

Meeting note

Friday 8 February 2018
10.15 am to 4 pm

Regulatory accounts working group (RAWG)

Industry Attendees	
Anglian Water	Phil Trussell, Richard Goodwin
Welsh Water	Paul Edwards, Jean Thomas
United Utilities	David Rogers, Louise Bird
Northumbrian Water	Neil Rutherford
Severn Trent Water	Bally Matharu, Eleanor Taylor
South West Water	Ryan Jackson, Matthew Woolcock
Southern Water	Peter Hughes, Phillip Newman
Thames Water	Claire Foster, Katie Davies
Wessex Water	David Peacock, Lucy Fifield
Yorkshire Water	Tanweer Yousef, David Darley
Affinity Water	Tim Charlesworth, Lisa Goddard
Bristol Water	Beverley Lawton, James Holman
Dee Valley Water	Steve Walmsley
South East Water	Matt Hersey, Sam Foreman
South Staffordshire Water	Philip Saynor
SES Water	John Chadwick
Thames Tideway	Heather Glass, Nicholas Andison
Industry Non-attendees	
Portsmouth Water	

Ofwat staff:

Robert Lee, Gayle Webb, Jenny Ngai, Elinor Mathieson, Mark Jones, David Young, Shifali Aggarwal, Simon Harrow, Kevin Ridout, Peter Hetherington, Paul Martin, Salim Lorgat, Hanif Jetha, Rebecca Paterson, Martyn Andrews, Martin Malinowski, Keith Mason

Agenda

Time	Description	Lead
10:15	Coffee and registration	
10:25	Introduction	Rob Lee
10:30	Cost assessment	David Young (OFWAT) Phil Trussell (Anglian Water)
11:30	Refreshment break	
11:45	<ul style="list-style-type: none">Review of 2016-17 APRGrants and contributions – reminderNet debt – table 1EForward look to 2017-18 APR	Jenny Ngai Gayle Webb Martin Malinowski Rob Lee
12:45	Lunch	
13:30	IFRS 16 - leases	Dave Rogers (United Utilities)
13:40	General application questions (please submit questions in advance)	Rob Lee
13:50	Data capture system	Hanif Jetha
14:00	<ul style="list-style-type: none">LTVSFinancial flows metric	Elinor Mathieson Martyn Andrews
15:00	Water resources	Peter Hetherington, Thames Water, Northumbrian Water
15:25	Reporting separate controls after 2020	Alison Fergusson
15:40	Wrap-up; feedback and next steps	Rob Lee

This meeting note should be read in conjunction with the slides as presented at the RAWG meeting.

Here is a link to the slides:



2018 01 10
RAWG.pptx

Cost assessment

Update on process and on 2017 Cost assessment information

Key points as discussed in the meeting:

- Ofwat will provide an updated housekeeping note after it has sought RAWG feedback.
- Ofwat notified the group of changes to the project team going forwards.
- Ofwat provided a review of the information request in July 2017, with the last submission being received in December 2017. In collaboration with CEPA, the data has been normalised, and has been emailed to the industry where relevant files that contain the companies' submission with Ofwat adjustments can be accessed on the Cloud.
- As signalled in the engagement manager calls, Ofwat is going to do a light touch consultation on modelling. An information note about this will be published soon. The consultation has yet to be decided about whether it will be restricted to within companies or for the wider domain. The information note will invite views on what the models should be, yet this is still subject to change.
- There were some concerns to publishing historic information (original and resubmissions).
- The master files have not been released to companies yet.

Issue	Ofwat's action
A company queried why there was no explanation of why some adjustments have been made so it does not understand how they can accept it.	Ofwat stated that CEPA would have provided comments and explanations to support any normalised adjustments to companies' submissions. Ofwat to check and follow-up on this.

Average pumping head update

Ofwat reviewed companies' July and December cost assessment submissions for 2016-17. It highlighted that there was an overall improvement in the submitted data, with some major issues addressed, resulting in some significant changes.

