previously that the sharing of accounting data via a pdf file is not ideal for any party. To allow analysis, it requires Ofwat, the industry and stakeholders each to manually input data, with associated time and error risk. The value of accounting separation data for competition is undermined if the information is scattered on multiple company websites, within large pdf files that require manual extraction for analysis and comparison purposes.

We would support an Ofwat prepared Excel based regulatory file with the proforma data (i.e. similar to Tables 18-29 of the Annual Return and the 2012 Supplementary Tables). This could be submitted to Ofwat alongside the pdf file. Ofwat could then put these files on their website as a central repository for all stakeholders.

Accounting separation

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.

We support the proposed approach. The guidance does not attempt to simply list the assets in detail, but instead explains the service from several points of view – the inputs & outputs, boundary points, processes, services, operating expenses, assets and third party involvement. This multi-faceted guidance helps companies interpret the primary aim targeted by the guidance.

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

There are some areas where more guidance may be required. The treatment of leakage expenditure is one example.

The current guidance does not specifically address capitalisation policy. One of the possible benefits of a move to a totex approach may be that different company capitalisation policies within a business unit become less relevant. It might therefore be appropriate to look at whether business units accounting separation pro formas could be merged on a totex basis rather than separate Opex and Capex.

Q7 We are proposing to merge the sludge treatment and sludge disposal business units into one called sludge treatment, recycling and disposal. Do you agree with this approach?

We agree with this approach as sludge disposal is relatively low value and is interdependent on sludge treatment.

Q8 We are proposing that all fixed assets should be recorded in the business unit of principal use. Do you agree with this approach? For some asset categories such as general and support expenditure (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 support the principal use approach. Not only is it less burdensome than an apportionment approach but it is in line with how a stand-alone business would operate.

We feel that G&S assets should be allocated to the most appropriate business unit. This allocation does not need to follow the principal use approach, as percentage use allocations will be more relevant in this instance.

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 the same level of assurance as the regulatory accounts? What are the implementation options available to companies to report operating costs by these services?

We have some concerns over the regulatory burden of expanding the number of services for accounting separation purposes. The proposal is to expand from 7 business units (4 water, 3 sewerage) to 15 (7 water, 8 sewerage).

In our view, such an increase would have to be justified by an impact analysis, which would need to be fully supported by an assessment of associated benefits. We have not yet seen such an analysis, so, until there is a clearer explanation of the benefits that this increased regulatory data would bring, we cannot support this change in approach.

Northumbrian Water
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