

July 2019

Trust in water

PR19 draft determinations

Affinity Water – Accounting for past delivery actions and interventions

PR19 Draft Determinations: Affinity Water - Accounting for past delivery actions and interventions

Following our initial assessment of plans, we categorised two types of actions for slow-track and significant scrutiny companies:

- required actions for companies which in general were required for draft determinations (or final determinations for some aspects of past delivery); and
- advised actions for companies to do by a specific date but that are not required for our draft determinations.

Table 1 below sets out the required and advised actions, the model the action relates to, a summary of the company's response to the action, our assessment of the company's response, and any further interventions we are making as part of the draft determination. Table 1 also sets out any further interventions that are not resulting from an action which we are making as part of the draft determination.

Each action and further intervention that is not resulting from an action has a unique reference. The prefix 'AFW' denotes the company Affinity Water. The central acronym references the test area where the action has been identified, please see the 'PR19 draft determinations: Glossary' for a key to these acronyms. Actions whose numbers are preceded with an 'A' denote required actions. Actions whose numbers are preceded with a 'B' denote advised actions. Interventions not resulting from an action are preceded with a 'C' followed by a three digit code for the model the intervention is relevant to, and a two digit reference for the interventions in that model. The model codes are set out below.

Model	Code
ODIs	002
Land sales	003
WRFIM	005
Totex	006
Water trading	007
Residential retail	008
SIM	009
RCV adjustments feeder model	010
Revenue adjustments feeder model	011

For all other documents related to the Affinity Water draft determination, please see the [draft determinations webpage](#).

Table 1 – Affinity Water’s response to required actions and interventions for draft determinations

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Land disposals	AFW.PD.A1	Required	PR14 Land sales: Affinity Water is required to provide additional evidence to support the forecast trajectory in table App9.	1 April 2019	Affinity Water provides additional evidence to support the forecast trajectory in table App9.	No intervention required. Commentary supplied to support the forecast is sufficient.	N/A
Outcomes	AFW.PD.A2a	Required	PR14 Outcome delivery incentives: Affinity Water is required to update its forecast for 2019-20 performance to take account of the actual 2018-19 performance for all its performance commitments. We expect the company to pay particular focus where we found the evidence provided in its business plan for the 2018-20 forecasts to be insufficient which was for:	15 July 2019	No company action required for the draft determination.	No intervention required. We will review Affinity Water’s updated data before making any interventions for the final determination.	N/A
Outcomes	AFW.PD.A2 _b	Required	W-A2: Average water use	15 July 2019	As AFW.PD.A2a	As AFW.PD.A2a	As AFW.PD.A2a
Outcomes	AFW.PD.A2c	Required	W-A3: Water available for use	15 July 2019	As AFW.PD.A2a	As AFW.PD.A2a	As AFW.PD.A2a
Outcomes	AFW.PD.A2 _d	Required	W-B1: Compliance with water quality standards (mean zonal compliance)	15 July 2019	As AFW.PD.A2a	As AFW.PD.A2a	As AFW.PD.A2a
Outcomes	AFW.PD.A2 _e	Required	W-B2: Customer contacts for discolouration	15 July 2019	As AFW.PD.A2a	As AFW.PD.A2a	As AFW.PD.A2a
Outcomes	AFW.PD.A2f	Required	W-C2: Number of burst mains	15 July 2019	As AFW.PD.A2a	As AFW.PD.A2a	As AFW.PD.A2a

