

Date: 22 February 2019

Owat
City Centre Tower
7 Hill Street
Birmingham
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Via Emails to: FinanceAndGovernance@owat.gsi.gov.uk

Dear Sir/Madam,

REGULATORY REPORTING FOR THE 2018-19 REPORTING YEAR

This is South West Water's response to Owat's consultation on regulatory reporting for the 2018-19 reporting year. We welcome the opportunity to respond.

We provide our responses to the questions raised in Appendix A. In addition to these specific points we make the following observations in relation to the reporting of financial flows:

- Across the water industry there are many different types of ownership and capital structures. Some structures result in financial flows up to direct/indirect parent companies in the form of loans, whereas more traditional structures rely on only dividend flows being paid to parent companies. It should be noted that dividend financial flows have to be funded from realised retained earnings as required by the Companies Act 2006, whereas for loans there is no such requirement, which can give rise to financial flows being paid up to parent companies in advance of realised earnings
- All equity like financial flows, including crucially the capital financial flow of the loan advance, should be included in addition to dividend flows to give an overall picture of distributions from regulated companies.

If you have any questions on our views we will be pleased to provide further information.

Yours faithfully,



**Louise Rowe
Finance Director**

APPENDIX A

Question 1

Transparency of financial flows - Appendix 1 contains our new table 1F

a. Do you agree with the scope of the proposed information items in the new table?

We agree with overall objective of the financial flows table, in that it is directed at tracking and transparently showing the regulatory returns earned in comparison with the equity related financial flows such as dividends.

However, we believe the scope of the financial flows table should more fully consider the capital financial flows related loans with direct/indirect parent companies.

b. Is there any information missing from this table which you think should be included in order to achieve transparency and consistency for financial flows reporting?

Across the water industry there are many different types of ownership and capital structures. Some structures result in financial flows up to direct/indirect parent companies in the form of loans, whereas more traditional structures rely on only dividend flows being paid to parent companies. It should be noted that dividend financial flows have to be funded from realised retained earnings as required by the Companies Act 2006, whereas for loans there is no such requirement, which can give rise to financial flows being paid up to parent companies in advance of realised earnings.

To ensure the financial flows table consistently captures all equity-like financial flows between an operational water company and its owners, we believe further consideration should be given to loans with direct/indirect parent companies.

Currently the financial flows table captures interest financial flows related to loans from operational water companies and their direct/ indirect parent companies, but more crucially the capital financial flow of the loan advance is not included. A way to reflect these financial flows and create consistency of reporting would be to include all outstanding loan balances from operational water companies to direct/ indirect parent companies as a financial flow.

Question 2

New connections - Appendix 1 contains our new table 2K

a. Do you agree with the scope of the proposed information items in the new table?

We do not have any specific comments on the changes proposed.

b. Is there any information missing from this table which you think should be included in order to achieve transparency and consistency for new connections reporting?

We do not have any specific comments on potential missing information at this time.

c. Do any of the line item definitions require further explanation?

We make the following observations and request for clarification:

- Line 2K.1 - Infrastructure charges. The table line definition currently says "Value of grants and contributions receivable, as recorded in table 2E, lines 2E.2 and 2E.9". Clarification is

required on which column (1, 2, 3 or 4) the data should link from in table 2E?

- Line 2K.2 - Discounts applied to infrastructure charges. The table line definition currently says "The value of the discount applied to infrastructure charges". Clarification is required on what is meant by discount? Examples of such discounts would help provide consistency of disclosures.
- What is the period covered for the data in table 2K, all connection data or only connection data since the 1 April 2018 (i.e. new charging rules came into effect)?

