# Consultation questions and responses

We have published the responses to the consultation on our website. Below we summarise responses to consultation questions and our actions.

## Questions relating to 2017-18 reporting

| | Question | Consultation response | Our response |
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| **Q1** | **Appendix 1 contains new tables for;**<br><br>• **Information on new connections (table 2J)**<br>• **Information on cost assessment (tables 4J to 4W)**<br><br>**a. Do you agree with expanding the APR with more tables to capture more granular cost data?**<br>**b. Do you agree costs should be captured through a controlled process?**<br>**c. Do we have sufficient guidance and definitions for** | a. 14 responses in respect of table 2J, all agreed. 15 responses in respect of tables 4J to 4W, 9 disagreed and 6 agreed. Most thought that the cost assessment data tables would make the APR more difficult to understand.<br>b. 14 responses, all agreed. Companies that did not wish to see the cost assessment tables in the APR agreed that specifying the requirements in the RAGs was appropriate. However they had the view | We have included the cost assessment tables in the finalised RAGs.<br><br>Most companies that did not agree with including this data in the APR did agree that the data was important for the price review process. However they thought that the APR was not the appropriate means of collecting doing this data.<br><br>We understand the concerns of respondents that such an increase to APR tables could make the document large and difficult to read. Consequently, we are amending RAG3 to allow separate reporting of the cost assessment tables. However we are clear in |

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| | **the additional line items provided?**<br>**d. What line items need further definition?** | that the cost assessment data should not form part of the APR.<br>c. 14 responses, only 2 disagreed, most companies agreed but provided some detailed technical comments.<br>d. 10 responses with detailed comments. | the RAGs that this does not mean that these tables should be treated differently to the other tables in section 4 for assurance purposes.<br><br>We have made minor changes to the cost assessment tables as suggested by the responses which we have listed separately. |
| **Q2** | **What are your views on the proposed changes to the existing tables in Appendix 1?**<br><br>**a. Tax and non-appointed revenue (table 1A)**<br>**b. Totex analysis (table 2B, 4D and 4E)**<br>**c. Other minor changes** | a. 13 responses in respect of tax, 11 agreed. 12 responses in respect of non-appointed revenue, 9 agreed.<br>b. 14 responses, 13 agreed with the changes but there were some technical comments.<br>c. 11 responses, 8 agreed with the changes. | One company who did not agree with changes to table 1A said that publishing additional non-appointed revenue data was disproportionate as this revenue only represented a small part of the overall business. However, we expect that as bioresources trading increases then the non-appointed business will grow to become a more important area. More disclosure of non-appointed activities will increase transparency in the bioresources market.<br><br>We have accepted many of the technical changes suggested in response to the consultation as these will ensure consistent reporting. |

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| **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?** | 15 responses, 14 agreed with many respondents making suggestions as to how these should be accounted for. Some companies suggested reclassifying activities from Retail to Wholesale. | We do not think that reclassifying activities as wholesale is practical as this would mean that the reported results would not be comparable with the PR14 Wholesale price control.. We will monitor activities in this area and consider changing the RAGs for the 2020-25 period so that the APR is then aligned with the 2019 price review forecasts. |
| **Q4** | **Do we have sufficient guidance around cost allocations between business units?** | 14 responses, 13 agreed. | One company highlighted the need for consistency for measuring sludge liquor transfers. RAG 2.07 sets out factors that should be taken into account but also acknowledges that more prescriptive guidance may be appropriate. We will look at the reported costs for 2015-17, engage with the regulatory accounts working group and if appropriate review the RAG guidance in the future. |
| **Q5** | **Do we have sufficiently defined boundaries for water resources and Bioresources?** | 14 responses, 13 agreed. | One company asked for further clarity for a particular sludge thickening scenario – we will consult on this in more detail for the 2018-19 reporting year. |

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| **Q6** | **Have we provided sufficient guidance for Average Pumping Head in table 4P (wholesale water non-financial data)?** | 15 responses, 10 agreed. | To address concerns we have clarified our definition for table 4P and added an explanatory appendix to RAG2. |

## Questions relating Outcomes reporting

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| **Q7** | **Should companies accrue for future ODI revenue rewards/ penalties?** | 15 responses, none of which thought that the prospective change in accounting standards would require ODI outperformance payments/underperformance penalties to be recognised in the statutory accounts. | When changes to accounting standards as a result of International Financial Reporting Standard (IFRS) 15 were first proposed there were some views in the industry that this may have required prospective ODI outperformance payments/underperformance penalties to be recognised in the statutory accounts as soon as the ODI payment was earned/incurred.<br><br>We said we would consult on this point, but all respondents said that they will not be required to recognise these amounts in the accounts. We will not therefore make changes to the RAGs as the statutory reporting of revenue will not be changing as a consequence of this change. |

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| **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?** | Most companies provided feedback alongside the 2016-17 shadow return which companies have submitted since the consultation. The points raised were specific technical issues. | We have reflected on company comments and made technical changes to table 3S where appropriate. |

## Question relating to small companies (RAG3)

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| **Q9** | **Do you agree with the proposal to raise the small company turnover threshold to £10.2m?** | 10 responses, all agreed with the proposal. | We have adopted the £10.2m threshold level. |