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Outcomes	AFW.PD.A2 _g	Required	W-A1: Leakage	15 July 2019	As AFW.PD.A2a	As AFW.PD.A2a	As AFW.PD.A2a
Outcomes	AFW.PD.A2 _h	Required	W-C1: Unplanned interruptions to supply over 12 hours	15 July 2019	As AFW.PD.A2a	As AFW.PD.A2a	As AFW.PD.A2a
Residential retail	AFW.PD.A3a	Required	PR14 Residential retail: Affinity Water is required to clarify what the correct number of unmetered water customers in 2016-2017 is.	1 April 2019	Affinity Water responds to our action by confirming that the number of actual unmetered water customers in 2016-17 is 659,818. However, this action sought a clarification of the number of reforecast unmetered water customers in 2016-17 because of a difference in this number between the submitted model and table R9.	Intervention required. We issued a query to Affinity Water to clarify that we require confirmation of the correct number of reforecast unmetered water customers in 2016-17. The company confirmed that the correct number of reforecast unmetered water customers in 2016-17 is held by the submitted reconciliation model. Therefore, our intervention is to reinstate the value contained in the submitted reconciliation model.	We are intervening to reinstate the value in the submitted reconciliation model for reforecast unmetered water customers in 2016-17 of 667,225 to replace the figure contained in the submitted table R9 of 667,255. Our intervention does not result in any changes to the total residential retail revenue payment at the end of the 2015-20 period which remains at £1.091 million (2017-18 FYA CPIH deflated price base). Please see published draft determination residential retail revenue reconciliation model for Affinity Water.
Residential retail	AFW.PD.A3b	Required	PR14 Residential retail: Affinity Water is required to clarify the justification for its table R9 2019-2020 forecast which departs from the previously observed trends.	1 April 2019	Affinity Water provides evidence to support its forecasts by referring to details of its metering programme in 2019-20.	No intervention required. The company provides sufficient evidence to support its forecast.	N/A
Residential retail	AFW.PD.C008.01	Intervention not resulting from an action	N/A	N/A	N/A	Intervention required. We are intervening to round Affinity Water's modification factor figures to two decimal places to ensure consistency with the ' PR14 reconciliation rulebook '.	We are rounding to two decimal places, modification factor figures for 2015-16 to 2019-20 associated with the following lines in business plan table R9: <ul style="list-style-type: none"> unmetered water-only customer; unmetered wastewater-only customer; unmetered water and wastewater customer;

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
							<ul style="list-style-type: none"> metered water-only customer; metered wastewater-only customer; and metered water and wastewater customer. <p>Our intervention does not result in any changes to the total residential retail revenue payment at the end of the 2015-20 period which remains at £1.091 million (2017-18 CPIH deflated price base).</p> <p>Please see published draft determination residential retail revenue reconciliation model for Affinity Water.</p>
Residential retail	AFW.PD.C008.02	Intervention not resulting from an action	N/A	N/A	N/A	<p>Intervention required.</p> <p>We are intervening to apply the appointee WACC as the discount rate to be used to provide a financing adjustment for the time value of money of the reward or penalty in line with the 'PR14 reconciliation rulebook'. This may be required if the materiality threshold for financing adjustment is exceeded.</p> <p>Our intervention ensures that there is no mismatch between the discount rate used and the revenue control to which it is applied.</p>	<p>For Affinity Water we are including a figure of 3.85% for the 'Materiality threshold for financing adjustment - Discount Rate.' This replaces the figure of 3.6% contained in Affinity Water's April 2019 submission.</p> <p>Our intervention do not result in any changes to the total residential retail revenue payment at the end of the 2015-20 period because the materiality threshold is not exceeded.</p> <p>Please see published draft determination residential retail revenue reconciliation model for Affinity Water.</p>
SIM	AFW.PD.C009.01	Intervention not resulting from an action	N/A	N/A	N/A	<p>Intervention required.</p> <p>We are intervening to adjust Affinity Water's household retail revenue as a result of its SIM performance from 2015-16 to 2018-19.</p>	<p>We are intervening to set the service incentive mechanism adjustment to - 8.91% of household retail revenue, which is - £12.482 million (2017-18 FYA CPIH deflated price base) in total over the period. We further explain how we calculate this is in the 'Accounting for past delivery technical appendix'.</p>

