

August 2016

Trust in water

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

[www.ofwat.gov.uk](http://www.ofwat.gov.uk)

**ofwat**

## About this document

This document is a second, short, focused consultation on the regulatory accounting guidelines (RAGs) for the 2016-17 reporting year. It follows and builds upon our first consultation in March '[Consultation on regulatory reporting for the 2016-17 reporting year](#)'. We intend to finalise the regulatory accounting guidelines (RAGs) in October by publishing an information notice.

This document covers three areas.

1. We are proposing changes to reporting to support our regulatory decisions in our '[Water 2020: our regulatory approach for water and wastewater services in England and Wales](#)' (May Water 2020 document), with an increased focus on water resources and bioresources.
2. This consultation also focuses on our findings from the first year of reporting under the new Annual Performance Report (APR) format, as well as earlier consultation responses and further feedback from companies.
3. More generally, we provide an update on our future plans for developing reporting for 2017-18 onwards.

## Contents

Responding to this consultation	3
Consultation questions	4
Executive summary	5
1. Introduction	9
2. Responses to the March 2016 consultation	11
3. Changes to the RAGs as a result of the responses	13
4. Proposals for water resources and bioresources	16
5. Proposed changes to RAGs 1-4	20
6. Potential changes for 2017-18	23
7. Next steps	26
Appendix 1 Proposed regulatory accounting guidelines	27
Appendix 2 Technical changes proposed by respondents	28

## Responding to this consultation

We would welcome any comments on this document. Please email them to [regulatory.accounts@ofwat.gsi.gov.uk](mailto:regulatory.accounts@ofwat.gsi.gov.uk) or post them to:

Regulatory reporting consultation response  
Ofwat, Centre City Tower  
7 Hill Street  
Birmingham  
B5 4UA.

The closing date for this consultation is **13 September 2016**. We will publish responses to this consultation on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk), unless you indicate that you would like your response to remain unpublished.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the Data Protection Act 1998 and the Environmental Information Regulations 2004. If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory ‘Code of Practice’ which deals, among other things, with obligations of confidence.

In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

## Consultation questions

The RAGs and tables referred to below are contained in Appendix 1.

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

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?

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).

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).

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.

Q6 In the responses to our March consultation, some companies suggested that to avoid recognising numerous 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 value of that threshold be?

## Executive summary

Our shared vision for the water sector in England and Wales is one where customers, the environment and wider society have trust and confidence in water and wastewater services, reflecting the vital nature of these public services. We want the companies that provide these services to be accountable to their customers for delivering the services they need and want at a price they can afford.

We expect companies to report on their performance directly to customers and other stakeholders (including Ofwat) and engage effectively with their customers to find out what they want to see. Having information that is easy to understand and navigate provides transparency and helps everyone build trust and confidence in the sector. Information forms the basis for conversations so that water companies can listen to their customers and other stakeholders and deliver the outcomes they, the environment and wider society want.

We want companies to explain their performance and their leading indicators of risk. Companies should decide how they report on their performance each year. But we also expect companies to publish some common content in an annual performance report – this is important as it allows customers and stakeholders to compare the performance of individual companies to the rest of the sector, and sets out a minimum we would expect companies to report on.

This regulatory reporting consultation covers three main areas.

1. Changes to support our policy development ahead of our next price review in 2019 (PR19) and in particular our [May Water 2020 document](#).
2. Changes resulting from our findings from 2015-16 reporting, from our earlier March 2016 consultation on the RAGs ([‘Consultation on regulatory reporting for the 2016-17 reporting year’](#)) and from other feedback gathered during the year.
3. Communication about our future wider development plans around regulatory financial reporting.

## Supporting our decisions on our regulatory approach in Water 2020

The regulatory financial reporting supports the decisions we have made in our May Water 2020 document.

In March, we consulted on the RAGs for the reporting year 2016-17. In that document, we said specifically that we would hold back any changes relating to our

Water 2020 policy development, until we had further clarity after publication of the May document. We are therefore setting out our proposals now in this consultation.

In the Water 2020 [December consultation](#), we proposed separate binding price controls for both water resources and bioresources, and we confirmed this decision in our [May Water 2020 document](#). Separate price controls for water resources and bioresources are a targeted and proportionate response to limitations of the existing wholesale price control framework for both water resource and bioresources market development. We explain this in more detail at chapter 4.

In support of our decision to have separate controls for water resources and bioresources, we have raised the status of reporting for these areas, elevating them from section 4 (which covers additional regulatory reporting under development) to section 2 (price control segmental reporting) of the APR. This is an important distinction as, although it may not significantly change the scope of information currently reported, it increases the emphasis on this information and reflects the move to separate controls. We believe that this will bring increased focus to cost reporting in these areas, leading to the development of more robust data and should result in the data receiving more focus under companies' individual assurance frameworks. This mirrors our approach in the run-up to our price review in 2014 (PR14), regarding separate retail controls. We will not be requiring separate revenues to be reported.

In addition, even in the absence of separate price controls, we would still need this data for cost assessment and comparative benchmarking purposes, as we prepare for setting price limits in 2019.

Our May Water 2020 document also discussed the main elements of the boundaries for water resources and bioresources. We will continue to consult on this through our water resources and bioresources working groups until we confirm the methodology we will use for the next price review. For 2016-17, we have reflected our current position in proposing revised definitions for the boundaries in RAG4.

Finally, we carried out a targeted review of Water and Sewerage companies (WaSCs) in January and February and Water only companies (WoCs) in May. These have led to us proposing improvements and further guidance regarding reporting, particularly around water resources and bioresources.

We therefore summarise our changes as follows:

- Moving water resources and bioresources reporting from section 4 to section 2 of the APR, reflecting the move to separate controls and an increased focus on these areas.
- Refining our reporting definitions of the boundaries for water resources and bioresources in RAG4.
- Improvements flowing from our WaSC and WoC targeted review during 2016.

## **Further changes resulting from our findings over the past year**

We note that this is the first year that companies have published an Annual Performance Report (APR). This was a new format and approach to reporting and both we and the companies are learning from the issues arising as companies have started to implement it. We have therefore proposed changes resulting from these. We are currently reviewing the APRs that were published in July and may introduce further improvements to future reporting requirements as a result of these (from 2017-18 onwards).

We have listened to observations made, primarily by companies, on the practical issues associated with the requirements as they worked through the 2015-16 reporting process. We have clarified definitions where needed and made some changes to tables and the links between them where necessary. Our approach has been that of incremental changes rather than any significant shifts in the overall level of reporting.

We have reviewed the responses to our March RAGs consultation (summarised at chapter 2) and have proposed changes as a result of these responses, which we set out at chapter 3.

Finally, we have picked up other changes and improvements, including minor clarifications and improvements, through our ongoing dialogue with companies during the year and we have included those proposals in the relevant sections throughout this consultation.

