

Information notice

IN 20/03 April 2020

ofwat

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.

Expectations for monopoly company annual performance reporting 2019-20

This information notice covers the information that we expect the largest regulated water companies in England and Wales to produce annually in addition to the reporting requirements for the Annual Performance Report (APR) that are contained in our Regulatory accounting guidelines. It also provides a link to the Excel template for small companies to submit the two pro forma tables which are required in RAG 3.11.

Potential impacts of COVID-19 pandemic

As Rachel Fletcher set out in her [letter](#) to company chief executives of 19 March, all water companies are working extremely hard at the absolutely critical work of providing customers with reliable water and wastewater services, while protecting their employees' welfare as the UK contends with the effects of COVID-19.

We are very much aware that this will have consequential impacts across companies' businesses, some of which are uncertain at this time. At present, we expect that companies are likely to be able to proceed with submitting their APRs and accompanying submissions by 15 July without impacting on the provision of essential services. However, we recognise that the situation is fast moving.

Consequently, if a company considers that it may not be able to deliver a complete and/or appropriately assured APR and accompanying submissions by the deadline because of the impacts of the COVID-19 pandemic, it should contact us. We will then engage with the company to understand what issues it faces and how we can ensure that there is no impact on the delivery of essential services as a result of the submission of information to us. Companies should initially contact us by email at FinanceAndGovernance@ofwat.gov.uk clearly setting out what they expect the impacts to be and why, and their proposed options for an appropriate way forward.

Background

One of the three goals set out in our strategy is to transform water company performance. A key part of achieving this is through the publication of information about how the companies are performing. This helps us, customers and other stakeholders to hold companies to account.

We expect all monopoly companies to decide how best to report their performance each year. But we also expect companies to publish some common information. This is to allow customers and other stakeholders to compare the performance of individual companies to the rest of the sector. The largest companies also publish their comparative information on the [Discover Water](#) website. Providing comparative information helps us, customers and other stakeholders challenge companies on performance and future targets.

Each company's board is accountable for the quality and transparency of the information it provides on its performance. Companies should set out the assurance processes they have followed in providing the information about their performance.

What companies will publish

As part of their annual reporting we expect companies to be transparent about their performance and explain clearly, and in a balanced way, what is driving performance, and the steps they are taking to improve. This should cover all aspects of performance, including financial and operational performance.

The following sections set out either what we expect companies to publish in addition to the reporting requirements for the APR that are contained in Regulatory accounting guidelines or provide further clarification for 2019-20 reporting on areas where we have previously set out our expectations.

Risk and compliance statement

A risk and compliance statement, appropriately signed off, in which the Board clearly confirms that the company:

- considers that it has full understanding of, and is meeting, all its relevant statutory, licence and regulatory obligations and has taken steps to understand and meet customer expectations;
- has satisfied itself that it has sufficient processes and internal systems of control to fully meet its obligations; and
- has appropriate systems and processes in place to allow it to identify, manage, mitigate and review its risks.

Where the company considers it is unable to provide such a statement it should explain why it is unable to do so.

Data assurance summary

A data assurance summary of the results of the data assurance that the company has carried out to evidence that the data provided is accurate.

Board leadership, transparency and governance

The new [board leadership, transparency and governance principles](#) came into effect from 1 April 2019. A new licence condition came into effect on 1 August 2019 requiring companies to meet the objectives of the principles and explain in an effective, accessible and clear manner how they have done so. Companies' 2019-20 reporting will therefore be against the new principles.

In [Board leadership, transparency and governance – Report on companies' preparations for meeting the 2019 principles](#) we signalled important areas of focus for companies in their explanations of how they are meeting the objectives.

Requirements and expectations for ring-fencing certificates

In [IN 20/01: Requirements and expectations for ring-fencing certificates](#), published in February 2020, we set out guidance for companies on preparing their ring-fencing certificate and accompanying statement of factors. Companies should follow this guidance when submitting their ring-fencing certificate and accompanying statement alongside their APR. To clarify, we expect companies to explain that the ring-fencing certificate has been subject to assurance and link to the audit opinion provided in the APR that contains the ring-fencing certificate. Companies are also responsible for ensuring that Ofwat receives a copy of any other report provided by the auditors on the ring-fencing certificate.

Financial flows table

Companies should follow the following guidance when completing table 1F (financial flows for the 12 months ended 31 March 2020 and for the AMP to date) of the APR.

