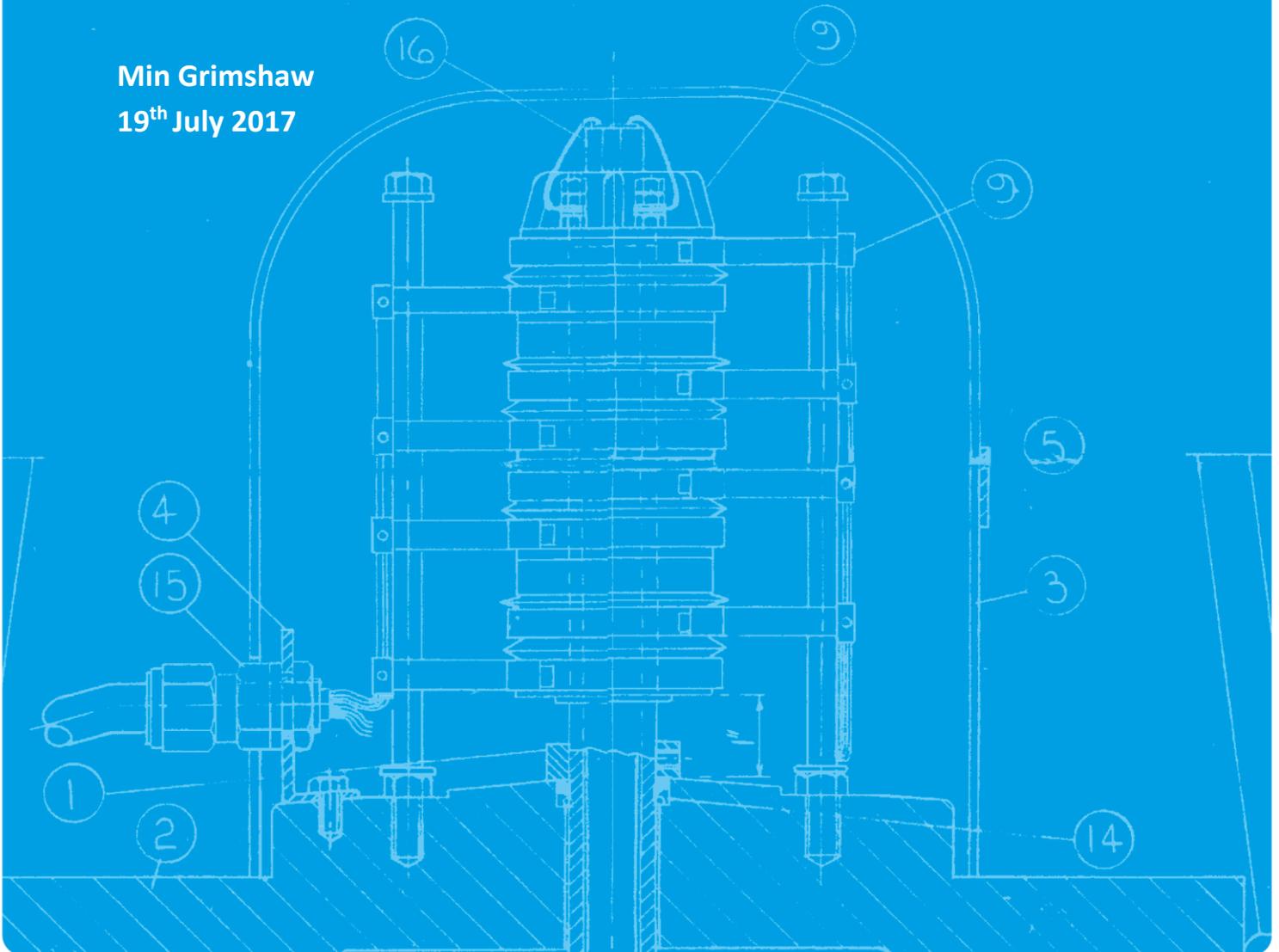


# Consultation on regulatory reporting for 2017-18 reporting year

*Severn Trent Water response*

Min Grimshaw  
19<sup>th</sup> July 2017



# Consultation on regulatory reporting for the 2017-18 reporting year

**Q1 Appendix 1 contains new tables for;**

- **Information on new connections (table 2J)**
- **Information on cost assessment (tables 4J to 4W)**

**a. Do you agree with expanding the APR with more tables to capture more granular cost data?**

The range and depth of the recently published APRs shows that they have been successful in allowing companies to develop and take ownership for their own reporting on how they are delivering for their customers. The APRs are substantial documents, each containing a mix of standard data tables and commentaries designed to be “accessible to all stakeholders so that they show how the sector is delivering for its customers, environment and wider society.”<sup>1</sup>

Alongside the APR process, Ofwat have been working on developing cost assessment models for PR19. We recognise that this is not an easy task and we are supportive of the approach Ofwat is taking to drive consistency of definition and robustness of data across the industry. We support Ofwat’s proposal to formalise the 2017/18 reporting requirements in October 2017. Early confirmation of requirements will help drive further improvements in our own data and consistency across the industry, and it also drives efficiency in data capture. We also welcome the work of the Cost Assessment Working Group in its endeavour to bring clarity and transparency to the process, and will continue to support this group over the coming months. This work should be aligned with better regulation principles in an aim to reduce the regulatory burden, removing aspects of data/tables if confirmed they are not required for the cost assessment exercise.