## **Our future plans**

This consultation will run for 4 weeks closing on 13 September 2016. We plan to publish the finalised RAGs in October 2016.

Chapters 6 and 7 discuss potential future changes for 2017-18 covering the following.

- Data for cost assessment,
- Cost of new connections.
- Information to support the retail market for Business, Charities and Public Sector Organisations in England.

Finally, the 2016-17 RAGs being consulted on here, in particular the definitions of water resources and bioresources, will form an important link to the licence modification process which will start this autumn. In terms of licence modifications to implement separate binding price controls for water resources and bioresources, we set out our approach in the May document (see chapter 5, page 158 and chapter 4, page 110 respectively). We expect to continue working with companies, in the future, to fine tune definitions as required (including after licence modification if necessary).

Timeline	
17 August	Launch RAG consultation
13 September	RAG consultation closes
October	Publish: <ul style="list-style-type: none"> <li>• Information notice;</li> <li>• summary of changes made to proposed RAGs; and</li> <li>• finalised RAGs</li> </ul>

## 1. Introduction

In our document [Consultation on regulatory reporting](#) (September 2014) we stated that the Annual Performance Report would have to be flexible so that we could make updates as required. Updates would be driven by changes in policy objectives driven by Ofwat's wider strategy or from feedback from interested stakeholders.

Since that consultation we also published in July 2015 our [Consultation on financial monitoring framework](#) which set out how we will monitor the financial stability of the sector. The purpose of this is to enhance visibility and transparency of company financing to ensure stakeholders can maintain trust and confidence in the sector.

In December 2015, we engaged Cambridge Economic Policy Associates (CEPA) to lead a targeted review focusing on bioresources and water resources cost reporting. The scope of this review covered only the WaSCs because they are involved in both of the activities that CEPA have studied. We met the WoCs in April-June 2016 as they face similar issues in respect of water resources.

CEPA identified issues in the WaSC review and these drove the proposed changes to the RAGs as consulted on in March 2016 in '[consultation on regulatory reporting for the 2016-17 reporting year](#)'.

We have continued to engage through our Regulatory Accounts Working Group (RAWG). Dialogue with members of this group since the last consultation has ensured that comments and suggestions from that group have been taken into account in this consultation.

In May 2016, we published '[Water 2020: our regulatory approach for water and wastewater services in England and Wales](#)'. We propose changes to reporting to support our policy decisions in this document. In particular, following the decision to put separate binding controls in place for water resources and bioresources from April 2020, we have elevated the importance of reporting in these areas by moving them from section 4 to section 2 of the Annual Performance Report (APR).

This is an important distinction as, although it may not significantly change the scope of information currently reported, it increases the emphasis on this information and reflects the move to separate controls. This is because Section 4 contains additional regulatory reporting still being developed, whereas a move to Section 2 aligns the activities with the current price control segmental reporting structure. We believe that this will bring increased focus to cost reporting in these areas, leading to the development of more robust data and may result in this data receiving more focus under companies' individual assurance frameworks. This mirrors our approach in the

run-up to our price review in 2014 (PR14), regarding separate retail controls. We have not gone as far as requiring separate revenues to be reported for 2016-17 but we will keep this under review for future years.

In addition, even in the absence of separate price controls, we would still need this data for cost assessment and comparative benchmarking purposes, as we prepare for setting price limits in 2019.

Our May Water 2020 document also discussed the main elements of the boundaries for water resources and bioresources. We will continue to consult on this through our water resources and bioresources working groups until we confirm the methodology we will use for the next price review. While the boundary definitions may continue to evolve, for the purposes of 2016-17 reporting, we have reflected our current policy position in proposing revised definitions for the boundaries in RAG4.

This consultation will run for 4 weeks from 17 August to 13 September 2016. This is a shorter period than we would normally consult on. However, the wider engagement since our last consultation (via the regulatory accounting working group (RAWG) and the water resources and bioresources working groups) means that the background to any of the changes to the RAGs has been communicated well in advance.

## 2. Responses to the March 2016 consultation

We asked 10 specific questions and responses were received from 17 companies (including one NAV) and CCWater.

Question	Response
Q1 What are your views on the content and format of the proposed tables in Appendix 1?	54 technical points were made in respect of the tables, these are discussed further in chapter 3.
Q2 Do you have any views on the revised guidance in RAG1 which is intended to assist completion of pro forma table 4G?	12 responses. Three companies stated that the guidance was still ambiguous with the remainder agreeing with the proposed guidance.
<p>Q3 RAG2 consists of a mixture of high level principles and detailed guidance for cost reporting;</p> <p>Q3a Is the balance of principles and rules appropriate?</p> <p>Q3b Are there areas where more principles should be provided?</p> <p>Q3c Are there areas where more guidance should be provided?</p>	<p>16 responses. 15 were in agreement with many suggestions for further guidance.</p> <p>One company suggested that companies should be allowed to deviate from the guidance.</p>
Q4 RAG2 suggests that a common method for calculating returned sludge liquors should be implemented. Do you have any observations on the approach suggested and any suggestions for a common formula?	10 responses. One company thought that the RAGs should not dictate what the structure of the recharge should be and that companies should use their trade effluent charges as a basis for the recharge. Most of the nine other responses agreed more work should be done on this, particularly using the Sludge working group.
Q5 In RAG2 we have set out how energy costs and savings from sludge processes should be treated – do you have any views on this approach?	10 responses. All were in favour of the proposed approach, but there were requests for clarification on the basis of the price that Network+ should pay sludge for power, for example at the average cost of externally purchased electricity. One suggested a charge be made by Network+ for the sludge which is passed to the sludge treatment centre.
Q6 In RAG2 we have set out how imported potable bulk supplies should be treated – do you have any views on this approach?	13 responses. All except two were in favour of the proposed approach, but there were requests for the text to be clarified.
Q7 In RAG3 we have clarified our expectations for reporting transactions with associates and the non-appointed business. Do you have any comments on these?	10 responses. All agreed with a minority requesting some minor clarification.
Q8 Our intention is to include the metrics for the Financial monitoring framework and site data for the Abstraction Incentive Mechanism (AIM) in the Annual Performance Report. Do you agree with this approach?	14 responses. All except two were in favour of the proposed approach. One dissenting view was that the financial ratios were not consistent with those used by the ratings agencies but there were requests for the text to be clarified.

