

Information notice

IN 16/09 October 2016

The logo for Ofwat, consisting of the letters 'o', 'f', 'w', 'a', and 't' in a blue sans-serif font. The 'w' is enclosed within a blue circle. To the right of the logo is a vertical blue bar.

This is a formal document that alerts our stakeholders to a change in the way that we regulate the water sector in England and Wales.

Regulatory accounting guidelines 2016-17

This information notice summarises the changes we have made to the regulatory accounting guidelines that all monopoly water and wastewater and water-only companies in England and Wales must follow in preparing their annual performance reports.

The annual performance reports show both operational and financial information that monopoly companies are required to publish about their regulated business. This is in addition to the requirement to produce statutory accounts as required in the UK according to the Companies Act.

Background

Statutory accounts on their own are insufficient to assess the performance of vertically integrated, price-controlled monopolies. This is particularly relevant in a water sector with long-life assets. The regulatory accounting guidelines (RAGs) define in detail the treatment of particular items (for example; revenue and interest) where Ofwat requirements (defined in company licences) differ from those normally required under UK accounting standards and Companies Act legislation. Companies then follow this guidance to complete their regulatory accounting statements which form part of the annual performance report. Ofwat then uses the information in the annual performance report to monitor performance over the price control period and to inform development of future policy for the regulated activities. This information should be widely available to

encourage a sector that is accountable to its customers for its performance.

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. RAGs 1-4 have been revised for 2016-17 following two consultations in March and August this year. This information notice sets out the changes introduced to our revised RAGs. This will impact on the annual performance report for the reporting year ended 31 March 2017. Companies must publish their reports by 15 July 2017.

In December 2015, we engaged Cambridge Economic Policy Associates (CEPA) to lead a targeted review focusing on bioresources and water resources cost reporting. At the next price review in 2019 (PR19) we will be setting disaggregated price limits for these markets for

the first time. The scope of this review covered only the water and sewerage companies (WaSC) because they are involved in both of the activities that CEPA have studied. We met the water only companies (WoC) in April-June 2016 as they face similar issues in respect of water resources. Our [findings](#) have been published on our website.

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 with members of our Regulatory Accounts Working Group (RAWG) since the March consultation.

In May 2016, we published ['Water 2020: our regulatory approach for water and wastewater services in England and Wales'](#). This document set out our decision on implementing separate binding controls for water resources and bio-resources.

As companies completed their 2015-16 annual performance reports, they have provided further comments which we took into account in ['Further consultation on regulatory reporting for the 2016-17 reporting year'](#) (August 2016). These guidelines take account of comments received on that consultation.

Proposals for water resources and bioresources

Included in our May Water 2020 document was a discussion of the main elements of the boundaries for water resources and bioresources. We have continued to consult on this through our water resources and sludge [working groups](#). These RAGs incorporate changes that have been discussed at these

groups and have also been modified to take into account different scenarios that exist across the sector.

For water resources we have added a '15 day storage' rule to ensure raw water reservoirs that serve a water resources function are captured under water resources. This change has been introduced as a result of consultation with companies. We have also clarified that assets located between two water resources (such as connecting pipework) will come under water resources, as essentially all the assets are working in combination to provide a yield availability at the last water resource asset in the chain to enter raw water distribution / treatment. These changes have been supplemented by further guidance and examples to aid the application of the guidelines.

We need to enhance the reporting of costs in these areas in support of both modelling at PR19 and to underpin future reporting under the disaggregated price control period from 2020. This means we will collect the cost information in section 2 (rather than in section 4 only) where we disaggregate company financial information at the price control unit level. We do not however require revenues to be split out for water resources and bioresources at this stage.

Other changes for 2016-17 reporting

Significant areas where we have made changes to the RAGs are set out below. A comprehensive list of changes to the RAGs and the technical changes to the tables has been published alongside this information note. These are split between those changes

made following the March consultation and those in response to the August consultation.

