

Our ref: GIA/CR/SWS

Water Services Regulation Authority (Ofwat)  
7 Hill Street  
Birmingham  
B5 4UA

For the attention of Robert Thorp

**Grant Thornton UK LLP**  
30 Finsbury Square  
London EC2P 2YU

T +44 (0) 20 7383 5100  
grantthornton.co.uk

28<sup>th</sup> February 2018

Dear Sir

## 1 Introduction

- 1.1 In accordance with our service order dated 4 December 2017 (the Service Order) Grant Thornton UK LLP has examined the financial model prepared by Ofwat version PR19 11z.xlsm (the **Model**).
- 1.2 Our work was based on reviewing and commenting upon the Model, Service Order documentation, Model Rulebook and PR19 Methodology supplied by yourselves and discussions with yourselves.
- 1.3 This letter, including the appendices and/or any information derived therefrom or any conclusions or recommendations that we have formed or made (this **Letter**) has been prepared solely for the benefit of Ofwat in connection with the specific purpose for which Ofwat engaged us. Whilst we recognise that this Letter is publicly available, we stress that the Letter was prepared for Ofwat only.
- 1.4 No person other than Ofwat may use or rely on this Letter and/or any information derived therefrom and Grant Thornton UK LLP do not accept any responsibility or liability of any kind whatsoever and howsoever arising to any other person to whom the same is shown or into whose hands they may come.
- 1.5 If any person other than Ofwat choose to rely on this Letter and/or any information derived therefrom, such reliance shall be entirely at their own risk and without any recourse to Grant Thornton UK LLP. To the fullest extent permitted by law, Grant Thornton UK LLP owes no duty to any person or entity other than Ofwat, whether in contract or in tort (including in negligence) or under statute or otherwise with respect to or in connection with this Letter and Grant Thornton UK LLP has no liability to any party other than Ofwat for any loss or damage suffered or costs incurred, arising out of or in connection with this Letter or its use, however such loss or damage is caused.
- 1.6 By accessing this Letter, any party other than Ofwat, agrees that it will not bring or threaten to bring any actions, proceedings or claims against Grant Thornton UK LLP where the action, proceeding or claim in any way relates to or concerns or is connected with the use of or reliance on anything included in this Letter.

## **2 Scope**

2.1 The Model has been developed for the following reasons:

- to determine the wholesale price controls;
- to calculate the revenues arising from the retail price controls;
- to help assess financeability of the appointee, with the ability to refine the wholesale price control limits until target financeability indicators are satisfied; and
- test return on Regulated Equity in different scenarios (the above being Ofwat's Stated Objectives).

2.2 Our work was carried out as specified in the "Key Output & Deliverables" section of the Service Order. For the avoidance of doubt, our work on the Model does not constitute an audit in accordance with auditing standards issued by the Financial Reporting Council.

2.3 Our work did not include, for the avoidance of doubt, any form of review of the commercial merits, technical feasibility of the proposals or the factual accuracy of the input data.

## **3 Conclusion**

3.1 On the basis of the work undertaken, and subject to the matters listed at Appendices A to C, we confirm that:

- a) in terms of its logical construction and arithmetical accuracy, the Model materially achieves the Stated Objectives on the basis of the Model's stated assumptions; and
- b) the Model calculations are materially in accordance with the supporting information contained in Ofwat's final methodology document (the Methodology Document).

3.2 The comments and opinions set out above are given solely in respect of the Model version as defined and cease to be valid if there are any subsequent changes to the Model.

Yours faithfully



Grant Thornton UK LLP

### Appendices

- A Assumptions and comments on the Model
- B Model version reviewed and Methodology Document
- C Service Order Extract

## **Appendix A – Assumptions and comments on the Model**

During our review, test input values were used in order to review the Model outputs. We understand that the Model will be populated by individual water companies which are regulated by Ofwat (**Water Companies**), and whilst we have considered during our review how the inputs flow through calculations it is important to note that the reliability of the Model outputs is necessarily a result of the reliability and internal consistency of model inputs. Although the Model does include some integrity and logic checks these will not necessarily identify or prevent all errors in a populated Model.

The Model has been developed applying the FAST<sup>1</sup> financial modelling standard but we note that in order to aid the readability of the model formula calculations have been started 3 periods into the timeline as described in Section 2 of the Rulebook. We consider this approach to be reasonable and does not impact on our conclusion set out in this letter.

We note that the treatment of Welsh Water differs to that of the rest of the Water Companies with regards to competition. There is no differentiation in the model between English and Welsh companies and we understand that this is intentional and consistent with the objectives.

The following were excluded from the scope of our review:

- any form of review of the appropriateness of the accounting and tax assumptions underpinning the Model;
- any form of review of the validity or the factual accuracy of the input data and assumptions contained within the Model;
- consideration as whether the Model outputs are in a format that would be required for statutory reporting purposes;
- any comments stored using the cell note functionality within Excel;
- any opinion on user defined functions in MS excel, such as the REF\_TEXT function – we note that macros need to be enabled for these to operate without generating a “#NAME?” error, but also note that these do not cause any issues with the model during our review; and
- any opinion on the operation and on-going use of the macros within the Model.

---

<sup>1</sup> FAST is a modelling standard providing guidance on the structure and design of efficient spreadsheets

## **Appendix B – Model version reviewed and Methodology Document**

Our review was based upon the Model with file name “PR19 11z.xlsm” with a file size of 6.08 Mbytes and was last modified on 28/02/2018, 15:01.

The Rulebook is as set out in the worksheet “Rulebook” of the Model which summarises how the calculations are intended to be applied within the Model (the Methodology Document).

For the avoidance of doubt, Grant Thornton offer no opinion on the feeder models in this suite, such as the ‘RCV adjustment feeder model’ or ‘Revenue adjustment feeder model’.

### **Appendix C –Service Order Extract**

The following is an excerpt of the Service Order depicting the Key Outputs and Deliverables.

#### **Key Output & Deliverables**

The Contractor will be required to deliver a report for publication by Ofwat covering the areas of advice mentioned in paragraph 3 of section A of the ITT (Objectives and Scope of the Work) and specified below:

- a) whether the methodology used in the model fits with Ofwat's policy requirements outlined in the final methodology document;
- b) whether the formulae in the model have been implemented correctly; and
- c) how to correct issues found with the Model and to ensure it complies with best practice with Ofwat's policy requirements.