<p>Q9 Should the Annual Performance Report contain more transparency over metering assets and installation and maintenance costs from 2017?</p>	<p>16 responses. Six respondents disagreed saying that the annual performance report was not the appropriate means of collecting the data. Most of the responses in agreement stated that detailed proposals would be needed to ensure consistent information was being reported by all companies.</p>
<p>Q10 Ofwat is working with the sector to develop new charging rules covering activities such as connection charges, infrastructure charges and other contributions from third parties. Should the Annual Performance Report contain more detailed cost information on new connections and other costs associated with these charges?</p>	<p>16 responses. Seven respondents disagreed saying that the annual performance report was not the appropriate means of collecting the data and that as the work on charging rules was still ongoing it would not be appropriate at this stage to include such data in the annual performance report. Those in agreement raised concerns about the cost of producing and assuring such information as well as the level of detail, for example, the costs of 'new developments' at the water and wastewater level would be acceptable, but further disaggregation would not.</p>

## **3. Changes to the RAGs as a result of the responses**

### **3.1 Technical points**

There were 54 technical points made in the responses. These have been detailed in appendix 2.

We have not made any changes in respect of 30 of those points. Some of the observations were made in respect of the excel data collection tables (typically calculation rules) which are not part of this consultation (although any changes in the RAGs will be reflected in a later release of the tables for 2016-17). Some were comments that simply agreed with changes that had been made. We had also made changes before the consultation responses had arrived, where companies had raised queries as part of the 2015-16 reporting process.

There were some comments that suggested more explanation could be provided. Companies that wish to add more explanation to a table could do so using the commentary. Additionally the methodology statement can be used to explain the basis of any reported figure.

Where the observations were on topics covered by the specific questions then these are addressed in the remainder of this chapter.

Where we have made changes as a result of these observations then these can be found in chapter 5 of this document.

### **3.2 Current cost accounting information**

Some of the responses to this consultation echoed the views made at the last regulatory accounts working group meeting, that the guidance was somewhat confusing, despite the desire to make this table less burdensome. We have taken on board the suggestion to provide a worked example as an appendix to RAG1 and amended some of the relevant text in RAG1.

### **3.3 Guidance for cost reporting**

The majority of responses felt that the balance between guidance and prescription was acceptable. However in specific areas, where there has been support from respondents, we have included more prescription in RAG2. For example, we have

improved our previous guidance on the allocation of local authority and cumulo rates, to make it more comprehensive and to enable consistency across the sector. This resulted from our recent WoC visits, where we learnt more about the particular circumstances of some companies and the way that they are billed for rates in their area.

### **3.4 Sludge liquors returning to treatment works**

Most respondents supported a common methodology for calculating the strength of sludge liquors being returned to the sewage treatment works. We have not made any changes to the guidance in this version of the RAGs but we will continue to engage with the sludge working group in order to develop proposals that can be used consistently across the industry.

### **3.5 Accounting for energy related income**

All of the responses supported the position that where bioresources (or sludge) assets are used for energy generation then all of the cost savings and all of the negative operating expenditure (opex) from external sales should be recorded as part of sludge treatment. Costs of generation should similarly be included in sludge treatment. There have been requests for clarification of the price that should be paid by the remainder of the wholesale wastewater network (Wastewater Network+) for the electricity that is generated on the co-located sites. There has also been a suggestion for a charge by Wastewater Network+ for the sludge being passed to the sludge price control unit. We will expect that all transfers between price control units do not create a cross subsidy in accordance with the transfer pricing rules (set out in RAG2 and RAG5). Whilst there is a market for electricity (and hence sufficient information to ensure there is no cross subsidy) the 'value' of sludge is less clear. However we expect that as companies implement the rules prescribed in the proposed RAGs then this will reveal the value and costs involved with treating sludge.

In terms of future work, we think that there is scope for developing the approach further and this is supported by some of the respondents. We will look to work with companies to do this. We might consider more detailed information for energy savings from the use of self-generated energy within the bioresources price control unit. As reporting in this area develops, we may issue more guidance to improve consistency. Some respondents supported this.

### **3.6 Imported potable bulk supplies**

Most companies were in favour of the inclusion of guidance which means that the import cost is split between water resources and water treatment.

### **3.7 Reporting transactions with associates and the non-appointed business**

All responses agreed with our slightly revised guidance and we have clarified one paragraph as requested by a respondent. These changes will ensure that the disclosure provides useful information to stakeholders as the price controls become more disaggregated and transparency over such transactions becomes of greater interests to new participants in the market.

### **3.8 Financial monitoring framework**

The majority of respondents felt that it was acceptable to include the financial monitoring framework (FMF) metrics in the annual performance report. Two companies asked for some technical clarifications on some of the definitions for the FMF tables 4H and 4I.

We do not propose any further changes to the definitions for this release but will continue to work with companies to refine the guidance where necessary.

### **3.9 Site data for the Abstraction Incentive Mechanism**

All except one respondent agreed with the proposal to include the AIM site data in the annual performance report. This has been included in the suite of tables in RAG3.

## 4. Proposals for water resources and bioresources

### 4.1 Overview

In the Water 2020 [December consultation](#), we proposed separate binding price controls for both water resources and bioresources, and we confirmed this decision in our May Water 2020 [document](#). Separate price controls for water resources and bioresources are a targeted and proportionate response to limitations of the existing wholesale price control framework for both water resource and bioresources market development. They allow the regulatory framework to be adapted to realise the greater opportunities from markets in these parts of the value chain, while maintaining the existing framework for the other parts of the wholesale price control where there is less scope for markets at present. The realisation of benefits from markets is an important part of the case for separate price controls, but not the only element. Separate price controls are also likely to help in developing better targeted regulatory incentives, and in increasing the focus on the water resource and bioresources parts of the value chain.

To support the implementation of separate price controls for water resources and bioresources we need good quality accounting information. For several years now, companies have been reporting cost information for the wholesale business at a more disaggregated level. These have included specific areas including water resources, sludge transport, sludge treatment and sludge disposal. We expect that the separation of price controls will increase the accuracy and consistency of cost reporting for different wholesale activities because the regulatory reporting and cost allocations will become more important. Reflecting this, companies will have stronger incentives to understand and disaggregate their costs and should improve the overall quality of information on costs they report for regulatory purposes. Experience with separate retail price controls suggests that, despite several years' experience with accounting separation, it was not until separate price controls were introduced that costs were disaggregated between retail and wholesale activities on a consistent basis between companies. The quality of information on incumbents' water resource and bioresources costs will improve as this information plays a more important role in the price control framework.

Since the May document there has been ongoing consultation, both through formal responses from stakeholders and from collaborative working with companies and others in the working groups.

These RAGs reflect our current thinking on the boundaries for water resources and bioresources – we have modified the May Water 2020 decision document position.

The changes are discussed in more detail below. These changes are in line with the direction of travel for Water 2020 and will mean that we will be in a stronger position to prepare for the 2017-18 version of the RAGs.

Our decision on separate price controls will be further developed when we publish the PR19 Methodology consultation in July 2017. Likewise, we may further develop our policy around the boundary points in the Methodology consultation. This means that this consultation is not a final statement of policy for price setting. Similarly it is not prejudging any changes that may come about as part of the licencing discussions this autumn.

