



Regulatory Reporting Consultation Response

Strategy & Regulation

Ofwat
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Dear Sir/Madam

Further consultation on regulatory reporting for 2016/17

Thank you for the opportunity to respond to your further consultation on regulatory reporting for the 2016/17 reporting year.

We are committed to producing an Annual Performance Report ("APR") that best meets the needs of our customers. This is particularly relevant where additional and more detailed disclosures are being considered, for example the proposal for cost assessment data to be included in the APR (page 23 of the consultation document), where we want to ensure we focus on maintaining the right balance for customers.

We highlight below our comments on the more significant points in the consultation and we include our detailed responses to the consultation questions in the attached appendix.

In respect of Question 1, "*What are your views on the content and format of the proposed tables in Appendix 1?*", Question 3, "*Do the definitions for the water resources activities in RAG4 provide sufficient detail for you to complete pro forma tables 2A, 2B, 2D, 4D and 4E?*", and Question 4, "*Do the definitions for the bioresources activities in RAG4 provide sufficient detail for you to complete pro forma tables 2A, 2B, 2D, 4D and 4E?*", we have the following comments:

- We would be grateful if further guidance is provided over the definition of 'bulk supply' and 'third party services'. Specifically, what should be included in each category and where the costs should be recognised both in 2B and by Upstream Service in the more detailed Section 4 tables. This clarification would be aided by some practical examples and diagrams that show the nature and type of bulk supply and third party services costs and how they should be allocated.
- We wish to clarify whether Ofwat has given companies the option (i.e. not obligatory) of making an amendment to the properties figure already reported to arrive at a customer number, or whether this is in fact a requirement?
- Following on from the work presented at Ofwat's Water Resources working group in July, we have identified potential gaps or overlaps within the definitions of RAG4 for raw water transport, raw water storage and raw water abstraction. We highlight these in Appendix 2 to this letter using specific examples from our network. We would like to discuss these with you in more detail.
- We have concerns that specifying a hard threshold of 10% of dry solids could have a disproportionate impact in practice, as it implies companies are required to measure

% dry solids at multiple stages in the sludge process where this has not previously been measured, and will incur additional cost. We can see the logic of the 10% dry solids as the boundary, but think the same consistency of boundary could be achieved by defining a few specific rules to be applied in RAG4, at a lower cost to customers.

Please do not hesitate to contact either myself or my team at regulatoryreporting@thameswater.co.uk if you have any questions or comments on our response. We look forward to working closely with Ofwat in supporting the further development of our Annual Performance Report.

Yours faithfully

A handwritten signature in black ink, appearing to read "Nick Fincham". The signature is written in a cursive, slightly slanted style.

Nick Fincham
Director of Strategy & Regulation

Appendix 1: Detailed response to questions

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

Our view on the content and format of the proposed tables in Appendix 1 of the consultation document are reflected in the comments below:

Content:

With respect to the content of the proposed tables in Appendix 1 of the consultation paper, our view is that the overall nature and extent of content being reported is reasonable, useful and that it is appropriate to continue to produce the information specified, however, we would like to note the following:

- Table 2D (per Appendix 2 Technical changes proposed by respondents Proposal 12), we have a concern that the principle use allocation rules may cause some confusion when the principle use is determined by a variable cost driver. This could result in a given asset being reassigned to different price controls each year. We would welcome an additional disclosure line for principal use assets in these circumstances to make this transparent in the accounts.
- Table 2D: We are concerned with the new disclosure requirement for depreciation split between principal activities and third party services. We do not currently record our fixed assets in our system in this way and it is likely to be a labour intensive and manual exercise to obtain this split. This is further complicated by the fact that some of our principle assets are used in the provision of both our principal activities and third party services and would be difficult to apportion in a meaningful way.
- Table 4E: we consider our methodology for calculating surface water and highway drainage is reasonable and practical, though wish to note this did not form part of the historical June Return process and is potentially an area of inconsistency within the industry.