Further industry reporting improvements are expected for 2017-18 APRs.

No issues were raised on the slides presented.

Presentation from Anglian - Cost assessment tables for the APR

Phil Trussell (Anglian) provided a presentation on Cost assessment tables for the APR to the group that highlighted the company's key issue areas. Due to time constraints, issues 8 and 9 (slides 21 and 22) were not covered at the meeting.

The following table summarises Ofwat’s response for each issue that was discussed:

Issue raised by Anglian	Ofwat post-meeting response and actions proposed
<p>Allocation of capex to business unit of principal use – should the ‘recharging of depreciation in table 2A’ also be in tables 2B, 4D, and 4E?</p>	<p>It would seem logical that all costs reported in table 2B, 4D and 4E would be AFTER recharges had been made for services supplied to those recipient price control units (PCU). Suggest that we consult on this for 2018-19 such that this issue is resolved in advance of the PR19 AMP period.</p> <p>Depreciation could be recharged by adding lines to table 2A. But this would not resolve the issue of financing costs which are reported below the operating profit line. We could consult on options for this.</p>
<p>Principal use - confusion occurs when principal use is one service and then recharged to another service. Analysis then is across business units within the service. Principal users will vary across the WaSCs in particular, with wastewater being the largest price control unit for most, but not all companies.</p> <p>An asset owned is depreciated and is above operating profit whereas recharges are below operating profit. Comparison across companies is not possible. Companies have suggested a mandate across all companies to have principal use as water and recharge to wastewater. This will provide consistency across industry.</p>	<p>The 2018-19 RAG consultation could include a question on potentially standardising the principal user [usually for large M&G assets]</p>
<p>Treatment of atypicals - signage</p>	<p>CEPA had opted for the approach that is illustrated in the right hand example of slide 14. Ofwat clarified that this issue has been resolved in the latest updated RAGs for the reporting year 2017-18.</p>
<p>Treatment of revenues – renewable energy schemes</p> <p>One company asked whether assets used for solar power generation should be appointed or non-appointed.</p> <p>Companies stated that Ofwat’s information notice PR09/14 suggests that income should be offset against costs.</p> <p>Companies stated this was not as simple as most of the generation would be used in-house and any surplus would be exported to the grid. Companies think that Ofwat needs to have further thought and consider the impact it has on customer bills.</p>	<p>In general, per PR09/14, renewable assets are non-appointed unless they are integral to the appointed business, e.g. CHP at a STW or hydro on a dam outlet.</p> <p>However, we are aware of situations where it makes sense for the appointee to install small-scale renewable installation where it makes sense e.g. solar PV on the roof of a refurbished office or a single wind turbine on a corner of a site or roof. These assets would typically support energy use on site rather than have a significant export capability.</p> <p>For appointed assets generating power then any income or cost savings would be recorded inside the appointed business, so customers will benefit. Expenditure on</p>

	<p>solar power installations has been included in companies FDs and their RCV at PR14 (examples South West and South Staffs).</p> <p>Where companies make use of large amounts of appointee land e.g. a PV array near a river or reservoir) then the generation activity will be non-appointed. The appointee then makes the appropriate recharge, and any loss of interest in land is also recognised and governed by condition K. Such a recharge maybe in the form of a reduced tariff for power which recognises a rental element.</p> <p>In summary the 2 different regimes are appropriate for different circumstances. But they both ensure that customers benefit from cost savings. Companies are welcome to raise this as part of the 2018-19 RAG consultation.</p>
Table 4W – no column for advanced digestion	Agreed – Ofwat will review APR table to include a column for advanced digestion.
Table 4V – no separate row for abstraction licences	To be considered in the housekeeping note.
Table 4N – what is meant by ‘sludge’ in the column heading?	<p>Ofwat confirms that table 4N is a sewage treatment table and the sludge column is not applicable for 2017-18. Ofwat will make the change to table 4N as part of the RAGs consultation for 2018-19.</p> <p>For 2017-18 purposes, Ofwat’s 2017-18 APR excel table will contain Table 4N that reflects what was published in RAG 3.10. Ofwat will add some text in the annual information note to flag the error and remind companies to ignore the sludge column.</p>
Average pumping head	The graph presented in the slide contains old data, and has been updated via CA Dec 17 submissions. No further action required.

