

Information notice

IN 19/03 March 2019



This is a formal document that alerts our stakeholders to a change in the way that we regulate the water sector in England and Wales.

Regulatory accounting guidelines 2018-19

This information notice summarises the changes we have made to the regulatory accounting guidelines that water and wastewater and water-only companies in England and Wales must follow in preparing their annual performance reports. The annual performance reports show both operational and financial information that companies are required to publish about their regulated business. This is in addition to the statutory accounts required in the UK under the Companies Act 2006.

Background

Statutory accounts on their own are insufficient to assess the performance of price-controlled water companies as their assets typically have a much longer life than an average UK company. The regulatory accounting guidelines (RAGs) define in detail the treatment of particular items (for example, revenue and interest) where Ofwat disclosure and accounting requirements differ from those normally required under UK accounting standards and applicable legislation. Companies use these guidelines to complete their annual performance report (APR). We then use the information in the APR to monitor performance and to inform future policy in relation to the regulated activities.

We expect companies to report this information in a clear and transparent way. Ensuring that stakeholders understand how companies are performing is important in providing trust and confidence in the sector and allowing Ofwat and stakeholders to hold the sector to account.

RAGs 3 and 4¹ have been revised for 2018-19 following a consultation in January this year. This information notice sets out the changes introduced to our revised RAGs. This will impact the APR for the reporting year ending 31 March 2019. Companies must publish their reports by 15 July 2019.

We had 18 responses to our consultation. These have been published on our website. Some respondents made suggestions as to how the table definitions could be clarified and

¹ Updated 29 March 2019

improved. Where appropriate, we have taken these into account and modified RAG4 to give more clarity.

Changes for 2018-19 reporting

Transparency of financial flows

In early 2018 a working group, including representatives from a number of companies, developed an appropriate metric to improve transparency concerning financial flows, incorporating those elements that have the most significant impact on the financial flows to investors. This metric allows clear comparison between the financial flows under actual capital structures that companies have adopted and the structure we have used in setting the prices that customers pay.

On 3 April 2018 we published [IN 18/08: Expectations for companies reporting of financial flows for 2017-18](#) which contains reporting requirements for companies to complete alongside the 2017-18 APR. Following the submission of the data, the guidance notes were revised to further clarify and explain the information required.

In our consultation for 2018-19 we proposed to incorporate the new 'financial flows' table 1F into the APR.

We have received 15 responses concerning financial flows. The vast majority were in favour of the proposals, and we have incorporated the table into our final version.

There were a number of areas that respondents highlighted as needing further attention. This included;

- additional guidance in the line definitions,
- clarifying the treatment for retail non-household exit,
- clarifying consideration of corporation tax in calculations; and,
- consistency of regulatory equity and regulatory capital values (RCVs) used in the calculations.

We have looked again at our guidance and we have addressed concerns in this final version. Additionally, in April we will be publishing our view of regulatory equity on our website alongside the usual RCV values.

New connections – infrastructure

Our [charging rules for new connection services](#) for companies whose areas are wholly or mainly in England (English companies) came into effect on 1 April 2018. Our new rules for English companies include the redefinition and clarification of the services and costs that developers pay for through infrastructure charges. This is to ensure they are fair and address developers' concerns about the charges that they face. The aim of the changes was to make clear what network reinforcement costs English companies can recover through infrastructure charges. We require companies to balance their revenues from infrastructure charges with the costs they are intending to recover over a rolling 5-year cumulative period as far as is reasonably possible.

In the consultation we proposed a new table 2K 'Network Infrastructure reinforcements reconciliation'. This table requires information on the balance of costs and revenue each year.

We have received 13 responses regarding the scope of the new table 2K, all of which agreed. There were some requests for further clarity which we have considered in producing this final version, in particular regarding;

- The table title,
- Operation of the rolling 5 year calculation,
- Impact on Welsh companies; and,
- Clarification of 'discounts'.

Cost assessment data

We proposed corrections to the 2017-18 requirements (such as cross references and requirements that were incorrectly omitted) and aligned the APR requirements with the business plan data table requirements where possible.

There were over 50 points made in response to question 3 in our consultation which were directed towards the requirements in the cost assessment tables. Many of these requests for clarification arose as companies had to include forecasts for similar information in the PR19 business plan tables. Where inconsistencies have been identified we have resolved these where possible.

New lines have been added to 5 tables and some of the table layouts have been revised to aid understanding and reconciliation back to the financial statements. The full list of changes to these tables is in our comprehensive [list of changes to the RAGs](#).