Format:

With respect to format, we have the following recommendations and areas requiring additional guidance/clarification:

- Table 1C: Where possible, we would welcome seeing regulatory categories disclosed in the Section 1 tables more closely aligned with IFRS categories. Closer alignment would reduce the level of complexity and manual intervention involved in populating the regulatory tables, for example removing the 'capex creditor' disclosure and aligning the definition of borrowings with the IFRS definition. If additional disclosure is required around levels of accrued interest this could instead form part of the additional borrowings note disclosure;
- Table 2B: we support Ofwat's proposal with respect to the definition of grants and contributions to be included as described in 2B.17; and
- Table 2B: Bulk supply and Third Party Services'. We would be grateful of further guidance being provided over the definition of 'bulk supply' and 'third party services'. Specifically, what should be included and where these costs should be recognised both in 2B and in the more detailed Section 4 tables (4D and 4E). This clarification would be aided by some worked examples and diagrams that show the nature and type of bulk supply and third party services costs and how they should be allocated.

2	<p>Do you have any comments on our proposal to elevate the reporting for water resources and bioresources from section 4 of the APR to section 2?</p> <p>We support the proposal to elevate water resources and bioresources from section 4 to section 2.</p>
3	<p>Do the definitions for the water resources activities in RAG4 provide sufficient detail for you to complete pro forma tables 2A, 2B, 2D, 4D and 4E? (Note that the decision over the location of the boundary is outside the scope of this consultation as set out above)</p> <p>We think there may be some gaps or overlaps in the definitions of raw water transport, raw water storage and raw water abstraction. We assure you that we are not seeking to redraw the boundary between water resources and network plus, but rather we wish to clarify our understanding of RAG4 and highlight potential instances of duplication or omission within the definitions which may cloud consideration of the boundary. We have provided examples in Appendix 2 which support our analysis, and refer to them in the points below.</p> <ul style="list-style-type: none"> • We would like Ofwat to clarify what it means when it refers to a “Reservoir with / without an abstraction licence”. In our view, all abstraction (above the current de minimis threshold) requires an abstraction licence. We use abstraction licences to fill our (storage) reservoirs, and other companies have abstraction licences to take water from their reservoirs. In some cases the abstraction licence may specify a reservoir as a particular destination for the abstracted water, but this is not always the case. We think the definitions in RAG4 could be clearer here. In Examples 1-5, we classify our reservoirs without natural catchment and filled using abstraction licences as Raw Water Storage. • The existence or absence of an abstraction licence appears to be a key determining factor in deciding whether a reservoir is within Raw Water Abstraction or Raw Water Storage. This does not seem to be appropriate, given that almost all abstraction requires a licence. We suggest that further clarity is necessary on the definition of “reservoir with an abstraction licence”. For example, a reservoir from which water is abstracted via a licence for subsequent use would be classed as Raw Water Abstraction, and a reservoir filled by abstracting from a river would be classed as Raw Water Storage. We would welcome your views on this alternative definition. • In most cases the abstraction pump, valve, meter and pipe channel are located close to the abstraction inlet. We interpret the guidance to mean all of these assets sit within Raw Water Abstraction. There are some cases where the abstraction pumps are not located at the intake on the river (see Examples 1 & 2) and they may be some distance away, at the end of gravity fed pipes. Our interpretation of RAG4 is that such pumps are in Raw Water Abstraction and the pipe or channel before and after the abstraction pump sits within Raw Water Transport. For extra clarity, it may be necessary to take account of Ofwat’s suggestion of a de minimis length of pipe, to distinguish between pipes that should be in Raw Water Abstraction and those that should be in Raw Water Transport. Some flexibility to review the application of a de minimis threshold should be retained for potentially complex cases. • In Example 3, we might discharge water from our reservoir back to the river instead of transporting it for treatment. Our interpretation of RAG4 suggests the return asset would sit within Raw Water Transport. We would welcome your views on our interpretation. • We note that RAG4 does not appear to consider the specific existence of transfer licences, by which water is authorised to be moved from one location to another and subsequent return to the natural environment. The Environment Agency treats these differently to abstraction licences. Our interpretation (see Example 4) of the guidance is that the transfer licence would sit within Raw Water Abstraction but the transfer pipe sits within Raw Water Transport. We would welcome your views on this.

