



South Staffs Water

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Rob Lee,
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31 October 2012

Dear Rob,

Consultation on changes to the Regulatory Accounting Guidelines (RAGs)

Thank you for the opportunity to respond to the above consultation. I trust you will find our comments useful. Each question is answered in turn below. Please note that question 7 is not applicable as this relates to sewerage services.

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?

The Company welcomes the reductions in disclosures in the regulatory accounts. However, it should be noted that a 50% reduction in data requirements does not mean a 50% reduction in work to produce the data. For example, the current cost balance sheet and the movement on current cost reserve are outputs of the Company's current cost model that produces the other current cost schedules. As a result, they are automatically produced and so no material time is saved other than completing the proforma tables. The burden on reporting would only be significantly reduced if current cost accounting in its entirety was withdrawn.

It is recognised that the additional non-financial tables are required to operate the Revenue Correction Mechanism, namely property numbers and PCC. Whether this data sits best within the regulatory accounts needs to be considered. The Principal Statement already captures some of this data and is more relevant to charging than the regulatory accounts. It may therefore be possible for this to be the primary source of data to avoid duplication in reporting. Another alternative is to include this as part of the PR14 process through a data capture system.

Going forward, it is proposed that companies include its accounting separation methodology statement in the regulatory accounts. The

Company's statement is 23 pages long and it will be difficult to reduce this to a manageable size that will still be of benefit to readers of the regulatory accounts. It may be better to make reference to it in the accounts and that it is available to view on the Company's website as was done for 2011-12.

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?

As this statement is a requirement under the Water Act, removing it from RAG3 makes no difference to the fact that the information still needs to be published. However it is recognised that for some companies, detailed information on directors' pay is already included in the statutory accounts. It would therefore make sense that where appropriate, the requirements of the Water Act should be incorporated within the same note to the 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?

The Company believes that including a table in the regulatory accounts for one year and then not for the next four would confuse users of the accounts as they would be unable to compare any changes year on year. This is one of the fundamental concepts of accounting. If the sole purpose of collecting this data is for Ofwat rather than the other users of the regulatory accounts, it would be more logical to include this as part of a data capture system for PR14.

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?

For the last few years, the Company has published a pdf version of the accounts on its website which includes the relevant signed pages. The Company believes that this is still the most appropriate electronic format in which to publish its 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 has found the prescriptive guidance useful and it has highlighted those areas where improved analysis has been required. To this end, it would be a backward step to then move to a principles based approach. As a minimum, Ofwat should still specify the preferred method of allocation so that companies know where improvements to their systems, data and reporting should be concentrated. This would also aid Ofwat at the next Price Review as they could focus their analysis on those areas that do not follow the preferred method rather than having to analyse every single allocation method and decide how appropriate it is.

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.

Moving away from prescriptive guidance will increase the risk of misclassification. Within that, the biggest areas of risk would be around how WASC's allocate costs between water and sewerage and how all companies allocate costs to retail as it will be in their interest to keep these as low as possible. Although the methodology statement should aid Ofwat's review of companies' data at a high level, it will not reveal all of the detail and may lead to a vast number of queries being raised by Ofwat at the next Price Review.

The best way to mitigate this risk is to engage the use of the Reporter who should already have a good understanding of the methodologies used and will have challenged where appropriate. Following on from Q5 above, the Reporter could be asked to report on an exception basis only where the preferred methodology has not been followed and comment on the appropriateness of the basis used. This would cut down on the analysis required by Ofwat and the number of queries raised with companies at the next Price Review.

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?

Although the Company could record fixed assets in this way, it would not be worthwhile if it involves significant additional work to do it. If all opening balances for each business unit need to be recorded in this way, the Company would have an enormous task of having to analyse thousands of the Company's fixed assets, determine those that have been allocated, decide the unit of principle use, then recalculate the CCD charge and then set

up an allocation model to calculate the cross charge. The Company sees little benefit in doing this at this time. If Ofwat decide to request all companies to revalue their assets at PR14, then they could also request at the same time that assets should be allocated by principle use, hence covering off two exercises in one. As an alternative, Ofwat could request that only fixed asset additions from 2008-09 are allocated in this way.

The Company believes that all G&S assets should be allocated although these assets would need to be defined to ensure consistency of approach between companies.

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?

The information in appendix 6 is sufficient. However, the issue is in setting up the Company's reporting system to record the costs in this way. It will mean that for the 2012-13 report year, for which we are already six months into, the confidence of reporting will be lower than for the business unit reporting with more management judgment being required.

The Company is also concerned about whether service operating costs include CCD. This would involve further work on top of that from the proposal to allocate assets to units of principle use.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'P. J. Saynor', with a long horizontal flourish extending to the right.

Philip Saynor ACMA

Director of Finance
South Staffordshire Water Plc