

Meeting note

Friday 28 February 2017
10.00 am to 3.30 pm

Regulatory accounts working group (RAWG)

Industry Attendees	
Phil Trussell	Anglian Water
Gagan Gulati	Anglian Water
Paul Edwards	Welsh Water
Jean Thomas	Welsh Water
Frank Grimshaw	United Utilities
Mark Local	Northumbrian Water
Bally Matharu	Severn Trent Water
Eleanor Taylor	Severn Trent Water
Ryan Jackson	South West Water
Peter Hughes	Southern Water
Phil Newman	Southern Water
Lucy Aplin	Thames Water
Katie Davies	Thames Water
David Peacock	Wessex Water
Sarah Shaw	Yorkshire Water
Tamar Robertson	Yorkshire Water
Tim Charlesworth	Affinity Water
Lisa Goddard	Affinity Water
Beverley Lawton	Bristol Water
Caroline Jemphrey	Portsmouth Water
Matt Hersey	South East Water
Philip Saynor	South Staffordshire Water
Jo Campbell	SES Water
Hannah Morrey	Tideway

Scope of meeting

Ahead of Ofwat's next Regulatory Accounting Guidelines (RAG) consultation for 2017-18 being published, Ofwat held a RAWG meeting on 28 February 2017. Ofwat invited two representatives from each company to attend.

Ofwat's RAG consultation is for the 2017-18 reporting year (to be published early April 2017) with a focus on including the Cost Assessment tables into the annual performance report.

Ofwat covered the following agenda items:

Description	Ofwat Speakers
Introduction	Andrew Boardman
Cost assessment	David Young
RCV allocation	Iain McGuffog Peter Jordan
2016-17 Reporting - Tax disclosures - Audit opinion - Ignore changes in tables 2B/4D/4E - anything else?	Rob Lee
Data capture pilot exercise	Hanif Jetha
Cost of new connections	Mark Jones
Bioresources and Water resources - separate price controls; - Market information - Sludge measurement	Alison Ferguson
RAG5 - sludge trading and transfer prices	Andrew Boardman
2017-18 and future reporting 1. Review of the RAWG follow-up questions on 11 Nov 16 2. Retail market opening 3. Small company threshold 4. Consultation document	Rob Lee

Other supporting Ofwat staff: Jenny Ngai, Cheryl Steventon, Kevin Ridout, Ian Pemberton

Link to slides:



workshop slides 28
Febv.pptx

Cost assessment

This session discussed the proposed amendments to the 2017-18 Annual Performance Report (APR) for Cost Assessment data.

Ofwat had circulated three documents to the RAWG group to review in advance of this agenda item:

- Cover note
- APR Tables incorporating Cost Assessment
- APR Guidance incorporating Cost Assessment

Ofwat stated this was work in progress and subject to change.

Overall, companies accepted the need for good data to drive the models for PR19 to mitigate the issues that were faced at PR14.

Ofwat had commissioned CEPA to review the cost assessment tables. A request was made by a company to share the final copy of the CEPA report with the group when available.

Companies expressed a desire for the Cost Assessment Data Sub Group to be resurrected. In this group, they would want to discuss:

- Definition of Average Pumping Head
- Issues coming out from the Information Request and RAGs consultation

Information Request for 2016-17

The Information Request for 2016-17 will build on the request issued in 2015-16 for Wholesale Water and Wholesale Waste Water. It should align with the APR tables provided – thereby incorporating any amendments made. Ofwat stated that the APR tables provided a good indication of the Information Request – but again this could be subject to change before being issued.

Ofwat also clarified that the data should be submitted in out-turn prices in line with the APR rather than in base year prices which was the approach taken in 2015-16.

Ofwat had requested full assurance (external or internal assurance methods) for the Information Request at the Cost Assessment Working Group meeting in January 2017. One company thought that it would be a good idea to incorporate it into the main audit within the existing section 4 arrangements for 2016-17. However, several companies raised concerns about the full data assurance requirements for the 2016-17 information request. For example, given that budgets have been set any additional assurance requirements will have a cost implication. In addition, some of the governance procedures and assurance have already been agreed for 2016-17. Any changes to the assurance procedures would have to be consulted with the

companies' audit committees. While it is not impossible, some frustration was expressed.

A company thought that the assurance plan only applies to published data, i.e. it would not apply to a data request that Ofwat was not publishing. To clarify, Ofwat expects there to be assurance whether data is provided for a pilot exercise to Ofwat or shared in a working group. Therefore, we would expect companies to match what they do for APR section 4 in the 2016-17 information request ahead of it being incorporated in section 4 of the 2017-18 APR.