	<ul style="list-style-type: none"> In Example 5 we show an impounding reservoir that is not located on the main river, but instead is filled by an open channel via gravity. Our interpretation of the guidance is that this reservoir, the open channel and the upstream abstraction licence would sit within Raw Water Abstraction. We would welcome your views on our interpretation. This would mean that this is the only reservoir that is included in Raw Water Abstraction, despite being in a chain of several reservoirs, all gravity fed, which require interdependent management. This may not be the most efficient and appropriate allocation.
4	<p>Do the definitions for the bioresources activities in RAG4 provide sufficient detail for you to complete pro forma tables 2A, 2B, 2D, 4D and 4E? (Note that the decision over the location of the boundary is outside the scope of this consultation as set out above)</p> <p>We have concerns that specifying a hard threshold of 10% of dry solids could have a disproportionate impact in practice, as it implies companies are required to measure % dry solids at multiple stages in the sludge process where this has not previously been measured, and will incur additional cost, that will be borne by our customers.</p> <p>We can see the logic of the 10% dry solids as the boundary, but think the same consistency of boundary could be achieved at a lower cost, more simply, by stating in the RAG4 that:</p> <ul style="list-style-type: none"> Bioresources transported by liquid tanker will have originated from a Network plus asset. Bioresources transported by truck will have originated from a Bioresource asset. <p>We note that “tanker” and “truck” are terms used in the Wastewater cost assessment submission due for submission to Ofwat on 6 October 2016, so there should not be any difficulties in companies understanding this distinction. A consequence of this is that the sludge holding tank upstream of the dewatering plant would be the last part of the Network plus boundary.</p> <p>We agree that 10% dry solids is a useful guideline for companies for identifying Bioresources assets, provided it does not require companies to incur additional costs to measure the % of dry solids at multiple stages in the process.</p>
5	<p>Please could you provide an estimate of the impact, for the changes that we have proposed to the boundary definitions for both water resources and bioresources at RAG4? (see questions 3 and 4 above).</p> <p>The impact should include an estimate of the change in Net MEAV resulting from the assets that have moved under the change in boundary definitions for both water resources and bioresources separately.</p> <p>Our original interpretation of the guidance assumed that all of our reservoirs hold abstraction licences as they are directly connected to an abstraction site. This assumption resulted in all of our reservoirs being included in water resources and none in raw water storage.</p> <p>Through our involvement in the water resources working group and the on-going consultation on regulatory reporting we have revised our interpretation and now consider the majority of our reservoirs to be raw water storage and the pipe connecting the abstraction site to the reservoir to be predominantly raw water transport. In order to calculate the impact of this change in boundaries we require further clarification over the scenarios described in the diagrams included in Appendix 2. The maximum impact based on figures published in table 4D of the 2015/16 APR is £36.7m opex and £10.2m capex.</p> <p>For Bioresources, our interpretation of the guidance for the boundaries is consistent with the views discussed in the working group. We do not anticipate any material reclassifications between price controls resulting from changes to the boundaries. The only change we anticipate as we move forward is the attribution of a cost to the sewage sludge product produced by the sewage treatment process and used as an input to the sludge treatment process.</p>