Review of 2016-17 APR

Disclosures

Ofwat provided a non-exhaustive list that set out examples where the companies named had provided good commentaries and/or disclosure notes on a number of specific RAG requirements. Other companies could reference these when compiling their APR submission for 2017-18.

Ofwat also highlighted that there was a concern around data quality. Ofwat stated that the onus is on the company to ensure that data is consistent across different types of submissions.

Two examples were provided:

1. Companies' populated 2016-17 APR excel file did not match with the companies' published 2016-17 APRs in pdf; and
2. More recently, the data consistency issue has been observed in the bioresources RCV allocation data tables that were submitted to Ofwat in January 2018 where data did not match back with what the company had previously submitted in its APR submission for 2016-17.

RAG5

Ofwat had previously provided a review of 2015-16 on RAG 5 to companies at a previous RAWG meeting on 18 November 2016 to help achieve improvements in companies' disclosures for the APR submission in 2016-17. However, Ofwat felt that there seemed little improvement even after highlighting the issues and clarifying the RAGs further for the reporting year 2016-17.

Ofwat provided a quick recap of RAG 3.09 and highlighted the key areas where non-compliance was identified. In a bid to help companies understand the requirements of RAG 3.09 better, an illustrative example was provided to depict a bad example to avoid and a good example to follow.

Ofwat highlighted that the updated RAG 3.10 for the reporting year 2017-18 now has additional reporting requirements in the 'transactions for associates' table for companies to comply with.

Issue	Ofwat post-meeting response and actions
Terms of supply	To review RAGs - to consider including in the RAGs some good and bad examples of descriptions to use as terminology for 'terms of supply'.

Grants and contributions

Ofwat's review of 2016-17 APR's highlighted that some companies are still not following the RAGs in this area. Ofwat listed the errors that were observed. Ofwat demonstrated the correct approach in a series of slides and stressed that this was important because it has an impact on the WRFIM reconciliation which will be assessed as part of the IAP.

No issues were raised on the slides presented.

Net debt

Ofwat pointed to differences in the 'indicative weighted average nominal interest rate' featured in APR table 1E ('Net Debt Analysis') and PR19 business plan table 'App20'. Reporting of this figure on a consistent basis across companies should increase external trust in the robustness of the figure, and promote a level playing field for the sector where it feeds into analysis.

Ofwat proposed that for the 2017-18 APRs, companies should submit Table 1E together with App20, showing how the 'indicative weighted average nominal interest rate' reconciles to the underlying interest cost of the debt instruments submitted in table App20. Guidance for the 2017-18 APRs will be updated to explain how assumptions which could affect the figure (e.g. inflation) should be derived.

Issue	Ofwat post-meeting response and actions
A company mentioned that they might have to check with their auditors on potential issues with Ofwat's proposed option, as Table 1E is audited, and App20 is not.	Ofwat to consult on proposed changes, providing companies with a chance to feed in auditor comments.
A company questioned why the APR table 1E was titled 'net debt' when it does not reflect a company's net debt as they know it.	To review RAGs - Ofwat will consider whether it is appropriate to rename the table to avoid confusion.

Forward look to 2017-18 APR

Ofwat reminded companies of IN 17/08 that was published on 16 November 2017 with reminders and clarifications for this year's reporting.

Ofwat stated that the annual information notice with the 2017-18 audit opinion and APR excel tables will be published in Feb/March 2018.

No issues were raised on the slides presented.