Companies are keen to see the Information Request by mid-March 2017 as per Ofwat's proposed timetable for the Information Request for 2016-17. However, there were mixed opinions about the deadline for the cost assessment 2016-17 data submission being aligned with the APR submission deadline of 15 July 2017. One company suggested that an extension to the deadline be made available. While another company thought that having a staggered data submission deadlines would cause more problems.

In addition to 2016-17 data, the Information Request will cover historic year reporting years 2013-14, 2014-15 and 2015-16. Ofwat may extend this for wholesale wastewater to include earlier years 2011-12. Ofwat recognises that there are some accounting issues that need to be thought through for the historic years. Ofwat is assessing costs on a cash basis. However, some companies disagreed and stated that IFRS vs UK GAAP remains a problem. There may be some issues about allocating costs for historic years where the systems didn't capture data as they do now.

A company asked for clarity on whether the Cost assessment query process will be separate from the general APR query process. Companies stated that there is a risk of staff unavailability to respond to queries during August because of annual leave commitments.

A company raised a query that the definition of IRE in the information request for 2016-17 is different to that currently in the APRs (where renewals accounting does not feature as per current UKGAAP).

A company thought that there was a different water resources definition in the licence mods work. To clarify, Ofwat confirms that whilst the licence sets out possible activities that could be included in the WR definition, it actually states that the definition is as per RAG 4.

APR for 2017-18 reporting year

Ofwat provided an overview of the changes to the APR with the following further areas to consider for the Regulatory Accounting Guidelines (RAG) consultation for 2017-18:

- Average Pumping Head
- Retail
- Pensions, 3rd Party Costs, Business Rates and Market opening costs
- Alignment with new connections definitions

For pumping heads, some companies raised issues around the practical application of the guidelines. Ofwat is currently working with Institute of Engineers on this area. To enhance the guidance for clearer definitions, Ofwat could include some practical examples on pumping heads in the RAGs. Ofwat suggested that companies could also provide further disclosures to explain the company position in its methodology statement.

A request was made by a company to share the details of any table changes in relation to 'Retail'. Ofwat may also require additional tables in relation to 'Pensions, 3rd Party Costs, Business Rates and Market opening costs'.

CEPA recommended that Ofwat included additional tables for Opex for wholesale water and wholesale wastewater in the APR (Tables 4V and 4W). These tables request for greater granularity of opex costs which provides the benefits of better transparency, enabling self-benchmarking analysis between companies. Ofwat suggested that these be included in the Information Request but recognises that there may be accounting issues for historic years.

RCV allocation

Ofwat provided an overview of RCV allocation with a summary of the differences between bioresources and water resources.

Water resources RCV allocation

Ofwat published guidance in January 2017. An unfocused approach would be the most appropriate methodology i.e. use of proportion of assets relative to total water wholesale. It is not proportionate to do a full revaluation.

Bioresources RCV allocation

Relatively more complex, with a focused approach the most appropriate methodology. We are consulting on specific valuation of economic value of assets, where economic value refers to the net present value of cash flows associated with the assets.

Ofwat needs companies to propose the RCV split in a way that is suitable for PR19. Ofwat will collect information on company economic valuation of bioresources assets in order to review RCV allocation proposals. The split of pre-2020 RCV between bioresources and wastewater network plus would be at the total company level rather than on an individual site basis.

Ofwat proposes a short-cut method in the absence of market prices. Companies will cost new build assets and then adjust for differences in asset life and economic value to existing assets. The company needs to consider if any adjustments are needed and use the pre-existing WACC as a discount rate in its present value calculations. Ofwat suggests that the company conducts sensitivity testing on e.g. WACC, as well as considering alternative valuation approaches in order to inform the RCV allocation proposal.

Discussion Groups

Group 1: Water resources and Bioresources – How can we get best value out of existing accounting data? Have we captured the relevant cross checks? How can we test the impact on charging structures?

The discussion focussed on specific issues to be considered in using existing data:

- MEAVs data collected
 - Roll forward of previous balances
 - Recalculate 2015-16
- Economic value for water resources would be very complex
 - Granularity of data
 - Historic data
 - Water resource boundaries
 - Can we roll forward asset value?
 - Potential issues
 - Robustness of data
 - Preferred approach BUT subsequent changes at business plan?
 - Approach and understanding pricing issues

Group 2: Bioresources - Views on level of data collection for the tables - for each sludge treatment site including costs and revenues for cross checks, separate data for satellite sites, vehicles and common costs.

Discussion focussed on the assumptions that would need to be made and data that could be collected on this:

- Question about whether to include mothballed assets?