	<p>We would appreciate further clarification over the role that current cost accounting will play going forward and in particular whether there is a need to maintain an up to date current cost fixed asset register. If this is to be an ongoing requirement, to what level of granularity (Accounting separation or upstream service) should it be maintained?</p>
6	<p>In the responses to our March consultation some companies suggested that to avoid recognising number of discrete connections as a raw water transport activity, a de minimis value (for example length of pipe) should be added to the RAGs. This would clarify the allocation of raw water transport between water resources and water treatment. Under this approach if the length of pipe were below the threshold, the asset would be classified as water resources, and raw water transport if above. We propose an amendment to RAG4 to address this concern by making a specific reference to sites in the definition of raw water transport but have not added a de minimis value. Do you consider that a de minimis threshold should be introduced? If yes, what should the value of that threshold be?</p> <p>Due to the complexity of the abstraction and reservoir system it seems sensible to have a reasonable de minimis threshold for pipe length, to add clarity to the boundary between Raw Water Abstraction and Raw Water Transport. However in cases where this is required we propose that it should be reviewed on a case by case basis. The value of such a threshold can be informed by further analysis of the types of scenarios where it would be applied.</p>
7	<p>Other</p> <p>7.1 Appendix 2 Technical changes proposed by respondents</p> <p>We support the majority of the proposals made in Appendix 2 of the further consultation on regulatory reporting. Those areas for which we would value further clarification and/or guidance are detailed below:</p> <p>7.2 Consultation document Appendix 2 Proposal 13 Table 2G & 2H (page 30) & RAG 4.06 Pro-forma 2G & 2h (page 19)</p> <p>This consultation makes reference to the number of connections reported in column 4 should be the <i>average number of properties billed (excluding void properties) in the year calculated at least on a monthly basis</i>. We wish to propose the use of a quarterly average in place of a monthly one. This is due to the challenges posed in obtaining customer numbers from water only companies on a more frequent than quarterly basis. We feel a quarterly average would be more easily attainable and still form an appropriate representation of underlying customer numbers.</p> <p>With respect to the additional line of analysis for number of customers, and average revenue per customer, we wish to clarify whether Ofwat has given companies the option (i.e. not obligatory) of making an amendment to the property figures already reported to arrive at a customer number, or whether this is in fact a requirement? The guidance available in RAG 4.06 p.19 appear to give companies an option whether to apply adjustments to the number of connections in order to arrive at a total number of customers.</p> <p>7.3 Consultation document Appendix 2 Proposal 15 Table 3A (page 30)</p> <p>While we recognise the need to report financial penalties to three decimal places, the pro forma tables for 2015/16 also had the performance metrics going to three decimal places. Not all of our ODIs can be measured in this way, while others do not need to be reported to three decimal places. We would welcome greater flexibility for companies to choose the appropriate number of decimals to report their performance levels to.</p> <p>7.4 Developer Services</p> <p>Developer services are shown in the consultation as part of the retail business. There is currently no guidance available on reporting requirements where water companies have decided (or may decide) to exit the retail non-household business. This will make compliance with the reporting requirements challenging for 2017/18. We would welcome further guidance over the reporting requirements where companies have chosen not to participate in the retail non-household market.</p>

7.5 Exit of retail non-household market

We would welcome confirmation that, where a company exits the retail non-household market on the market opening date (April 2017), there will be no requirement to report retail non-household information as part of the APR for 2017/18.

Appendix 2: Illustrative diagrams of water resource areas requiring further clarification