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
Totex	AFW.PD.A4a	Required	PR14 Totex: Affinity Water is required to provide an explanation on why 2017-18 expenditure values differ in the annual performance report and the submitted business plan table WS15 making corrective changes as appropriate in its annual performance report data or business plan table WS15 data.	1 April 2019	Affinity Water responds to this action in its 'AFW Accounting for Past Delivery Evidence Document' (P.8). It explains that its reported expenditure in its September business plan table WS15 was different to its annual performance report data due to a rounding error. This has been corrected in its April business plan submission.	No intervention required. The company provides a satisfactory response to this action.	N/A
Totex	AFW.PD.A4b	Required	PR14 Totex: Affinity Water is required to provide a detailed and numerically supported explanation to accompany its forecasted performance for years 2018-19 and 2019-20.	1 April 2019	Affinity Water responds to this action in its 'AFW Accounting for Past Delivery Evidence Document' (P.8) It states that it has increased leakage costs and higher supply chain management are some of the drivers of overspend during 2018-20.	No intervention required. The company provides a satisfactory response to this action.	N/A
WRFIM	AFW.PD.A5	Required	PR14 Wholesale revenue forecasting incentive mechanism: Affinity Water is required to provide an explanation to support the table WS13 forecasted performance for years 2018-19 and 2019-20.	1 April 2019	Affinity Water responds to this action. The company provides an explanation to support the forecasted performance for years 2018-19 and 2019-20 which are updated in the April submission and also includes a revenue claim. Affinity Watery makes a revenue claim in respect of higher revenue received relating to new connections than the PR14 revenue allowance. The company has adjusted the recovered revenue values in the WRFIM model to neutralise the impact of the higher contributions revenue, removing the over recovery, which would otherwise have resulted in a negative WRFIM adjustment.	Intervention required. We have raised four queries with Affinity Water to gather more information about its revenue claim, to enable us to understand why new connection volumes are so much higher than forecast and form a view as to whether it could have reasonably been expected to predict the increase and whether there was anything management could have done to lessen the impact. The WRFIM mechanism was introduced at PR14 to incentivise companies to accurately forecast revenue (including income from developers), and given the impact on customers we apply a high bar in terms of the evidence we expect from companies in support of an adjustment. Affinity Water has been able to demonstrate that there was a significant increase in new connections to individual properties fed off a large supply (e.g. a block of flats) compared to its forecasts, but it has not yet provided <ol style="list-style-type: none"> 1. sufficient explanation to support the level of its PR14 forecasts; 2. the reasons why these types of connections have increased so significantly from forecast and 3. an explanation of the process that the company went through to assess its forecasts at PR14 and how it took account of these types of connections in its assessment We are rejecting the proportion of the claim that relates to infrastructure charges for 2018-20, as, under the new ' Charges scheme rules issued by the Water Services Regulation Authority under sections 143(6A) and 143B of the Water Industry Act 1991 ', the company has the ability to smooth infrastructure charges over a five year period to recover its costs. This reduces the value of the claim from £24 million to £15.5 million.	We are intervening to remove the full amount of the revenue claim in respect of higher revenue from new connections. Our intervention decreases the total WRFIM adjustment at the end of the 2015-20 period from £8.212 million to - £15.669 million (2017-18 FYA CPIH deflated price base).