IFRS 16 – leases

Dave Rogers (United Utilities) provided a presentation on IFRS 16 to the group that highlighted the three key issues for regulatory accounting as a result of the new

reporting standard effective for 2019-20. The company suggested setting up a working group to further investigate the impacts.

Issue	Ofwat post-meeting response and actions
<p>Current operating leases – beyond April 2019.</p> <p>IFRS 16 will cause a proportion of totex not to be reportable as totex. Adjustment is required to ensure companies can recover future rentals on existing operating leases from 2019/20</p>	<p>Advised the company to re-route the query to PR19 mailbox.</p>
<p>Future totex allowances for new leases.</p> <p>Assessment of efficient totex for AMP7 will reflect historic accounting for operating leases (as annual opex), which will tend to understate future totex requirements (as equivalent leases will be capex)</p>	<p>Advised the company to re-route the query to PR19 mailbox.</p>
<p>IFRS 16 impact upon direct procurement.</p> <p>There will be an impact on tax which will need to be addressed.</p>	<p>Advised the company to re-route the query to PR19 mailbox to get confirmation of approach.</p> <p>Advised company to follow up any further clarifications about cost mechanisms with the Cost Assessment Working Group. All mechanisms are subject to relevant guidance documents Ofwat has provided – including the PR19 Final Methodology.</p> <p>We will know more about the tax issue nearer to the time BP's are submitted. For DPCs - the approach is set out in the PR19 methodology – companies should set out the tax implications of their DPC proposals in their business plan submissions</p>

General application questions

This segment covered a Question and Answer session based on questions that were submitted in advance of the RAWG meeting to Ofwat.

Issue	Ofwat post-meeting response and actions
<p>Retail non-household activities – companies stated that where they had exited the retail non-household market there still appeared to be 'retail' costs left with the incumbent. The SVT question was centred on;</p>	<p>The vision at PR14 was that a non-household customer would deal entirely with the retailer. Therefore any water efficiency activity on a customer site would be offered and procured by the retailer.</p>

<ul style="list-style-type: none"> • 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 <p>Ofwat pointed out the relevant text in RAG4 for table 2C which sets out the costs which should be recognised in retail (see slides).</p> <p>Ofwat explained that this would all appear to fit with the type of relationship between customer and retailer that was envisaged at PR14 and that the RAG definitions underpinned the basis of the price controls.</p> <p>However SVT did not think that if the wholesaler carried out some of the activities which were to be recognised as 'retail' then the wholesaler would have no right to recover those rights from a retailer. Legal advice had been taken on this issue by SVT.</p> <p>When challenged for an example in practice another company said that if a wholesaler does a site visit, discovers a leak and unilaterally takes action to repair it then, when billed, the retailer can refuse to pay the invoice.</p>	<p>We are not sure why, in the examples given, the wholesaler would get into the position where it carried out unauthorised work on customer premises that it could not recover the costs for.</p> <p>Another company did suggest that the RAGs be revised to move such costs in to wholesale. However, this would mean that the wholesale control would then need to be reopened to reallocate costs, otherwise the generality of customers would end up bearing more costs.</p> <p>Ofwat suggested that if companies consider this a material issue then it could potentially be addressed at PR19. Companies should route a query to the PR19 mailbox.</p>
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Data capture system pilot

Ofwat is developing a data capture system for online submission of data table templates to speed up the processing of data.

Ofwat reviewed the aims of the data capture system and the development timeline that was shared at the last RAWG meeting in February 2017. Unfortunately, due to a variety of factors, Ofwat has not been able to meet the ambitious timelines as first scoped.

Ofwat's data capture system will be developed to meet the minimum viable product for roll-out to live. Ofwat plans to pilot its use with the 2018 annual performance report data tables. Companies will complete and upload the 2018 annual performance report tables template to Ofwat's data capture portal in July 2018.

Ofwat will provide information on how to use the data capture portal in Spring 2018.