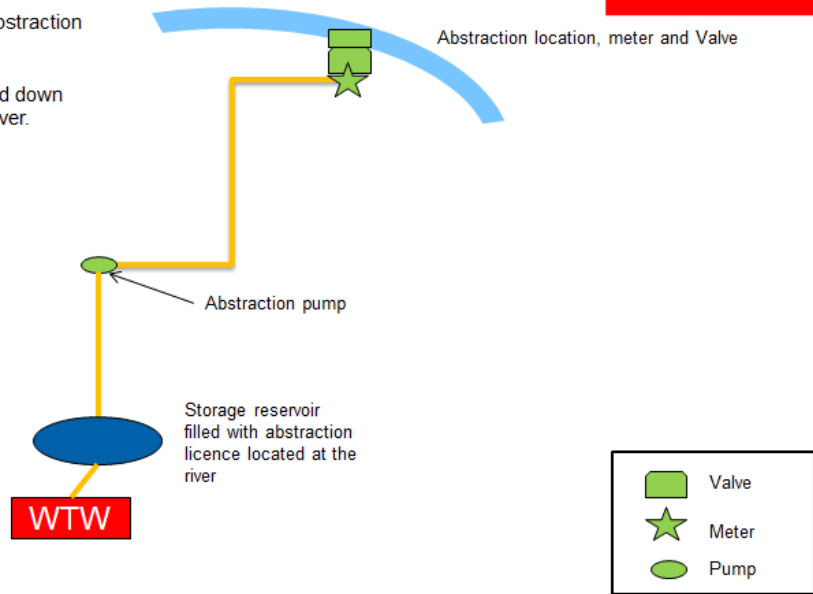
Example 1

Water Resources – raw water abstraction licence
Water Resources – raw water abstraction
Raw water distribution – raw water transport
Raw water distribution – raw water storage
Water treatment

Abstraction point & licence located next to the river.

Water then gravity fed to the abstraction pump approx 2km away.

The abstraction pump is located down stream from the intake at the river.

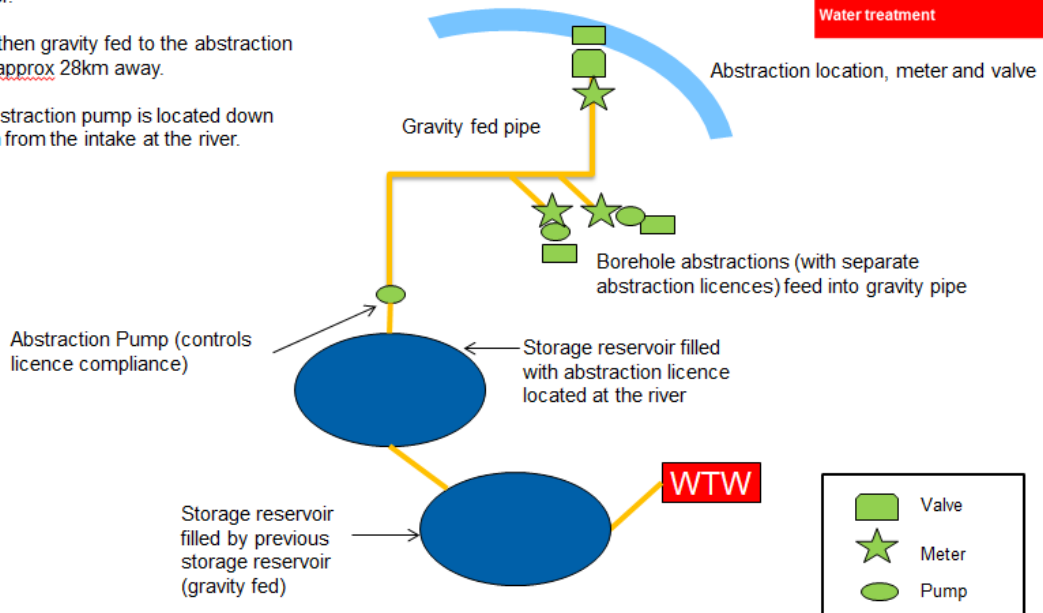


Example 2

Abstraction point & licence located next to the river.

Water then gravity fed to the abstraction pump approx 28km away.