However, we need data for 2016-17 to assist in the design and setting of price limits in 2019. And even if we do not have separate price controls, then we will still need robust and separated accounting data for these activities for cost assessment purposes and comparative benchmarking. It will enable us to more fully reflect these important parts of the value chain as we set price limits in the future. Therefore at this early stage we are merely clarifying our accounting definition (as opposed to setting policy). Indeed the requirements could change for 2017-18.

Our approach is not without precedent. In the run-up to PR14, as part of the accounting separation workstream, we collected data on retail costs in advance of the separate retail price control becoming effective. This data was collected outside of the regulatory accounts initially. However, we feel it is sensible to use the annual performance report as the central tool for collecting financial data. Therefore, in preparation for the new separate price controls to be introduced in PR19, we propose to include this data in the submission, rather than have a separate data collection exercise. We will continue to work with companies to ensure that our requirements are clear and that they minimise any additional reporting burden.

This data needs to be robust and assured appropriately as it will be one of the information sources that will support setting the level of the separate price controls at PR19. This is the reasoning behind exposing this information in section 2. We will not, however, require revenues to be calculated for water resources and sludge for 2016-17 reporting but we will keep this under review for future years.

## **4.2 Water resources**

In the May Water 2020 [document](#) we set out in section 5.6.3 the following.

**“We still intend to use the regulatory accounting guidelines as the basis for setting the boundary. The further work on accounting separation boundaries will take into account the practicalities of the different types of water resources and the need to avoid any undue regulatory burden. ... We look forward to working with stakeholders on the detailed definition of the boundary derived from accounting separation for the purposes of the separate water resources price control.”**

Since May we have had significant engagement on the boundary with companies. With the WoCs we have followed up our targeted review of WaSCs in January and February this year, with visits in May, where amongst other things, the boundary for water resources was discussed. This has also been followed up with a presentation on our thinking at the first meeting of the Ofwat water resources working group in which we asked companies to send us issues for discussion. This was followed by informal discussions with companies, an update call and an update provided at the second water resources working group. Our drafting of the boundary definitions in this consultation reflects the current position following these discussions, for the purposes of the 2016-17 regulatory reporting.

### **4.3 Bioresources**

In Appendix 2 to our Water 2020 May document called “[Moving beyond waste](#)” we set out some broad proposals for the boundary definition for bioresources for the PR19 price review, in particular proposing that “passive sludge thickening” would be a network plus activity. More active thickening with mechanical or chemical assistance was proposed to be a bioresources activity. We asked for views on the proposed boundary definition and received responses from all the WaSCs. Half of the companies reasoned that a split between active and passive thickening was difficult to implement and potentially means that many sites with active thickening would then be split sites for cost allocation and activity purposes, although the thickening activity is not easily contestable.

We have considered these approaches and are now proposing, through this consultation on the 2016-17 RAGs, to amend the definition from that proposed in the Water 2020 May document. The new definition means that all thickening of untreated sludge to typically less than 10% dry solids will be a network plus activity, but any dewatering to greater than 10% dry solids of untreated sludge, to optimise transport activities, will be defined as a bioresources activity.

In the May document at [Appendix 2](#) we stated the following.

**“The boundary between wastewater and sludge assets and activities may change as markets develop and we may need flexibility to modify that definition as markets develop.”**

However, we plan to confirm the boundary for 2019 price setting purposes through the price review methodology paper in 2017. Our aim is to gain as many years of data with as few changes to the boundary definitions as possible between now and setting prices in 2019.

## 5. Proposed changes to RAGs 1-4

### 5.1 Background

This chapter summarises the changes made to RAGs 1-4 since the March consultation. Some of the changes are as a result of queries from the companies as they produced the 2015-16 annual performance report. Others have been as a result of resolving technical observations made by companies in respect of question 1 and requests for clarification in response to the specific issues we raised in questions 2 to 7.

### 5.2 Proposed changes to text

RAG	Description	Paragraph affected
RAG1	Grants and contributions	1.8.1
RAG1	Clarification for current cost table 2G	2.1.7
RAG2	Allocation of local authority and cumulo rates	Table 2.4.1 2.10
RAG2	Tankered waste	2.8
RAG2	Borehole operating costs	2.11
RAG3	Grants and contributions	1.2.2
RAG3	Transactions with associates – Corporation tax group relief	6.2.1
RAG3	Methodology statement requirement	2.2.5 3.5.1 Appendix 3
RAG3	Long term viability statement requirement	3.1.1 3.13
RAG4	Expanded list of appointed energy generation	Appendix 1

### 5.3 Proposed changes to tables (RAG3) and definitions (RAG4)

	Table changes	Line definition changes
--	---------------	-------------------------

1A		Line 5 now clarifies the treatment of grants and contributions which are recorded in the income statement in statutory accounts.
1C		<ul style="list-style-type: none"> <li>Line 1 renewals accounting reference deleted.</li> <li>Lines 13 and 21 'accrued interest' added in.</li> </ul>
2A	<p>'Operating costs' now broken into 3 distinct lines;</p> <ul style="list-style-type: none"> <li>Operating expenditure</li> <li>Depreciation - tangible fixed assets</li> <li>Depreciation - intangible fixed assets</li> </ul>	Line 11 clarification of surface water drainage rebates.
2B	Grants and contributions – previously this related to 'price control' grants and contributions only but has now been expanded to cover all grants and contributions.	<ul style="list-style-type: none"> <li>Line 1 Treatment of power cost savings clarified.</li> <li>Line 2 Power sales clarified as being external to the appointed business.</li> <li>Line 17 is no longer restricted to 'price control' grants and contributions.</li> </ul>
2C	<p>'Depreciation' now broken into 2 distinct lines;</p> <ul style="list-style-type: none"> <li>Depreciation - tangible fixed assets</li> <li>Depreciation - intangible fixed assets</li> </ul>	Line 4 Clarifies meter reading commission treatment.
2D	<ul style="list-style-type: none"> <li>Title change</li> <li>Line 4 added for adopted assets included</li> <li>Lines 12,13,14 missing columns added in</li> </ul>	<ul style="list-style-type: none"> <li>Line 4 added for adopted assets included</li> <li>Lines 12,13,14 missing definitions added in</li> </ul>
2E	<ul style="list-style-type: none"> <li>Title change</li> <li>Prior year requirement removed</li> <li>Headings changed for clarification</li> <li>Lines 7 and 13 added for value of adopted assets (water and wastewater)</li> </ul>	New definitions added for lines 7 and 13 - value of adopted assets (water and wastewater)
2G 2H	<ul style="list-style-type: none"> <li>New title – distinction between customers and tariff types</li> <li>New line added for customer numbers as the detailed tariff information now applies to number of <u>connections</u>. This distinction is needed since a single customer could be supplied with services under more than one tariff e.g. sewage and surface water drainage or multiple sites</li> </ul>	<ul style="list-style-type: none"> <li>'Connections' has replaced 'customers'.</li> <li>Definition of customer numbers has been clarified.</li> <li>Units and decimal places clarified</li> </ul>
2I	2 lines added to allow for recognition of in-period ODI revenue adjustments	Line 14 – new line added to give a water and wastewater split.