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
						<p>We are rejecting the remainder of the claim as we consider that Affinity Water has not yet provided sufficient explanation to support the claim or sufficient evidence to underpin its forecasts for 2019-20.</p> <p>We will review our assessment based on further evidence provided in the past delivery update in July 2019, including for outturn data for 2018-19.</p>	
All models	AFW.PD.A6	Required	<p>PR14 reconciliations: Further to the actions we have set out to address our concerns over the evidence provided in its business plan for the individual reconciliations, we will require the company to refresh all of its PR14 reconciliations to replace its 2018-19 forecast performance with 2018-19 actual performance and update the evidence for its forecast 2019-20 performance taking into account of the actual 2018-19 performance.</p>	15 July 2019	No company action required for the draft determination.	<p>No intervention required.</p> <p>We will review Affinity Water's responses to its actions and further information provided for all the PR14 reconciliation models before making any further interventions for the final determination.</p>	N/A
Revenue adjustments	AFW.PD.C011.01	Intervention not resulting from an action	N/A	N/A	N/A	<p>Intervention required.</p> <p>We are standardising the discount factor used to profile revenue adjustments.</p> <p>Companies can choose to apply revenue adjustments either in the first year, or, spread over a number of years in the 2020-25 period to minimise the impact on bills or to generate a bill profile that is appropriate for its customers.</p> <p>We consider the wholesale WACC is an appropriate discount factor as this is a measure of the time value of money that is consistent with the price control framework. We are not intervening in Affinity Water's choices for profiling revenue adjustments in 2020-25.</p>	We are using our view of the wholesale WACC (3.09%) as the discount factor to preserve the net present value of the outperformance or underperformance payments due when spreading adjustments over the period.
N/A	AFW.PD.B1	Advised	<p>Affinity Water should produce and provide additional evidence that it has identified:</p> <ul style="list-style-type: none"> the drivers of its performance past and current outcomes performance, including financial and reputational performance commitments; lessons learnt from good and poor past and current performance; the performance gap between current performance and proposed performance in the 2020-25 business plan; and <p>measures to ensure deliverability of the 2020-25 business plan.</p>	24 May 2019	Affinity Water has submitted its response to this action.	<p>Following a risk-based review of Affinity Water's response to this action we will determine whether there is a need for intervention for the final determination.</p>	N/A for draft determination.

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
N/A	AFW.PD.B2	Advised	<p>Affinity Water should produce and provide an action plan that sets out:</p> <ul style="list-style-type: none"> how Affinity Water will continuously monitor performance against PR14 and PR19 performance commitments, including how this relates to section 3 of the Annual Performance Report and what evidence it will look for beyond itself and the sector; how Affinity Water will identify drivers of performance and lessons learnt from both good and poor performance; how Affinity Water will identify measures to improve performance and integrate these into its business; and <p>how Affinity Water will ensure that this is a continuous rather than one-off process.</p>	24 May 2019	Affinity Water has submitted its response to this action.	Following a risk-based review of Affinity Water's response to this action we will determine whether there is a need for intervention for the final determination.	N/A for draft determination.
N/A	AFW.PD.B3	Advised	<p>Affinity Water should produce and provide additional evidence that it has identified:</p> <ul style="list-style-type: none"> the drivers of its complaints handling performance both in terms of the number of complaints and how well complaints are dealt with; lessons learnt from good and poor past and current performance; the performance gap between current performance and proposed performance in the 2020-25 business plan; and <p>the measures planned or already in place to ensure deliverability of the 2020-25 business plan.</p>	24 May 2019	Affinity Water has submitted its response to this action.	Following a risk-based review of Affinity Water's response to this action we will determine whether there is a need for intervention for the final determination.	N/A for draft determination.
N/A	AFW.PD.B4	Advised	<p>Affinity Water should produce and provide an action plan that sets out:</p> <ul style="list-style-type: none"> how Affinity Water will continuously monitor performance, including with reference to CCWater analysis and targets, and those related to the delivery of C-Mex, including what evidence and best practice it will look for beyond itself and the sector; 	24 May 2019	Affinity Water has submitted its response to this action.	Following a risk-based review of Affinity Water's response to this action we will determine whether there is a need for intervention for the final determination.	N/A for draft determination.

Model	Ref.	Action type	Action	Date required	Summary of company response to the action	Our assessment and rationale	Interventions
			<ul style="list-style-type: none"> • how Affinity Water will identify drivers of performance and lessons learnt from both good and poor performance; • how Affinity Water will identify measures to improve performance and integrate these into its business; and <p>how Affinity Water will ensure that this is a continuous rather than one-off process.</p>				

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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