Question 3

What are your views on the proposed changes to the existing tables in Appendix 1

We make the following observations and request for clarification:

Table	Line	Issue
1A	1A.5	RAG 4.08 "Other Income" definitions say "similarly for adopted assets, both amounts recognised in the year and amortised credits should be recorded in this line". Clarification is required on what are classed as "amortised credits".
2E		RAG 4.08 definitions do not mention that sewer adoption inspection fees are different to sewer requisition contributions. Please clarify whether inspection fees should be included in table 2E or not?
2K	New Table	Response in Question 2
4B	4B.1	RAG 4.08 does not appear to have been updated with the reference change.
4G	4G.2	RAG 4.08 does not appear to have been updated with the reference change.
4J		The title of table 4J is "Atypical expenditure by business unit for the 12 months ended 31 March 20xx - wholesale water", however the Operating expenditure excludes atypical data. Please clarify whether atypical data should be included in the table or the table name changed?
4K		The title of table 4k is "Atypical expenditure by business unit for the 12 months ended 31 March 20xx - wholesale wastewater", however the Operating expenditure excludes atypical data. Please clarify whether atypical data should be included in the table or the table name changed?
4M	4M.29	This table now includes enhancement expenditure for "Transferred private sewers and pumping stations" Please can you clarify whether maintenance expenditure for "Transferred private sewers and pumping stations" should also now be included in the regulatory tables?

Question 4

What are your views on the issues highlighted in section 3 'Future developments in performance reporting'?

a. 3.1 - New accounting standard; IFRS 16 – Leasing.

We do not have any specific comments on the new accounting standard IFRS16 at this time.

b. 3.2 - Table 2A - Impact of additional price control units.

The 2014 Final Determination (FD14) was based on a wholesale water and wholesale wastewater revenue control. Allocations and assumptions for water resources and bioresources were not reflected. If revenue is to be allocated to these additional revenue controls then further clarification of how this should be approached would help support consistency.

c. 3.3 - Bioresources trading.

Similarly to point 3.2, clarity on how revenues should be allocated would help ensure consistency.

d. 3.4 - Impact of Retail non-household exit.

We do not have any specific comments on the changes proposed at this time.

e. 3.5 - Income from 'diversions' activity.

At PR14 we allowed diversions income to be recorded as being outside of price controls as some companies had made this assumption in their business plans. We intend to align RAG 4 appendix 1 with our PR19 confirmed approach of treating diversions income as part of the price control.

We make the following observations and request for clarification:

- RAG 4.08, Appendix 1 Income categorisation still shows "Diversions" income under section "Income not governed by price control". Clarification is required on whether this is an oversight or not and whether Diversions income should now be treated as part of the price control as per PR19?
- RAG 4.08, Appendix 1 Income categorisation shows "s104 sewer adoption fees" under section "Income governed by price control", this appears to be a change from RAG 4.07, Appendix 1. Please can you clarify if this is a genuine change to RAG 4.08?
- If the above is a genuine change, clarification is required on the effective date please. This is because the 2018/19 and 2019/20 tariffs (just published) do not include this revenue in the calculations as s104 sewer adoption fees was not part of the price control at that point. Given the different basis of recognition between FD14 and the proposed 2018/19 regulatory reporting the WRFIM calculations would need to be adjusted to ensure the correct comparison of revenues are made.

Question 5

What are your views on our preference to require all costs associated with the 'Traffic management act' to be reported (section 6)?

We do not have any specific comments on the changes proposed at this time.

Question 6

What are your views on our additional asset type descriptions for Water resources which recognise 'desalination' and 'effluent reuse' abstraction assets (section 7)?

a. Water resource definition changes

We do not have any specific comments on the changes proposed at this time.

We make the following observations and request for clarification:

- This proposal includes a new treatment asset type of desalination and re-use. We agree these are different from traditional treatment and have different costs. Clarification is required on whether it should state "direct re-use", as this is distinct from indirect re-use and the costs will be more akin to desalination. SWW would also query if the definition could be extended to allow other treatment types if the company can demonstrate they are very high cost; this would future proof the definitions.

- Calculation of the Water resource yield is defined as being constrained by the company levels of service. In conjunctive use system levels of service is implicitly linked to the constraints and linkages in the network plus system. Clarification is required on what is meant by “constrained by levels of service in the context of this measure” to ensure all parties are calculating a comparable yield.
- To aid communication and understanding please can you set out in diagram form the range of different water resource measures requested? For example the reporting of water resource yield requires a different calculation to the reporting of the drought resilience metric (which uses DO and no transfers) which is different from the reporting of SOSI and water resource management planning tables. It would therefore be helpful to set all of these different requirements and definitions in one water resource document. Possibly as an extended 4.08 appendix 2?