4A	Rows 1-3 deleted as duplicated in table 2F	Row 5 definition clarified re tankered waste.
4B	Rows changed and aligned with reconciliation rule book spreadsheet format	<ul style="list-style-type: none"> <li>• Reflects line changes</li> <li>• Cross refers to rule book model</li> <li>• Allowed totex definition corrected</li> </ul>
4C	<ul style="list-style-type: none"> <li>• Title changed for clarity</li> <li>• Column added so that water / wastewater are separate</li> <li>• Row titles expanded for clarity</li> </ul>	<ul style="list-style-type: none"> <li>• Reflects line changes</li> <li>• Cross refers to rule book model</li> <li>• Cumulative approach made clear</li> </ul>
4D 4E	Headings amended for clarification	<ul style="list-style-type: none"> <li>• Line 1 Treatment of power cost savings clarified.</li> <li>• Definitions now split into 2 separate tables.</li> <li>• Lines 8 and 15 cross reference to appendix 1</li> <li>• Line 2 Power sales clarified as being external to the appointed business.</li> </ul>

## 5.4 Grants and contributions

Some companies have questioned the definition of grants and contributions which we used for the purposes of calculating 'net totex'. They argued that whilst there was a distinct sub-set of grants that were considered part of the revenue control, the same was not true of the totex measure. We agree with this approach and so have modified the definition in table 2B so that all grants and contributions are taken into account for totex purposes.

## **6. Potential changes for 2017-18**

### **6.1 Data for cost assessment**

Cost assessment is an extremely important and material component of price reviews. We have said that we will continue to apply benchmarking to assess the efficient level of costs and to help protect the interests of customers.

In 2015 we discussed our initial thoughts on cost assessment data requirements with the RAWG. Since then we have established a cost assessment data working group.

This summer we collected historic data for 2015-16 outside of the Annual Performance Report process. This data is still at the experimental stage and is likely to change significantly over the coming year. We have requested 2016-17 data as a less formal 'off-line' data request.

Feedback from the group suggests that there is broad support for inclusion of future cost assessment data in the Annual Performance Report. Therefore we propose to collect 2017-18 data in Section 4 of the Annual Performance Report. We will continue dialogue with the cost assessment data working group and RAWG in 2016 to refine our proposals.

### **6.2 Cost of new connections**

Ofwat is working with the sector on developing new charging rules covering a range of activities undertaken by regulated water companies. They include rules covering charges for connections, infrastructure charges and associated contributions from developers and other customers.

We included changes in the Annual Performance Report for 2015-16 which gave greater transparency over the income generated in this area. This is key to understanding the actual receipts compared with that assumed in the PR14 final determination. In particular it allows interested parties to reconcile the statutory treatment to the cash receipts.

Following the receipt of the Annual Performance Reports for 2015-16, we are now proposing an additional change to separate out newly adopted assets in the Grants and Contributions table, as these are a non-cash transaction which could distort the objective of comparing actual receipts and payments.

A formal consultation on new connections charging rules was published on 27 July 2016. [‘New connections charging – consultation’](#)

Following on from this consultation and to support our proposed policy in this area, our aim is to develop a targeted and appropriate set of information requirements, covering both costs as well as revenues, in relation to developer services for the 2017-18 reporting year. We consider that this will improve transparency of charging in this area and enable stakeholders to understand and monitor the balance of costs and revenues particularly for the new redefined requisition charge and infrastructure charging regimes.

We will therefore consider these issues in more detail and propose to work collaboratively with the industry perhaps through the task and finish groups, Water UK or a separate new accounting pilot group.

We plan to include these proposals in our planned consultation on the RAGs for 2017-18.

### **6.3 Information to support the retail market for business, charities and public sector organisations in England**

From 3 April 2017, all business, charities and public sector organisation (referred to here as ‘business’) customers in England will be able to switch their retail supplier. Open Water is a programme of work that brings together all of the key organisations to design and deliver the new market by April 2017. Part of the enabling market architecture is a draft Code that governs interactions in the market between wholesalers and retailers, including those in relation to metering arrangements. This draft Wholesale-Retail Code (WRC) can be found on the [Open Water website](#). Following the opening of the non-household retail market in Scotland in 2008, the Water Industry Commission of Scotland (WICS) initiated some changes to the Scottish market framework and codes to support greater innovation and efficiency in the provision of metering and other services; by allowing certain accredited third parties to provide these wholesale services on behalf of Scottish Water. Information on these changes can be found on WICS’ [website](#).

The Business Terms (part 2) of the WRC for the business retail market in England set out the proposed framework for governing these interactions between wholesalers and retailers and the detailed ‘Code Subsidiary Documents’ (CSDs) provide more detailed process steps. The Operational Terms (part 3) of the WRC allow an ‘accredited entity’ to provide certain wholesale activities on behalf of the

appointee, including for example new connections, trade effluent sampling and analytical services and metering activities. Various processes further define how the new arrangements could work. Schedule 1A and B of the Business Terms in the WRC also includes some information about how these arrangements could operate. The arrangements in the codes largely mirror the revised arrangements in the Scottish market.

In our March consultation, we asked whether companies should provide more transparency over metering assets and installation and maintenance costs. We had a mixed response. Companies who disagreed stated they were not persuaded of the benefits or the proportionality of introducing extra reporting and if it were to be introduced then Ofwat should issue specific guidance.

We will not require further granularity around the reporting of metering costs for 2016-17, as the benefits are not yet sufficiently clear. We are open to considering this again as the market develops after the launch in 2017, should stakeholders make a case for it.

## 7. Next steps

We are seeking comments on the proposals in this document by **13 September 2016**.

After the conclusion of this consultation we will consider the responses and in September we plan to publish a technical information notice along with a finalised version of the RAGs.

Timeline	
17 August	Launch RAG consultation
13 September	RAG consultation closes
October	Publish: <ul style="list-style-type: none"><li>• Information notice;</li><li>• summary of changes made to proposed RAGs; and</li><li>• finalised RAGs</li></ul>

## **Appendix 1 Proposed regulatory accounting guidelines**

The links below are for the proposed RAGs.