The proposal to expand the APR to capture more granular cost data appears to conflate the two areas of work above. The inclusion of additional data tables appears to be inversely related to accessibility to stakeholders, particularly as there is no way of understanding the complexity of the information presented without access to the actual (or developing) cost models themselves.

Therefore, whilst we support the need to provide additional cost assessment information and the work of the Cost Assessment Working Group, we believe the 2017 process whereby the cost assessment data is submitted to Ofwat alongside publication of the APR is the most appropriate approach.

We support the inclusion of Table 2J in the APR but would encourage early sight of new requirements to aid the development of efficient data collection.

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<sup>1</sup> <http://www.ofwat.gov.uk/regulated-companies/company-obligations/annual-performance-report/>

## **b. Do you agree costs should be captured through a controlled process?**

Yes, it is essential that costs are captured through a controlled process. The PR19 Draft Methodology consultation highlights the importance of cost efficiency, reinforcing the need for companies to submit comparable and high quality information to ensure an equitable cost assessment process.

As proposed by Ofwat, it is appropriate to operate the same assurance and governance processes for the APR and cost data submission and for the new tables to be included within the Company Monitoring Framework assessment. However, this can be achieved without the need to publish the cost assessment tables as part of the APR, and thereby diminish the value of the APR for the reasons outline in our response to Question 1a.

## **c. Do we have sufficient guidance and definitions for the additional line items provided?**

The Cost Assessment Working Group have been pivotal in providing clarifications and guidance on the costs assessment tables, and we welcome their continued contribution.

There are lessons that can be learned from the 2016/17 process, including a much more controlled and timely release of information to companies. In particular, some clarifications were communicated to companies less than four weeks before the submission deadline. For Severn Trent, the clarifications came after we had completed our assurance programme.

We would therefore welcome a more formal timetable for the 2017/18 process, including a clear deadline for revisions well in advance of 31<sup>st</sup> March and consideration of the impact of changes on the quality of submitted data (particularly where there has been insufficient time to alter systems and processes).

## **d. What line items need further definition?**

We have identified the first tranche of line items where further guidance is required, and have listed these in Appendix 1. As indicated in our response to Question 1c, we believe a continued open dialogue via the Cost Assessment Working Group is essential, and believe a controlled clarification process is required.

## **Q2 What are your views on the proposed changes to the existing tables in Appendix 1?**

### **a. Tax and non-appointed revenue (table 1A)**

### **b. Totex analysis (table 2B, 4D and 4E)**

### **c. Other minor changes**

We support the proposed changes. As stated in our response to Question 1a, we believe early sight of new requirements would aid the development of efficient data collection.

### **Q3 Do you agree that there will be some residual non-household retail activities (for example, developer services and meter reading) for an incumbent that exits the non-household retail market?**

We think that there is scope for reclassifying the activities that are currently considered to be “residual non-household retail” for those companies that have exited.

Severn Trent Water completed the disposal of their non-household retail activities to Water Plus (a joint venture with United Utilities) during 2016/17 in advance of the market opening on 1 April 2017. However, certain activities which are classified as non-household retail under RAG 2.06 remained within Severn Trent Water. These activities were performed by Severn Trent Water wholesale teams and recharged to retail under the requirements of RAG 2.06. These were recorded in the Severn Trent Water non-household retail price control.

- Developer services costs in relation to providing information and administration for new connections
- Investigatory visits / first visit to the customer where the cause of investigation is not a network issue
- Customer side leaks expenditure (excluding costs to meet wholesale outcomes)

Although the above costs will remain with Severn Trent we think there is scope for each of these items to be recorded as either wholesale or non-appointed in the future. This would mean that following the exit of non-household retail activities there should be no residual income or costs remaining in the non-household price control.