Disclosure requirements

We have clarified and expanded our disclosure requirements in the following areas;

- for transactions with non-appointed business and associate companies,
- corporation tax – including disclosure for group relief transactions,
- Long term viability statement; and,
- Return on regulatory equity (RORE).

Energy related income

We have expanded the description of the different methods of energy generation. We have also clarified the treatment of the income from these activities with respect to reporting of the new bioresources price control unit.

Changes to Outcomes reporting

Pro forma 3B is a new table for reporting sub-measure performance. The table is pre-populated with performance commitment sub-measure base data to allow actual performance to be entered for each sub-measure.

Pro forma 3C is a new table for data relating to the Abstraction Incentive Mechanism (AIM). The table captures information for the 13 companies to which the AIM applies.

Pro forma 3D is a new table for reporting Service Incentive Mechanism (SIM) performance. The table needs to be completed with the qualitative (survey) scores,

quantitative (complaints) data, and the resulting overall score.

Grants and contributions

In our previous version of the RAGs we sought to prohibit the recognition of grant income as 'revenue' in the annual performance report. Our definition did not previously provide enough detail to cover some companies' accounting treatments, so the definition has been clarified.

Cost allocation guidance

We included more guidance for the treatment of borehole operating costs, costs of imported potable bulk supplies and treatment of tankered waste. Following feedback from the WoCs we have clarified the allocation rules for local authority and cumulo rates.

Responses

We had 16 responses to our August 2016 consultation. These have been published on our website. Most companies supported the recognition of water resources and bioresources in section 2 of the annual performance report. They were also largely supportive of the level of detail that was being included in the RAGs in order to define the new boundaries. Some companies have helpfully observed anomalies and gaps in our definitions. We have taken these into account and modified RAG4 to give more clarity.

Information capture system (ICS)

Companies will be required to complete our 2016-17 annual performance report tables templates alongside the publication of their regulatory accounts and annual performance report. The 2016-17 annual performance table templates will be published in early 2017.

In line with the less onerous reporting expectations for companies with a turnover of less than £6.5m, we have a separate template for the small companies to complete.

Next steps and future developments

RAWG meeting

We have scheduled the next RAWG meeting for 18 November at our Birmingham office. Some of the consultation responses contained questions on implementation – these concerns will be addressed at this meeting.

Cost assessment

Pilot data for the cost assessment project is currently being collected as a separate submission rather than part of the annual performance report. We will continue to consider the alignment of financial reporting under this workstream with the annual performance report requirements. We will continue to develop these requirements with both the cost assessment working group and with the RAWG.

Cost of new connections

A key part of our proposals is to bring about more transparent and fairer new connection charges. We will work with the Defra convened 'Task and Finish group' to define the detail of the cost data to be collected and reported.

Sludge liquors

We will work with the sludge working group to develop a common measure for quantifying the strength of sludge liquors which are reported in section 4 of the annual performance report.

Consultation for 2017-18 RAGs

We expect to publish a consultation for the 2017-18 RAGs in early 2017.

Enquiries

If you have any questions about this information notice please email FinanceAndGovernance@ofwat.gsi.gov.uk.

More information

Links to any documents cited in the briefing note and any other information that may be of interest to a wider audience

[Consultation on regulatory reporting](#) (September 2014)

[WoC visit findings](#)

[Consultation on regulatory reporting for the 2016-17 reporting year](#) (March 2016)

[Water 2020: our regulatory approach for water and wastewater services in England and Wales](#) (May 2016)

[Further consultation on regulatory reporting for the 2016-17 reporting year](#) (August 2016)

[Water 2020 working groups](#)

[Responses to our August 2016 consultation](#)

List of changes to the RAGs;

- [Changes following the March 2016 consultation](#)
- [Changes following the August 2016 consultation](#)

Regulatory accounting guidelines;

- [RAG 1.07](#)
- [RAG 2.06](#)
- [RAG 3.09](#)
- [RAG 4.06](#)
- [RAG 5.06](#)

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.

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