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Changes to the regulatory accounting guidelines (RAGs) consultation response

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Please ask for Mr Sheeran
Our reference NJS/KL
Your reference

Dear Mr Lee

**CONSULTATION ON CHANGES TO THE REGULATORY ACCOUNTING GUIDELINES
PORTSMOUTH WATER'S RESPONSE**

Firstly, Portsmouth Water welcomes the opportunity to take part in a consultation on the requirements for producing Regulatory Accounts in future years. Our responses to the questions set out in the consultation document are given below.

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?*

Given that there are now requirements to provide accounting separation information in the Regulatory Accounts at a detailed level, this has led to an increase in the work required to produce the accounts. Therefore, Portsmouth Water welcomes the proposed reduction in disclosure requirements in other areas.

However, the Company believes that the Current Cost Balance Sheet should not be removed completely. A summary Balance Sheet should still be included in the Regulatory Accounts, along with any associated notes. This is for completeness and would have to be put together anyway in order to ensure that the accounts reconcile.

Q2 *A statement on the links between Director's 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?*

The Company does not believe that it is necessary to remove the disclosure requirement from RAG3. A report on remuneration, including an analysis of director's pay, is appropriate in the Regulatory Accounts and is easily accessible 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?*

The Company believes that this is an acceptable approach.

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- 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?*

Portsmouth Water currently produces its accounts in Microsoft Word format and publishes them in a pdf file. This gives a professional presentation of the information for printing and distributing to stakeholders.

The Company therefore believes that pdf files are the most appropriate electronic format for the Regulatory Accounts.

- 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.*

The Company supports this approach, and believes that providing principles and business unit summaries is sufficient guidance for accounting separation.

- 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 an appropriate way.*

The Company believes that the areas at some risk of inappropriate classification involve the allocation of general administrative costs. This will be a result of different companies' accounting systems giving varying levels of accuracy in cost allocations.

Ofwat could carry out comparisons of each company's allocated costs in these areas to identify any problems in specific companies. Major outliers could be identified and action taken to establish the reasons for the differences in allocations such that corrective action could be taken.

- 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?*

N/A

- 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?*

Since the commencement of accounting separation, Portsmouth Water has adopted the approach of allocating assets across all relevant business units, and the detailed ledgers used for asset reporting have been developed in order to meet this objective. Depreciation, as it is calculated in these ledgers, is therefore automatically allocated to the correct business units.

If Ofwat decides that assets should now be allocated to the business unit of principal use, it will be an onerous task for this Company to go back and reallocate the assets out of all the relevant business units and into the one of principal use, with consequent impacts on the depreciation calculations.

The Company therefore is not in support of the proposal to allocate all fixed assets to the business unit of principal use.

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?*

The Company believes that the key to reporting costs by services is to ensure that the management accounting system has sufficient detail to enable the additional allocations to be arrived at.

It should be recognised that to achieve this there will be increased costs in terms of extra staff time and resources. In particular, there may need to be IT system changes to ensure that the Company can report to this level of detail, and with the same level of assurance as the Regulatory Accounts. These changes would potentially include a new General Ledger coding structure in order to capture more of the allocated costs at source.

We would be happy to have further discussions with you on any of our responses to the above questions, if this is required. Our contact in the first instance is Caroline Jemphrey, Management Accountant, telephone number 023 9224 9263, email address c.jemphrey@portsmouthwater.co.uk.

Yours sincerely

A handwritten signature in black ink, appearing to read 'N. Sheeran', followed by a horizontal line.

NICK SHEERAN
Finance and Regulation Director