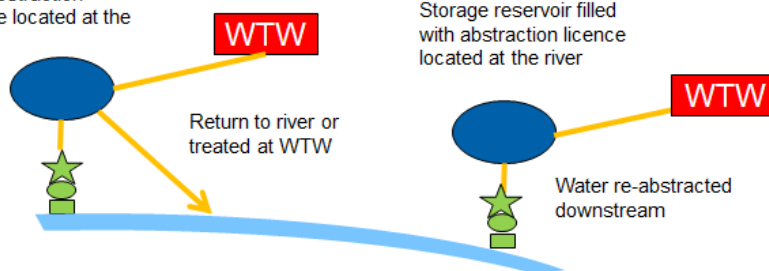
The abstraction pump is located down stream from the intake at the river.



Water Resources – raw water abstraction licence
Water Resources – raw water abstraction
Raw water distribution – raw water transport
Raw water distribution – raw water storage
Water treatment

Example 3

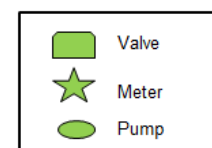
Storage reservoir filled with abstraction licence located at the river



Water is abstracted and either treated released back to the river and re-abstracted at a downstream intake with another abstraction licence.

Return pipe to river assumed to be raw water transport

Water Resources – raw water abstraction licence
Water Resources – raw water abstraction
Raw water distribution – raw water transport
Raw water distribution – raw water storage
Water treatment



Example 4

Water Resources – raw water abstraction licence

Water Resources – raw water abstraction

Raw water distribution – raw water transport

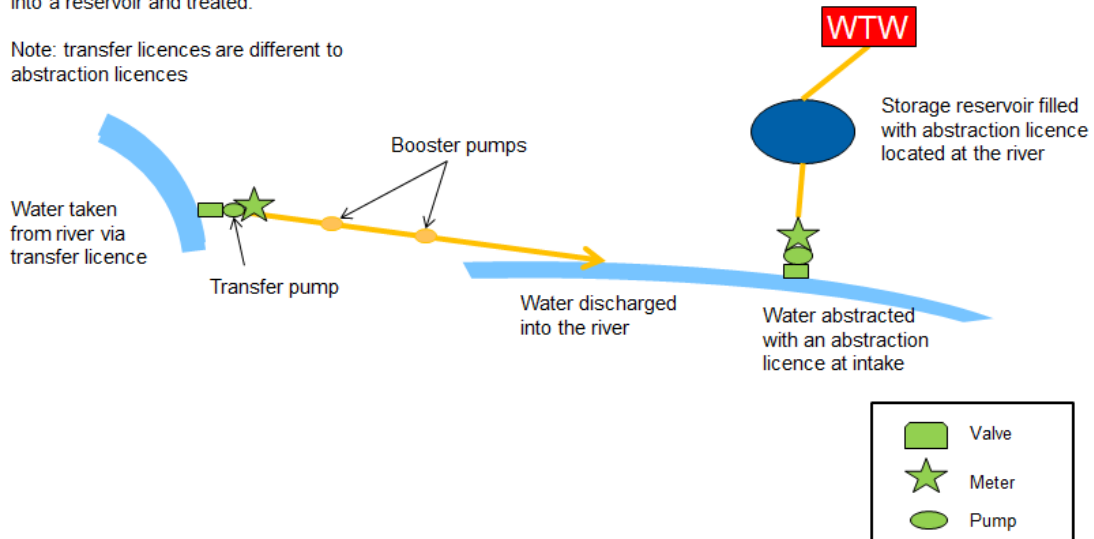
Raw water distribution – raw water storage

Water treatment

Water taken from one river and transferred to another river and discharged.

Then re-abstracted at downstream intake with an abstraction licence, before being transferred into a reservoir and treated.

Note: transfer licences are different to abstraction licences



Example 5

Water Resources – raw water abstraction licence

Water Resources – raw water abstraction

Raw water distribution – raw water transport

Raw water distribution – raw water storage

Water treatment

Abstraction licence point located upstream of impounding reservoir (Gravity feed from abstraction to reservoir).

Water from impounding reservoir is then gravity fed into another reservoir before being treated.