- Cost allocation in general
 - Where not captured at source, could be based on best guess/assumption
- Going forwards – justify cost base used
- Depreciation on old assets
- Boundary change on assets description
- General overhead costs allocation

Group 3: Bioresources - Views on the economic value approach? Have we highlighted the right areas for consistency in valuation approach (e.g. land)?

- Support clear guidance and economic value is appropriate
- Capacity – consider likelihood of use
- Sites – can take in what you have at 2020
- Shared assets – split or recharges
- RCV – not attributable to specific assets
- Land – record what's in which bit

Group 4: Water resources - How can we use information in Water Resource Management Plans to test the impact of proposed RCV allocations

The discussion focussed on the form of control – and the different situation where surplus water was available from where there was a deficit.

- Will Ofwat standardise allocations?
- If you have a surplus there is no marginal cost.

2016-17 Reporting

Ofwat provided RAWG with reminders and clarifications for this year's reporting for:

1. Tax disclosures
2. Audit Opinion
3. Cross references between tables 2B, 4D and 4E, error in RAG 4.06

Ofwat had circulated an updated 2016-17 Audit opinion (Draft) to the RAWG group to review in advance of this agenda item. Ofwat advised the group that it is currently agreeing the wording of the audit opinion with the five audit firms. Ofwat expects to finalise the wording and will publish it in the next 2 weeks.

A company raised a query on how costs in 2016-17 relating to Retail Market Opening should get classified according to the price control units; should retail separation costs be allocated in the same way as time spent on "other business

activities”. Ofwat advised companies to explain its approach in its methodology statement.

In the discussions, some companies stated that there is some Ofwat guidance that has been sent to company CEOs advising on categorising MOSL costs. Subject to Ofwat reviewing that guidance, it would seem sensible to allocate the costs in the same way as the MOSL related costs.

Some companies did not agree that the RAGs for 2016-17 incorrectly referenced the opex total for line 9 in tables 2B/4D/4E through to line 7 in table 2A. Ofwat will review this area again i.e. for table 2A – should the recharges just be for principal use asset only?

Data capture pilot exercise

Overall, companies welcomed Ofwat’s online portal for future data collections.

Ofwat will send an email to RAWG attendees (including primary and secondary contacts) inviting a company representative from each company to attend a half day demo on 20 March 2017.

Ofwat requested two companies (one WASC and one WOC) to work with Ofwat to test the data capture system and trial the system when submitting the APR submission in July 2017. Affinity Water and Southern Water volunteered.

Cost of new connections

Ofwat provided an overview of the changes to the APR from 2017-18 and 2018-19.

A company asked what would happen after the 5 years. Ofwat stated that this has not yet been decided but falls within the scope of the working group being led by Water UK, but re-emphasised that it is a rolling 5 year reconciliation of revenue and costs.

Bioresources and Water resources - separate price controls

This is separate from the APR process. Ofwat is proposing to consult on the market information it needs companies to publish/provide in April 2017. Company responses will be due in July. The final decision (akin to the RAGs) will be published in October 2017.

It is proposed that from October 2017, companies will publish bioresources market information on a voluntary basis. Anglian Water has already published this information and Ofwat encourages all other companies to follow suit.

RAG5 - sludge trading and transfer prices

Ofwat will be proposing some limited changes to RAG 5 in respect of bioresources and tax. It is likely that they will be included in Ofwat's next RAGs consultation for 2017-18.

The new RAG 5 would be effective from the 2018-19 reporting year.

Ofwat encourages all companies to seek their own legal advice because Ofwat will not be advising.

2017-18 and future reporting

A company thinks that it seems absurd that we are not recognising any ODI rewards and penalties in the accounts. However not all companies plan to recognise these accounts at this stage.

Actions

- Ofwat to circulate the slide pack and notes of this meeting to RAWG attendees.
- Cost assessment: APR for 2017-18 reporting year
 - Ofwat to circulate draft retail tables and guidance
 - Ofwat to share CEPA's final report with the group when available
 - Ofwat to consider including some practical examples on pumping heads in the RAGs
- Cost assessment: Information Request for 2016-17
 - Ofwat to provide clarification on historic years for water resources

- Ofwat to consider resurrecting the Cost Assessment Data Sub Group
- 2016-17 Reporting
 - Ofwat to finalise the audit opinion wording with audit firms and publish on the Ofwat website in the next 2 weeks
 - Ofwat to review the MOSL guidance and confirm how to allocate the RMO related costs to the price control units
 - Ofwat to review table 2A – should the recharges just be for principal use asset only?
- Data capture pilot exercise
 - Ofwat to send an email to RAWG attendees (including primary and secondary contacts) inviting a company representative from each company to attend a half day demo on 20 March 2017.