- The table should be completed on an accruals basis with the exception of:
 - dividends – which should reflect the actual cash payments made in the period / price control period; and
 - outcome delivery incentives – which should reflect the value of any underperformance payments due or outperformance payments earned up to the end of the period / price control period.

- Any changes / adjustments should be made to all reporting periods to ensure the accuracy of the data for the price control period.
- Companies should include the impact of any service incentive mechanism (SIM) penalties or rewards as stated in [PR19 final determinations: Accounting for past delivery technical appendix](#). The values should be recorded equally across the first four years (2015-19) only and deflated into a 2012-13 price base.
- As the table falls within section 1, it should be covered by the audit opinion which covers the tables in section 1 and 2 of the APR.
- Gearing out / under performance: In order to represent the true benefit or dis-benefit to shareholders, the monetary value and percentage calculated in the '**actual returns and actual structure**' columns should equally apply to the '**actual returns and notional structure**' columns. The percentage should not be calculated on the notional structure basis which was the case in previous years. The reporting template has been amended to reflect this.

IFRS16 – leasing

We note that many companies will be reporting under the new accounting standard for the first time this year. We set out in [IN 19/03: Regulatory accounting guidelines 2018-19](#), published in March 2019, that we are not planning to introduce special treatment of lease costs in the Regulatory accounting guidelines for 2019-20. Where companies have changed the accounting treatment in respect of leases, we expect companies to explain the impact of the change in their APR.

Companies should provide a reconciliation of their total expenditure to the previous accounting treatment to provide a consistent measure of totex performance.

We will be proposing in the forthcoming regulatory accounting guidelines consultation that all companies should report leases in accordance with IFRS 16 in APRs for periods ending March 2021 onwards to provide annual reporting consistent with the treatment of leases in PR19 final determinations.

Leakage and per capita consumption

Companies report leakage and per capita consumption information in table 3S (Shadow reporting of new definition data) of the APR. We expect companies to identify any changes that are required to earlier reported information for 2017-18 and 2018-19 clearly stating the reasons for any changes. The information for all three years should reflect full compliance with the reporting guidance set out in each company's 2019 final determinations performance commitment appendix.

As set out in each company's appendix we expect the company to provide commentary in its 2019-20 APR submission describing any differences in its 2019-20 total leakage level expressed in megalitres per day (Ml/d) and per capita consumption expressed in litres per person per day (l/p/d) in

comparison with its business plan forecasts. Reasons for any differences should be clearly explained and their volumetric impacts quantified.

SIM proxy

As set out in the [PR19 methodology](#), companies are required to estimate a proxy for their SIM score in 2019-20. We confirm how this should be calculated in [Reporting guidelines for SIM proxy and C-MeX and D-MeX in 2019-20](#) which is appended to this information notice.

Shadow year reporting for C-MeX and D-MeX

The new customer measure of experience (C-MeX) and developer services measure of experience (D-MeX) mechanisms introduced as part of the 2019 price review (PR19) have been running in shadow form since 1 May 2019 and until 31 March 2020.

Companies should report their annual scores from the shadow year in their 2019-20 APRs. We set out guidance for this in [Reporting guidelines for SIM proxy and C-MeX and D-MeX in 2019-20](#) which is appended to this information notice.

Reporting transition expenditure in Table 4B

This section applies to companies with allowed PR19 transition programme expenditure in 2019-20 only.

For the 2019-20 APR, we consider it is appropriate to deviate from the strict interpretation of the RAG 4.08 line definition for transition expenditure (line 4B.6) as strictly following the line definition would mean that only the 2015-20 transition expenditure (incurred in 2014-15) would be recorded within this line. This would result in no adjustment to exclude the 2020-25 transition expenditure from 2019-20 actual totex and impact on the cost performance incentives as 2019-20 totex would be overstated.

As set out in [PR19 final determinations: Securing cost efficiency technical appendix](#), we allowed companies to bring forward investment from the 2020-25 period to 2019-20 under the transition programme. This expenditure will be incurred in 2019-20, however for the purpose of the 2015-20 and 2020-25 totex incentives it needs to be considered as expenditure incurred in the 2020-25 period.