## Questions relating to transfer pricing guidance (RAG5)

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| **Q10** | **Does RAG5, in its current form, inhibit efficient bioresources trades from happening? If so, please explain why and if possible, provide evidence.** | 10 responses, all from WaSCs, 7 thought that trading was inhibited by the current RAG5. 2 companies thought that the existing RAG5 could be interpreted so as to allow transfer prices that would not inhibit trading. One of those companies | We took on board the majority view that trading could be inhibited by the current RAGs and so a change in the reporting approach was needed. We considered the options for changes to RAG5 that we set out in the consultation – see question 11. |

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| | | thought that this was possible with additional guidance outside of the RAGs. | |
| **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?**<br>**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.** | a. 10 responses, all from WaSCs, 9 preferred option B, only one preferred option A.<br>b. 9 responses, 7 were in favour of our approach to splitting the margin. Only one other comment was received, this was that the company should set the share of the margin. | We have used option B (incremental cost or above plus a margin) in the new version of RAG5. **For Bioresources only,** this replaces the requirement to apply a 'fully allocated cost'. This was our preferred choice which most companies agreed with.<br><br>For the approach to setting a margin, the RAGs now state that when deciding on the appropriate split that companies should consider the investment risks taken by both parties in order to provide the service, with a greater relative risk meriting a greater share of the reward. Companies should also balance the interests of customers of the appointed business and shareholders. |

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| **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?** | 3 responses, 2 suggested that incremental costing by incumbents is potentially restrictive to new entrants and one thought that environmental legislation acted as a barrier to trade. | We believe that incremental costing will, in the short term, remove a potential barrier between inter company trades. We recognise the concerns that could potentially impact on new entrants. We will review the effectiveness of the arrangements for bioresources transfer pricing by 2025 and if need be amend the RAGs to address any concerns. |
| **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.** | 2 suggestions were made; one that minimising transaction costs, possibly by the use of standard contract terms or trading codes, may help to stimulate trading. Another concern was that there was no proposal for an adjudicator role in the event of disputes regarding capacity and long run versus short run trades. | We will monitor development of the bioresources market and consider changes to our regulatory approach when we review the arrangements by 2025. |
| **Q14** | **Are there any other matters which we should be taking into consideration** | One company noted that if companies entered into an interruptible trade contract then this would allow reserve | Capacity is important to resilience. Interruptible contracts can be used to preserve capacity. |

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| | **regarding transfer pricing for bioresources?** | capacities to be shared between neighbours and so reduce industry wide costs.<br><br>2 companies thought the RAG5 wording could be clearer in stating that the existing parts of RAG5 did not apply to Bioresources. | In general, we would expect that incremental costs of a trade would increase with the length of the contract, however there may be circumstances, such as when a trade is interruptible, that this expectation would not necessarily hold.<br><br>There are other means by which operators can manage the volumes that they process, for example transporting sludge to different sites. It is possible that spare capacity could be reduced at a local level if a company entered into a trade. However we see no reason why there would necessarily mean a less resilient service overall.<br><br>We think that the drafting of RAG5 is sufficiently clear for companies looking to apply rules on Bioresource trading. |
| **Q15** | **Do our changes have any implications for the rest of RAG 5 or for activities other than bioresources?** | One company noted that incremental costing may be | Following the introduction of the water resources price control in 2020 we will review the effectiveness of the |

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| | | appropriate for areas other than Bioresources. | RAGs annually and will consult on proposed changes when we consider them necessary. We will continue to listen to company views through the regulatory accounts working group (RAWG). If we needed to introduce specific rules in RAG5 for water resource trades then we will include those in future consultations on changes to the RAGs. |

## Additional questions

During the consultation period, as companies completed the 2016-17 APR, they identified some practical queries about interpreting the RAGs. We gave all companies the opportunity to comment, issuing 4 further questions.

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| **Q16** | **Should an additional line be added to table 1C in the non-current liabilities section; 'Deferred income – adopted assets'?** | 6 responses, 4 agreed. 2 disagreed, one did not see the benefit of the additional line and the other did not support further deviation from statutory reporting. | We have added the additional line to table 1C to ensure a consistent approach and to aid transparency. We do not agree that this represents an accounting treatment that is different to statutory reporting, merely that it gives granularity to an area that is particularly important for |

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| | | | transactions which commonly occur in the water industry. |
| **Q17** | **Should RAG 1 be amended to specifically require amortisation of grants & contributions and adopted assets to be recorded as 'other income' and adjusted in table 1A?** | 5 responses, all agreed with the proposed change. | We made the proposed change to RAG 1. This will ensure a consistent approach and aid transparency. |
| **Q18** | **Should RAG 1 1.8.1 be amended to specifically include 'income recognised in the year which is recorded as negative operating expenditure' and require this to be adjusted and shown as 'other income'?** | 6 responses, all agreed for the issue to be resolved but one suggested an additional line in table 2A rather than adjusting in table 1A. | We have decided that table 1A should include an adjustment for this. We want to ensure that any differences between the statutory and financial statements are clear and transparent to stakeholders. This approach means that all of the accounting adjustments between the two sets of accounts are recorded in a single table. |
| **Q19** | **Should supervision fees [s104 sewer adoption fees] be added to RAG 4 appendix 1 as price control income and the reference in the 2E.11 line definition be removed?** | 4 responses, 3 agreed and one disagreed suggesting instead that 's104 sewer adoption fees' be added to the 'rechargeable works' [which are outside of the price control] in RAG4 appendix 1. | We have included the s104 sewer adoption fees in RAG4 appendix 1. We consider that as this fee income is generally related to new developments then it should be included with other related income rather than as other 'rechargeable' |

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| | | | activities as suggested by one of the respondents. This clarifies the treatment of this income and will ensure consistency. |