Ofwat will rely on enhanced data validation techniques in the excel files for business plans to help validate data prior to companies' submissions.

Long term viability statements

The proposals that Ofwat presented are consistent with that presented in FRC's consultation and required companies to provide greater clarity for stakeholders about the procedures that have been applied in determining that a company is financial resilient .

No issues were raised on the slides presented.

With reference to slide 66, a company asked for clarification on what third party assurance was needed from companies. Ofwat clarified that the use of third party assurance is a decision for company Boards and is not mandatory. It states that third party assurance includes auditors and/or reporters who should report on what has been checked and assured, explaining what and how the company has reached the position it has reached.

Financial flows metric

Ofwat demonstrated the 'three column approach' in a worked example.

Companies to complete both percentage and absolute values but only required to publish the percentages.

A company noted that for governance they were in discussions with auditors in March, so guidance on this was required before they met the auditors.

Ofwat clarified that the RCV growth is the impact of inflation (average RPI) on RCV.

Ofwat states that instructions and an initial template will be published in March 2018 with more details about this. It will apply for AMP6, with new ones in AMP7.

Companies welcomed more guidance on completing the tables in advance to iron out any of the problems as experienced when reporting for RORE.

Water resources

Ofwat's slides noted the importance of a consistent water resources definition and the role of RAG4.06 for the water resources control. The flexibility at the margins of

raw water transport and storage in designation enabled by the licence change was also noted and Ofwat explained that it wanted to have early sight on any issues here.

It was also noted that the RAG currently does not explicitly list desalination and water reuse assets under the water resources definition and Ofwat plan to consult on how to include these in the next version of the RAGs. Thames Water presented on how Beckton desalination plant was allocated, while Northumbrian Water explained how Langford water recycling plant water re-use scheme was allocated.

This was followed by a group discussion, the key points raised included:

- It was felt that for the examples provided the allocations were appropriate
- Effluent re-use was considered to a more complicated option, given the bespoke nature of individual schemes. For example, the differences between direct and indirect reuse schemes, and the issues of co-located works were also raised and how this would impact the allocation.
- Ofwat explained that clarifications to the assets and their definitions would be proposed as part of the RAG consultation, including the allocation of assets for direct reuse where the control structure/assets (between wastewater and water treatment) are likely to be considered as the abstraction point
- The potential for a re-designation of water resources at PR19 was also raised and Ofwat noted that this would only be at the margins and was not anticipated at this time

It was noted that further comments on the water resources definition and the points discussed today would be welcome, these should be sent to [Peter Hetherington](#) and [Simon Harrow](#).

Reporting separate controls after 2020

Ofwat slides noted that as we move into separate controls reporting of costs and revenues that go across the boundary between controls will be important, and that transparency and consistency will be key. We may therefore be trialling more detailed reporting before the next price review period to bring to light any issues that need resolving.

Companies noted that power cost is not metered separately at co-located sites.

Detailed breakdown is not available.

Sludge treatment includes some transport costs, due to where the boundary of bioresources falls.

Companies requested guidance on how to comply with bioresources post PR19, particularly around charging.

Companies wanted guidance on appropriate margin share. Ofwat stated that RAG 5.07 sets out the principles and it's for companies to demonstrate it.

No other issues were raised on the slides presented.

Wrap up, feedback and next steps

- Ofwat reminded companies to channel any PR19 queries to the PR19 mailbox.
- Ofwat will circulate the slidepack and notes to the meeting and publish them to the Ofwat website.
- Ofwat reminded companies that the 2018-19 RAGs condoc will be published around April 2018, with revised RAGs being published in October 2018.
- Companies requested Ofwat to avoid the pre- 15 July period when factoring time in for responses to the RAG condoc for 2018-19.
- Ofwat asked companies to provide feedback on the RAWG meeting to FinanceAndGovernance@ofwat.gsi.gov.uk.