We also asked for views on Traffic Management Act costs, specifically if it should include all costs associated with permit

schemes, i.e. including administration and implementation costs. In our final version we have confirmed that costs should include the associated administration costs but should exclude any fines.

Water resources

We proposed two additional asset type descriptions for water resources – **desalination** abstraction assets and **effluent reuse** abstraction assets. We also proposed an additional reporting requirement for **water resources capacity**.

Respondents agreed with these proposals but requested additional guidance including schematic diagrams. We will work with companies to develop our guidance further for future reporting years.

Interaction between companies' licences and APR requirements

On 18 December 2018 we published our [Conclusions on licence simplification and modification of all instruments of appointment](#) to simplify and modernise various conditions of all appointees' licences which came into force on 1 March 2019. This included replacing Condition F with a new Condition F that omits detailed requirements about the construction and presentation of accounting as that detail is already set out in RAG 3.

Within the published RAGs there are some matters which are outside the framework of Condition F. One example of this is information required on outcomes performance. This information is requested

under other licence conditions. In order to help users understand the basis on which we require information we therefore added a table to RAG 3 setting out the source of the requirement to provide specific information.

Common performance commitment measures

New common performance commitment measures have been included in table 3S, together with updated guidance to cross-refer to detailed descriptions not included in the RAGs. These have been developed as part of the PR19 process.

Financial metrics

New lines added to table 4H which will reconcile the differences in the components of RORE between the actual performance and that forecast at the previous price review.

Other changes

We have made smaller changes in several areas of the RAGs. A comprehensive [list of changes to the RAGs](#) and another for the technical changes to the tables has been published alongside this Information Note. Each of the lists are in 2 parts;

- changes incorporated in the version of the RAGs proposed in the January 2019 consultation; and,
- changes made after consideration of the responses to the consultation.

Next steps and future developments

Companies will be required to publish their 2018-19 annual performance report, and submit their completed Excel table templates by 15 July. The templates will be can be found in [IN 19/06 Expectations for monopoly company annual performance reporting 2018-19](#).

Companies with an annual turnover of less than the £10.2m threshold must complete a separate template which will be published at the same time.

IFRS 16 – leasing

We note that for 2019-20 companies are affected by this new accounting standard. To understand the impact of this we collected information in the PR19 business plan tables. We are not planning to introduce special treatment of these costs in the RAGs but we expect that companies will be able to explain the impact of the change in accounting treatment in respect of the leased assets in their annual performance report.

Following on from this we are thinking about the topic areas where it may be appropriate to make changes to the RAGs in 2020-21 to coincide with the start of the reporting period which relates to the 2019 price review. In our consultation we set out our preliminary views and invited responses in these areas, our latest thinking on each area is set out below.

We will be mindful of the specific views given in these areas and will take this into account

as we work with the regulatory accounts working group (RAWG) to draft reporting requirements. We will schedule a meeting of the RAWG for the second half of 2019.

Impact of additional price controls for PR19

Companies have made suggestions for presenting information on recharges between business units and on applying the 'principal user' rules. We will suggest changes to tables for the 2020-21 reporting year after consulting with companies in early 2020.

Bioresources trading

We suggested that the existing disclosures could be expanded to include costs and profits for bioresources. There was a mixed response to this but there was a suggestion that we should specify that traded volumes are disclosed in addition to existing requirements.

Impact of retail non-household exit

We suggested that there may be a need for an update of the activities listed under each of the wholesale and retail price controls which we could revisit in time for the 2020-21 reporting year. Some companies made suggestions to reclassify some of the activities set out in the RAGs. We will liaise with the RAWG to clarify our requirements in this area to address the issues encountered following exiting the retail market.

Income from diversions activity

We intend to align RAG 4 appendix 1 with our PR19 confirmed approach of treating diversions income as part of the price control. We will ensure that any decisions made as part of the PR19 process are reflected in the RAGs from 2020-21 onwards so that there is alignment between the final determination and the APRs over 2020-25.

Enquiries

If you have any questions about this information notice please email FinanceAndGovernance@ofwat.gov.uk.

More information

Links to any documents cited in the briefing note and any other information that may be of interest to a wider audience;

[Delivering water 2020: final methodology 2019 price review](#)

[RAG Consultation 2018-19](#)

[Charging rules for new connection services \(English undertakers\)](#)

[List of changes to the RAGs](#)

[Pro-forma tables 2018-19](#)

[Regulatory accounting guidelines;](#)

- [RAG 3.11](#)
- [RAG 4.08](#)

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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