

Regulatory Reporting consultation response
Ofwat
21 Bloomsbury Street
London WC1B 3HF

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Direct line: 01225 526351
Email:
phil.wickens@wessexwater.co.uk

Dear Colleagues

Further consultation on regulatory reporting for the 2016-17 reporting year

Thank you for giving us an opportunity to provide comment on your further consultation on regulatory reporting for the 2016-17 reporting year.

The changes you have made provide more clarity while the inclusion of diagrams is helpful in understanding the proposed boundary changes. The sludge boundary in our view now reflects operational practice and it should be possible to record transactions for services between Network+ and the sludge business on this basis.

To ensure that transactions can be costed, we have suggested an amendment to one of your diagrams (below) to add in meters on co-located STW/ STCs.

The changes proposed do not take account of the recent information requests made by the Cost Assessment Working Group, which would have allowed companies to submit this data within the 2017 APR. We would encourage you to consider again whether these items can be included in the 2017 APR so that we can both streamline our assurance processes.

We hope you find these comments helpful.

Yours sincerely



Phil Wickens
Director of Regulation and Reform



Questions: further consultation on regulatory reporting for the 2016-17 year

Q1. What are your views on the content and format of the proposed tables in Appendix 1?

We have reviewed the content and format of the proposed tables in Appendix 1 and envisage no problems with them.

Q2. 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?

This proposed change provides the sector with an important signal of your confirmed intention to introduce additional separate price controls for water resources and sludge as well as being a key step in the accounting separation process. While separate revenues will not be required for 2016/17, the change will allow for this to be introduced in future years.

Condition F, paragraph 9, specifies that, as a minimum, sections 1 and 2 of the APR should be subject to full external audit, although we already ask our auditors to review sections 3 and 4. For price control units included in section 2, companies must include an accounting policy note that makes clear the basis of the allocation of operating costs and assets and any major changes in the year and takes account of the accounting methodology statement. The increased scrutiny of a full external audit (resulting from a move to section 2) will require us to decide on our policies and then implement them. For opex activities relating to water resources and sludge activities, activity based costing is to be used to allocate cost consistently. For capex, we will need to identify capex activities relating to water resources and sludge activities, link the capex costs back to the principal use of the related asset and then recharge subsidiary use of the related asset back to any other price controls. This is all likely to be resource intensive.

One of the cost allocation principles outlined in RAG2 is that there should be no cross-subsidy between price controls and that, in accordance with RAG5 transfer prices between price control units should be based on market prices and only on cost where no market exists. Since separate price controls for water resources and sludge will not exist until April 2020, we assume this principle will not apply until that time for water resources and sludge activities. This is consistent with the approach taken for accounting separation of retail activities prior to PR14 where the intention was similar, i.e. that in the lead-up to separate price controls (and market opening) the accounting of costs came under more scrutiny to impose level playing field obligations within the vertically integrated business.

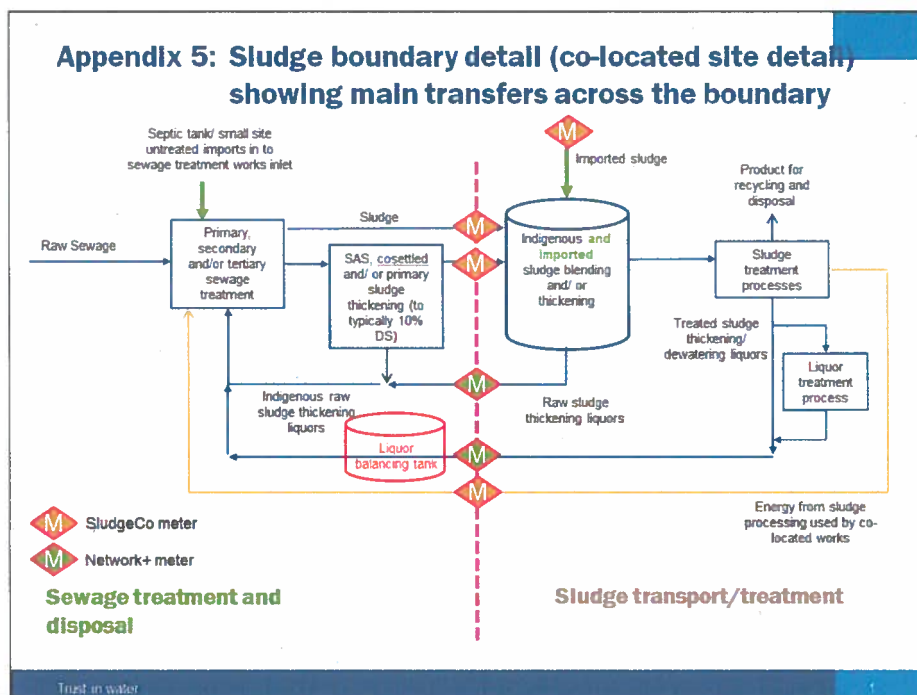
Q3. Do the definitions for the water resources activities in RAG4 provide sufficient detail for you to complete pro forma tables 2A, 2B, 2D, 4D and 4E? (Note that the decision over the location of the boundary is outside the scope of this consultation as set out above.)

A review of the definitions provided in section 2 of RAG4 leads us to believe that we will have sufficient clarity on the proposed boundaries to complete the required tables.

Q4. 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.)

A review of the definitions provided in section 2 of RAG4 leads us to believe that we will have sufficient clarity on the proposed boundaries to complete the required tables.

Since you have not specified who owns which meters in your list of assets for any of the wastewater services, we propose to adopt a rule whereby the meters will be owned by the service provider, since this rule is that normally adopted commercially and will allow the service provider to issue invoices for the services provided. We have adapted the diagram (RAG4, Appendix 5) below to add in a liquor balancing tank and to show where we believe meters are required (and who they should belong to).



In respect of the proposed definition for Network+ Sludge liquor treatment at p46 (RAG4), we recommend that the second sentence of the description is amended so it reads: “Excludes dedicated liquor treatment which is done within a self-contained process at a sludge treatment centre. A liquor treatment process that treats mixed use liquors would be within the Network+ business.”

In RAG2, you note that where a sewage treatment works is treating sludge liquors, the opex and capex costs will need to identify a consistent common method so a formula can be devised. This is not a simple problem (because of different consents) and your suggestion that this is taken forward by the Sludge Working Group is therefore sensible.

Q5. 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.)

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.

We shall provide an answer to this question under separate cover.