As such, the price control assignment of the above activities should be considered;

- *Developer services costs in relation to providing information and administration for new connections*  
Severn Trent Water still maintains a developer services call centre that handles applications and other queries directly from developers. As such activities are performed by the wholesaler we would expect income and costs in relation to these activities to be recorded in the wholesale price control.
- *Investigatory visits / first visit to the customer where the cause of investigation is not a network issue and customer side leaks expenditure (excluding costs to meet wholesale outcomes)*

The reporting of these costs going forward should be considered for both household and non-household customers. As an example, for any activity relating to repairing customer side leaks, the customer has the option to employ a third party other than its water retailer or the incumbent wholesaler to provide this service (e.g. a local plumbing company).

A competitive market for such services exists and therefore the water retailer or incumbent wholesaler is not a statutory supplier of this activity. With this in mind, it should be considered whether the investigatory and follow up visit costs (and related income) for this activity should sit within the appointed or non-appointed activity of business. Household retail costs relating to vulnerable customer investigatory and follow up visits should be separately considered as to whether they are appointed or non-appointed.

The above assignment of costs and related revenue would lead to there being no residual costs recorded in the incumbent non-household price control.

#### **Q4 Do we have sufficient guidance around cost allocations between business units?**

Yes, we previously worked with Ofwat to seek clarification where required and believe we have the required guidance. As stated elsewhere in our response, we believe there is scope for a more controlled and timely release of additional information, and that this would lead to a more efficient use of company resources in data collection and assurance.

#### **Q5 Do we have sufficiently defined boundaries for water resources and Bioresources?**

Yes, we believe the boundaries are now sufficiently defined. We will seek further advice from Ofwat if required.

#### **Q6 Have we provided sufficient guidance for Average Pumping Head in table 4P (wholesale water non-financial data)?**

Yes, we believe the additional guidance in RAG 4 chapter 2 provides sufficient guidance.

#### **Q7 Should companies accrue for future ODI revenue rewards/ penalties?**

Under IFRS adjustments to prices to be charged for services to be performed in the future cannot be recognised until the services are performed. This precludes the recognition of ODI rewards/penalties in the statutory accounts. We would propose to keep regulatory reporting in line with statutory reporting and minimise any differences arising between them.

#### **Q8 Do you have any comments on our proposed shadow reporting of leakage, supply interruptions and sewer flooding according to the new consistent reporting guidance?**

We welcome the approach the sector has taken to develop consistent reporting guidance for the three metrics above. Ofwat have introduced a sensible next stage whereby companies are required to collect consistent data through shadow reporting of 2016/17 data by 30 August. This reported data is required to have gone through the same assurance process as other data collected as part of the APR and, as such, this will be the first time that consistent and assured data is available.

We need to recognise the growing maturity of the data, particularly where new systems and processes have been introduced. We believe that the August submission will highlight disparities between company data which will require improvement before a truly comparable dataset is available.

Therefore, including 2017/18 shadow data within the APR appears premature at this stage and could introduce complexity for stakeholders when presented alongside existing performance commitment information. An alternative approach may be for APRs to refer to the ongoing work. The shadow reporting could be made separately available by Ofwat, with clear communication on maturity and comparability. This would enable APRs to report performance clearly against existing commitments, and enable interested stakeholders to access a transparent data set.

We also note that the PR19 Draft Methodology consultation proposes that companies submit performance commitment (PC) definitions by 3 May 2018. We welcome this approach and suggest a similar process to the convergence project is established to review consistency of proposed PR19 PCs.

### **Q9 Do you agree with the proposal to raise the small company turnover threshold to £10.2m?**

Yes.

### **Q10 Does RAG5, in its current form, inhibit efficient bioresources trades from happening? If so, please explain why and if possible, provide evidence.**

RAG5 in its current form does inhibit trading for the reasons offered by Ofwat in the consultation. The interpretation of RAG 5 that is made in the consultation document materially mitigates the issue. However, that interpretation does leave the individual companies in a position of having to defend under competition law prices that are not consistent with the more normal interpretation of RAG5. We look forward to seeing a reissue of RAG 5 with the interpretation for bioresources included.

### **Q11 a. Which of our proposed two options (Option A: incremental cost or above and Option B: incremental cost or above plus a margin) do you prefer and why?**

We believe that since this opportunity has arisen from customer funded assets, option b should apply.

### **b. In the case of Option B, do you agree with our proposed approach to specifying an appropriate margin? Please explain your reasoning and provide evidence where possible.**

We agree with the Ofwat's proposal for a 50/50 share of profits. A 50/50 split would be easy to apply. Quantifying and apportioning risk on a trade by trade basis, could potentially be difficult to perform consistently. We want to benefit customers and shareholders without adding administrative burden.

**Q12 What implications or concerns (if any) do you foresee for new entry to the bioresources market, as a result of our proposals on transfer pricing for bioresources?**

Using the interpretation in the consultation, we have no concerns as the market should develop appropriately. There be may be a concern if depreciation (applicable for long term trades) was based on RCV not historic cost.