[RAG 1.07 Principles and guidelines for regulatory reporting under the 'new UK GAAP' regime](#)

[RAG 2.06 Guideline for classification of costs across the price controls](#)

[RAG 3.09 Guideline for the format and disclosures for the annual performance report \(excludes tables – see link to excel document below\)](#)

[RAG 4.06 Guideline for the table definitions in the annual performance report](#)

[Pro forma tables \(Excel format\)](#)

## Appendix 2 Technical changes proposed by respondents

Proposal	Table	Description	Change required in RAGs?
1	2D	Intangible fixed assets should be included	Y
2	2E	We treat G&C as deferred income and subsequently release the income to the P&L over the life of the associated assets. There is currently no column in the table to reflect this treatment.	Y
3	4B	Needs to reflect reconciliation rulebook.	Y
4	4B	Needs to reflect programme deferrals	N <sup>1</sup>
5	1A-1D	It is more logical for column I to equal the sum of columns G and H.	N <sup>2</sup>
6	4H	<p>On 16 June we highlighted to Ofwat an anomaly in the way Funds from Operations (FFO) is calculated (line 12). The formula in the cell (F20) makes no adjustment for interest received on group loans to holding companies, and as a consequence our FFO is overstated by the intragroup interest received, this also affects the calculated cells in lines 15, 17 and 18.</p> <p>We note that in other cells (such as dividend yield in row 6) an adjustment is correctly made for the internal dividend to a holding company solely to enable that company to pay interest on an intragroup loan from the appointee, so it would be consistent to adjust the intragroup interest where appropriate.</p> <p>We recommend that the formula is removed from the FFO cell to allow companies to adjust for interest received on intragroup loans where appropriate. Cells in lines 15, 17 and 18 would then pick up the correct FFO figure so would retain their current formulae.</p>	N <sup>3</sup>
7	RAG2 2.8	<p>Allocation of operating costs and capital costs for imported tankered waste;</p> <p>For clarity, we suggest the following re-wording of the second paragraph: "Where this is the case then the non-</p>	Y

		appointed business should be recharged for costs of both the sewage treatment and sludge treatment activities.”	
8	RAG4 App1	<p>Definitions of non-appointed activities- car parks</p> <p>We are not convinced about the treatment of car parks as a non-appointed activity. There is a presumption in the Water Industry Act that appointees will make their land accessible for informal recreation, where appropriate. We view that activities carried out by appointees to enable this should therefore be regarded as appointed activities. Car parks at our reservoirs are used primarily by individuals using the reservoirs for informal recreation and are essential to enable safe access to visitors. We therefore view the provision of car parking, and the costs associated with that provision, as appointed.</p>	Y
9	2A	<p>Surface water drainage rebates: requires the rebates paid or credited to customers’ accounts in the year to be separately identified. The current guidance in RAG 4.06 leaves ambiguity about which rebates are to be included or excluded. We propose that this definition is expanded to “total value of surface water drainage rebates paid or credited to customers’ accounts in the year where the customer has challenged the proportion of their site that is connected for surface water”. Therefore any uncertainty surrounding rebates that may be due to properties made void for example would be excluded.</p>	Y
10	2A 2B	<p>Water sludges. The presumption is that the full value of the two sides of the transaction, i.e. the costs to the water price control and the recharge from the wastewater price control, would represent opex and negative opex in tables 2A and 2B. We would support clarification of this through a clear statement in RAG2.06.</p>	Y
11	2B	<p>Wholesale IRE is included in line 5 “other operating expenditure”. We recommend that the IRE should be reported on a separate line.</p>	N <sup>4</sup>
12	2D	<p>We think it would be helpful if two additional rows were inserted;</p> <ul style="list-style-type: none"> <li>The first addition would be to section A to disclose the value of transfers between price control units, so as to separate these from actual additions and disposals.</li> </ul> <p>Transfers between price control units would primarily arise</p>	N <sup>1</sup>

		<p>where assets under construction are allocated across price control units on commissioning, or where Management and General assets are reassigned to a different price control unit as the principal use price control unit changes over time. For example, an IT system used by all price controls may be reported in table 2D in the wastewater price control as it has the largest number of licences (e.g. 41%), however the following year the principal use of this system may change to the water price control as the percentage of licences moves from 40% water to 41% water, and wastewater reduces from 41% to 40%.</p> <ul style="list-style-type: none"> <li>• The second addition would be in section B for impairment losses, so as to separately distinguish these from the depreciation charge in the year.</li> </ul>	
13	2G 2H	<p>Requires column 4 to be populated with the number of customers to calculate the “average non-household retail revenue per customer”. The description leaves ambiguity as to whether the number of customers referred to the number of connections, number of sites, or number of separate customers. For the avoidance of doubt, and to ensure consistency across the industry, we recommend that RAG 4.06 is amended to state “The number of customers reported in column 4 should be consistent with the methodology used in the company’s Price Control”.</p>	Y
14	2I	<p>Currently requires section D “third party revenue – non price control”, broken down between bulk supplies, other third party revenue, and other appointed revenue, to be presented in total. We think it would be useful to users of the table if the revenue included in section D of table 2I was split between water and wastewater.</p>	Y
15	3A	<p>We agree with the content of table 3A, however reporting the £m absolute value of reward or penalty to 6 decimal places is inconsistent with both table 4C RCV (which states the ODI penalty/reward allowance to 3 decimal places) and also the Ofwat ODI calculator (which shows inputs to incentive calculation and the ODI penalty and reward to 4 decimal places.) We recommend that the reporting in table 3A should be to 3 decimal places.</p>	N <sup>2</sup>
16	4A	<p>Table 4A requires the breakdown of the number of households billed in columns 1 and 2, rows 1 to 3. This</p>	Y

		<p>appears to be the same information as required in table 2F in column 4, rows 1 to 6.</p> <p>The guidance for 2F states “the number of customers reported in column 4 should be the average number of customers in the year, calculated at least on a monthly basis”, however, the guidance for 4A is less prescriptive. If the customer numbers reflected in these tables are expected to be the same, we recommend that the guidance for customer numbers in table 4A is the same as for table 2F.</p>	
17	4B	<p>Line 4 of this table “Other adjustments” requires an adjustment for legacy household depreciation. The line definition currently states “other adjustments to the menu for example transition costs or legacy household depreciation”. For the avoidance of doubt, we think it would be useful for the guidance to explain when an adjustment for legacy household depreciation would be required. Our proposal would be to add the following to the line definition “Other adjustments in respect of legacy household depreciation are only required where the wholesale totex includes income from the retail business in respect of legacy household assets”.</p>	Y
18	4D 4E	<p>We suggest that there is further clarity in the descriptions for line 4D/E.4 bulk supply / bulk discharge “Total payments for bulk imports / exports” and for line 4D/E.8 third party services “Operating expenditure for providing third party services E.g. bulk supplies”.</p> <p>The existing descriptions have the potential to generate uncertainty, and therefore inconsistency, over the expenditure to be included in each of these lines. The use of “exports” in the description for 4D/E.4 could suggest bulk supplies being exported or bulk discharges.</p> <p>We recommend that the descriptions be amended to remove this uncertainty. The descriptions that were provided in RAG 4.03 pages 7 - 9 contain a greater level of detail and we would support reflecting this in RAG 4.06.</p>	Y
19	4D 4E	<p>To allow consistent comparison of performance across the sector, the company believes the unit cost table on Tables 4D and 4E should be based on the sum of operating expenditure, infrastructure renewals charge (IRC) and</p>	N <sup>5</sup>