**Q13 Are there any other ideas that you propose, to improve our regulation of transfer pricing for bioresources? If so, please provide analysis and where possible, evidence, to support these.**

No.

**Q14 Are there any other matters which we should be taking into consideration regarding transfer pricing for bioresources?**

No.

**Q15 Do our changes have any implications for the rest of RAG5 or for activities other than bioresources?**

No, we do not believe so.

## Appendix 1: Line items requiring further clarification (Question 1d)

RAG	Issue	Description of change	Paragraph/table /line definition affected	Response
RAG 1, RAG 3	Revenue reporting	Expand application note to include a reference to the new accounting standard IFRS 15.	RAG 3 para 1.22	There is no reference to IFRS 15 in RAG 3 para 1.2.2.
RAG 4	Eligibility for retail switching	The retail household definition has been amended to include any non-eligible non-households that are non-eligible for market participation.	RAG 4 chapter 3	<p>For Severn Trent, we believe it is appropriate to align the definition in England to the control that applies. We would have to record and monitor the number on the market eligibility basis separately if we did not do this through the APR and the differences would potentially be confusing.</p> <p>We also understand why it might be appropriate to have a different definition in Wales – at least in the short term. A change in definition would change revenue and charges. In addition, Welsh companies have not performed any data cleansing to check eligibility because they did not have to, therefore they could not report on the new basis immediately.</p> <p>Some issues we will need to consider for our Welsh population:</p> <ul style="list-style-type: none"> <li>• DVW NHH customer definitions will not match the new guidance.</li> <li>• As you will be aware, we are discussing the alignment of our company borders to the English / Welsh border (via the the NAV process). If this goes ahead, we will have to cleanse the data for England (Chester) and aggregate it with the remainder of our English non-households.</li> <li>• For Powys (which has been cleansed) we'd have to revert to the old definition.</li> </ul> <p>Additionally for cross border customers with Welsh Water customers, we note that once the Wales Act comes into force, they will need to cleanse their NHH data and apply the new definition for Herefordshire. Unless Welsh Water also varies its appointment, this could lead to different definitions being applied within a single area.</p>
2B (amendments), 4D and 4E - rename	For clarity Local authority rates includes cumulo rates			Cumulo rates to be excluded from Table 4E heading and also RAG 4 line item description for 4E.8.
2B, 4D, 4E	New connections - network reinforcement	Add new line, redefine 'other capex' lines (12 and 13) in 2B, 4D, 4E to exclude network reinforcement.		RAG 4 line item description for 4D/E.14 and 4D/E.15 to be updated to exclude 4D/E.16 (to be consistent with 2B).
4C	New lines	New lines to give increased transparency in calculating changes to the RCV.		We are unclear why there is a change in the calculation of the adjustment to the RCV for totex performance from the previous two years. The PR14 reconciliation rulebook published in October 2016 (page 36) is clear that the reward/penalty calculated by using the sharing rate will be through revenue and the totex adjustment for the revenue and RCV true up should be calculated using the weighted average PAYG rate.

RAG	Issue	Description of change	Paragraph/table /line definition affected	Response
4J to 4W	Cost assessment - new tables	Add new tables 4J to 4W.		<p>Table 4N and 4O (Sewage treatment works operating expenditure) - confirmation of what should be included in functional expenditure required in RAG 4 line item description - please see cost assessment query and response below:</p> <p>Query - Historically the cost data for these tables excluded business rates but on these new tables they appear to total to give Total operating expenditure (excluding 3rd Party costs) which would include business rates.</p> <p>Response - We apologise for any confusion caused by the use of lax terminology. What we have called 'Total operating costs (excluding 3rd party services)' in Line 11 of Table 10 should strictly be termed 'Functional expenditure' as the line definition makes clear it is simply the sum of the direct expenditure lines (1-5, 7) and the General &amp; support expenditure lines (6, 8). As such, it excludes business rates (as well as doubtful debts and exceptional items). We note that the corresponding line in Table 11 (line 13) is indeed termed 'Functional expenditure', again being calculated as the sum of the Direct expenditure and General &amp; support expenditure lines (lines 11 and 12).</p> <p>There is no intention that any of these lines should include business rates.</p>
<b>Other table/line item queries arising during the APR process</b>				
1C	Cash equivalents	The definition for cash equivalents is missing from RAG 4 1C.11.		RAG 4 1C.11 line item description to be updated for this.
RAG 1	Amortisation of grants and contributions (G&Cs) held as liabilities	There is currently no guidance for where to record amortisation of G&Cs held as liabilities	RAG 1 para 1.8.1	Propose to updated RAG 1, para 1.8.1 for amortisation of G&Cs to be recorded as 'Other income', similar to treatments of G&Cs which are charged directly to the income statement.