		depreciation rather than operating expenditure alone. One would expect companies to be implementing solutions that result in different levels of operating expenditure relative to capital expenditure, and the utilisation of operating expenditure alone in comparing unit costs may therefore distort comparisons.	
20	4D	Line 27 – Distribution input treated water - The units in the table are m3 and the units in RAG 4.05 are MI	N <sup>2</sup>
21	4H	Net Debt - we assume the swapped GBP amount for the principal amount of foreign currency debt (which therefore include foreign exchange movement) can be used?	N <sup>3</sup>
22	4H	<p>RORE - the current definition appears to allow for a wide range of alternative interpretations. There are two primary differences in interpretation</p> <p>-in respect of assessing real interest cost performance. The current methodology allows for either outturn RPI or the FD RPI value to be used when rebasing interest costs for assessing financing outperformance. To generate a better representation of company performance we recommend that outturn RPI is used</p> <p>-Secondly, the definition allows a company to choose whether to smooth totex performance for annual profiling impacts. We recommend that totex is smoothed.</p>	N <sup>3</sup>
23	4H	Credit rating - the requirement should be to list all solicited long-term ratings for the appointed business along with the outlook / watch status. We would recommend that only solicited ratings are reported as they receive additional non-public information on which to make their assessments and so are likely to be more accurate than unsolicited ratings. We recommend that (as per existing guidance) the ratings reported are those for the appointed business as opposed to ratings applied to debt issuance as debt structuring impacts the rating applied to debt (either up or down) making cross sector comparisons difficult, in particular subordinated debt ratings should not be reported.	N <sup>3</sup>

24	4H	FFO to be calculated in accordance with credit rating agencies' methodology, where an underlying finance expense and current tax are deducted. The calculation in the 2015/16 tables does not deduct either interest or tax, and as a result this causes problems in the calculation of other ratios in the table.	N <sup>3</sup>
25	4H	Interest cover: "Interest cover" interest is added back to FFO, whereas in calculating FFO in line 12 interest was not deducted. In order for this ratio to be more useful, interest should have been deducted in the definition of FFO.	N <sup>3</sup>
26	4H	Adjusted interest cover: The issue with line 13 is also relevant for line 14 "adjusted interest cover (cash)".	N <sup>3</sup>
27	4H	FFO / Debt: Likely to be interpreted by users as mirroring the rating agencies' calculations. Whilst we recognise that Ofwat has stated that its approach will differ to the credit rating agencies, we still consider it would be more appropriate that this ratio is calculated based on Standard & Poor's methodology to ensure consistency in the calculation of this metric.	N <sup>3</sup>
28	4H	Free cash flow (RCF) should be calculated based on FFO defined to be after interest and tax. In addition we would advocate Moody's methodology, in particular by adding back IRE to FFO. IRE was previously reported as part of capital expenditure, but for 2015-16 reporting onwards it is now reported within operating costs; adding IRE back to FFO would improve comparability with previous years.	N <sup>3</sup>
29	4I	<p>We recommend that line 1 "Floating to / from fixed rate" is split into two lines, one for "floating to fixed rate" and the second for "floating from fixed rate". Whilst there may be instances where the principal amount may net to zero, the interest rates do not necessarily net down. Separating this into two lines will be more informative for the user.</p> <p>If line 1 is to remain combined, it would be useful for Ofwat to clarify the signage to be used for pay and receive – we propose that "pay fixed" should be a positive figure and "receive fixed" a negative figure.</p>	N <sup>3</sup>

		<p>The current format of the table does not incorporate interest rate swaps where the rates are locked in but they start at a future date. It would be useful for clarification that forward dated swaps should not be included in table 4I.</p> <p>Where cross currency swaps convert both the debt principal to sterling and also the interest rate from currency to sterling it would be misleading to split up the swaps into sections B and C. We recommend guidance that where swaps convert both debt principal and interest rate that these should not be separated and reported only in section C.</p>	
30	4D	We note the use of population as a comparator for unit costs. However, typically we scale by properties served, rather than customers served.	N <sup>5</sup>
31	RAG2	<p><u>Cumulo Rates</u></p> <p>Ofwat have now specified that the allocation of rates should be using gross MEA values. We would appreciate further guidance as we are unclear if this means <i>all</i> assets or <i>excluding below ground assets</i>. However, subject to this further clarification, we feel that this is probably the best method of allocation.</p>	Y
32	RAG2	<p><u>Borehole pumping of Raw Water</u></p> <p>We agree that pumping head is the best allocation method for electricity pumping costs, as well as direct materials and maintenance &amp; electrical costs. However, direct pumping labour costs should be on a more direct allocation basis, with timesheets where possible. This is particularly important where the borehole and treatment works are in close proximity. We discussed this issue at the recent targeted review.</p>	Y
33	RAG2	<p><u>M&amp;G Assets' allocation</u></p> <p>We noted that the CEPA report highlighted the differences in the approach of companies to the allocation of shared assets within Price Controls, such as Wholesale. We would welcome further guidance on this and whether the principal use methodology is the preferred approach.</p>	N <sup>6</sup>
34	RAG3	<u>Risk and Compliance Statement</u>	N <sup>7</sup>

		We note that the risk and compliance statement has been removed. However, this is not discussed in the document and we would value further clarification/discussion.	
35	1A-1D	We consider that the sign convention for some of the tables in the APR may lead to users of accounts misinterpreting subtotals unless they are presented with the accounts in an excel form. Non appointed adjustments in section 1 have been presented as positive numbers. We propose that these are entered as negative amounts and the total adjustments column be adjusted to the sum of statutory and RAG differences and non-appointed	N <sup>2</sup>
36	2B 4D 4E	Grants & contributions are presented as positive numbers and deducted from calculations to arrive at the totex totals. We propose that these are entered as negative numbers and added to calculations to arrive at the totex total	N <sup>2</sup>
37	4H	Expenditure funded by Wholesale is presented as a positive number, again we propose these to be presented as negative numbers	N <sup>2</sup>
38	2A	Line 1 currently requires manual input. It would be useful if these cells could be linked to Table 2I to avoid the risk of errors	N <sup>2</sup>
39	2G 2H	Line 20 sums the total of customer numbers. However customer numbers may be duplicated in the lines above if they are provided more than one water or wastewater service (e.g. for wastewater, customers can receive sewerage, surface water drainage & trade effluent in some instances), resulting in customer numbers being overstated. We would propose that the subtotal for customer numbers is not automatically calculated but to be input manually.	Y
40	2D	In light of the recent changes to the tables, it would be useful for the title of table 2D to include 'Tangible' and also have a validation check to table 1C line 1.	Y
41	RAG2 2.10	Clarify which class of assets are included in the cumulo rates allocation approach (infra, non infra or both).	N <sup>8</sup>
42	RAG2 2.12	Clarify if power cost savings resulting from energy generation should be netted against power costs or classed as negative opex.	Y

43	RAG2 2.13	Clarify which class of assets are included in the local authority rates allocation approach (infra, non infra or both).	N <sup>8</sup>
44	1C	The cash & cash equivalents definition states that overdraft balances should not be netted off as it should be included separately in 'Trade & other payables'. We believe that overdraft balances should be disclosed in borrowings especially where there is a right of set-off.	N <sup>1</sup>
45	2B 4D 4E	Grants & contributions are disclosed in line 17 of 2B, 4D and 4E. The guidance states that this is equal to the sum of lines 2E.1, 2E.2 & 2E.3 for water and 2E.7 & 2E.8 for wastewater. We consider this to be an error in the definition as all grants and contributions should be included in totex performance.	Y
46	4E	Requires BOD volumes to be disclosed for imported sludge liquor treatment. We consider the volume of ammonia treated to be more appropriate to use in the calculation of unit cost information as BOD is not used in the sludge liquor treatment process.	N <sup>9</sup>
47	2I	Both the WRFIM model and table 2I currently do not allow the adjustment of the allowed or recovered revenues for in-period ODIs. Whilst this does not affect us until 2017/18, we consider that it is useful to raise this so that future releases of the tables and the WRFIM model address the current omission.	Y
48	4B	<p>We have already raised in an email to Rob Lee on 10 May a query on whether the totex reported in line 8 of the 2015-16 version of the table should be allowed totex or baseline totex as the line title in the table suggested 'allowed' but the line definition states 'baseline' and whether excluded costs from the menu should be included or not.</p> <p>We have reviewed the suggested table for 2016-17 forwarded to Mandip Bhangal in an email by Rob Lee on 16 June 2016 and agree that the revised table addresses the definition issues raised in our query above and is now consistent with the intention of the PR14 rule book where actual totex (excluding pensions and exclusions) is compared to allowed totex (excluding pensions and exclusions).</p>	Y

		<p>We have the following queries with the line definitions set out in Rob's email:</p> <ul style="list-style-type: none"> <li>• Line 4B.4 – Other 'Rule book' adjustments – states transition expenditure should be reported in this line and therefore treated as an exclusion. We do not consider that this is correct as transition expenditure relates to costs that have been allowed in the menu but spent during 2014-15. The costs should only be reported in line 4B.6 – Transition expenditure of the table.</li> <li>• Line 4B.9 – Allowed totex (final menu choice) – base year prices – states the final menu choice totex for PR14 is set out in line 4 of the 'Wholesale water / wastewater allowed expenditure' tables in chapters A2 (water) and A3 (wastewater) of 'Final price control determination notice: company-specific appendix'. We think the reference is incorrect as line 4 refers to 'Company's view of menu costs' and it should be line 6 – 'Allowed expenditure from menu'.</li> </ul>	
49	4C	<p>We have already queried in an email to Rob Lee on 20 May, two issues with the definition of line 2. These related to whether the calculation should use allowed or baseline totex and whether the annual FD PAYG rate or the weighted average PAYG should be used. As with table 4B, we have reviewed the suggested table for 2016-17 forwarded to MB by Rob Lee on 16 June 2016 and agree that it addresses the issues raised in our earlier email.</p>	Y
50	1E	<p>Additional disclosures re adjusted gearing would be helpful.</p>	N <sup>1</sup>
51	2D	<p>Additional clarification on the new depreciation disclosure.</p>	Y
52	4D	<p>'Water abstracted' – further information on treatment of imports/exports.</p>	N <sup>10</sup>
53	4C	<p>Clarify that the impact up to the yearend only should be included, not a forecast of the whole AMP position.</p>	Y
54	2E	<p>Specifically, currently a number of grants and contributions are amortised through the income statement within other income or turnover. As Table 2E stands there is not a column to enable us to do this. As such we would suggest amending the column headed as "amortised against depreciation" to "amortised through the income statement" to resolve this. Alternatively an additional column could be added.</p>	Y

## Key

Y		Change made to RAGs
N <sup>1</sup>	No change to RAGs	Companies can provide an explanation of any variances, including deferrals in the accompanying narrative.
N <sup>2</sup>	No change to RAGs	Issue relates to calculations in the electronic data capture template – this is not within the scope of the RAGs.
N <sup>3</sup>	No change to RAGs	Financial indicators; No change for this release of RAGs, we may consider enhanced guidance at a later stage.
N <sup>4</sup>	No change to RAGs	No longer a relevant measure following the revisions to UKGAAP which became effective from 2015-16.
N <sup>5</sup>	No change to RAGs	The unit cost section is clearly headed 'operating expenditure'. This table is intended to be a precursor to a more developed table in future, this change could be introduced in future years but we would need to consider the 2015-16 data and then work with the RAWG group to develop this for 2017-18.
N <sup>6</sup>	No change to RAGs	We have noted the CEPA observation, we do not consider this to be material enough to require specific guidance as the Principal use guidance in RAG2 should be sufficient for companies to comply. We would be happy to look at specific queries or to discuss this as a topic at a future RAWG meeting.
N <sup>7</sup>	No change to RAGs	This requirement was separate from the Annual performance report and as such is outside the scope of the RAGs.
N <sup>8</sup>	No change to RAGs	This is an isolated request for guidance, we would suggest that the company makes its treatment clear in the methodology statement and if required it could be put forward as a topic to be discussed at a future RAWG meeting.
N <sup>9</sup>	No change to RAGs	No change for this release but this definition will evolve through further consultation with the sludge working group.
N <sup>10</sup>	No change to RAGs	See section 2 RAG 4.06 for links to former June return guidance.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA

Phone: 0121 644 7500  
Fax: 0121 644 7533  
Website: [www.ofwat.gov.uk](http://www.ofwat.gov.uk)  
Email: [mailbox@ofwat.gsi.gov.uk](mailto:mailbox@ofwat.gsi.gov.uk)

Printed on 75% minimum de-inked post-consumer waste paper.  
August 2016

ISBN 978-1-910739-68-10

© Crown copyright 2016

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit [nationalarchives.gov.uk/doc/open-government-licence/version/3](http://nationalarchives.gov.uk/doc/open-government-licence/version/3) or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email [psi@nationalarchives.gsi.gov.uk](mailto:psi@nationalarchives.gsi.gov.uk).

Where we have identified any third party copyright information, you will need to obtain permission from the copyright holders concerned.

This document is also available from our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk).

Any enquiries regarding this publication should be sent to us at [mailbox@ofwat.gsi.gov.uk](mailto:mailbox@ofwat.gsi.gov.uk).