In the 2019-20 APR companies should report the transition expenditure incurred in 2019-20 within line 4B.6 'transition expenditure'. This will be entered as a negative value so that it is treated as a deduction to actual totex and excluded from line 4B.7 'adjusted actual totex'. The values included in line 4B.6 should be capped at the maximum allowed value with any excess transition expenditure being reflected within the 2015-20 totex. Please continue to report any 2015-20 transition expenditure

incurred in 2014-15 (as an addition to actual totex) within the cumulative 2015-20 position such that the cumulative values for the 2015-20 period reflect the value of the 2014-15 transition spend minus the value of the 2019-20 transition spend.

We would expect to include the positive value of the 2019-20 transition spend in the totex analysis of the 2020-21 APR.

Information on PR14 reconciliation

The reconciliation for performance over the 2015-20 period included in the PR19 final determinations was based on 2019-20 forecasts, since outturn data was not available at that time. In our [PR19 reconciliation rulebook – proposed approach and policy](#) consultation we explain that we treat this year as the ‘PR19 blind year’ and set out our proposed approach for the blind year adjustment. The blind year adjustment will require companies to refresh all of their PR14 reconciliations to replace the 2019-20 forecast performance with 2019-20 actual performance. We expect companies to submit their PR19 blind year information alongside their APR in July 2020.

However, at PR19 companies did not provide their detailed calculations for outcome delivery incentives (ODIs) at a performance commitment level in a prescribed standardised format; companies only provided the resulting payments. We completed the relevant calculations independently and where we found a difference we set out our calculation in detail in the ODI model that we published on our website with the final determinations.

To increase the transparency of this exercise we propose that companies use the new ODI performance model for the 2020-25 period (see section 2.3 of [PR19 reconciliation rulebook – reconciliation model guidance](#)). This includes standardised calculations that will be applicable for most ODIs.

We propose to work with companies to agree and finalise before June 2020 a version that they will use to reflect the assumed performance that were made at PR19. Companies should provide their initial version by 30 April 2020. For models provided by this date we will review and confirm the model accurately reflects the final determination or suggest changes by 29 May 2020. Companies should use the agreed version to reflect any changes to ODI payments from replacing the 2019-20 forecast performance with 2019-20 actual performance and provide this their PR19 blind year information alongside their APR in July 2020.

If a company believes that it may now not be able to provide an initial version of its model by 30 April because of the impacts of the COVID-19 pandemic it should contact us.

Assurance

Each company is responsible for implementing assurance procedures to make sure they meet all of their legal and regulatory obligations. We explained in [IN19/04: Update on information quality and assurance](#), published in August 2019, that we would no longer be publishing Company Monitoring Framework (CMF) assessments. However, in that notice we set out the expectation that all companies should adopt, as a minimum, the requirements of the ‘targeted’ category.

The wording of the audit opinion that we expect all auditors to provide is set out in [Audit Opinion for the Annual Performance Report 2019-20](#). As a minimum the audit opinion should cover the pro forma tables in section one and section two of the APR and should be consistent with this required wording where appropriate.

Next steps

Companies should:

- publish the information set out in this information notice no later than 15 July; and
- as soon as practicable after publication send us a link to where the information has been published.

It would improve transparency for stakeholders if companies also publish or link to the latest accounts of their ultimate controller on their websites.

As we set out at the beginning of this information notice, where a company considers that it may not be able to deliver a complete and/or appropriately assured APR and accompanying submissions by the deadline because of the impacts of the COVID-19 pandemic it should contact us.

Companies should send electronic links to FinanceAndGovernance@ofwat.gov.uk and upload any supporting information, tables, or copies (that they would have otherwise attached by e-mail) to our SharePoint DCS website. We have created a folder for ‘July APR 2020’.

Where evidence emerges that a company is not providing assurance or may not be complying with its obligations and commitments we will take appropriate action to protect customers. We reserve the option to ask for more specific information on any performance issues which we deem carry significant risks to customers or if we do not have confidence that a company is meeting its obligations and commitments. The action we take would be targeted, proportionate and progressive in nature – where appropriate starting from informal action and resulting, if necessary, in more formal action. Our [approach to enforcement](#) provides further detail.

Enquiries

If you have any questions about this information notice, please send them to FinanceAndGovernance@ofwat.gov.uk.

More information

[RAG 1.08 – Principles and guidelines for regulatory reporting under the ‘new UK GAAP’ regime](#), November 2017

[RAG 2.07 – Guideline for classification of costs across the price controls](#), March 2017

[RAG 3.11 – Guideline for the format and disclosures for the annual performance report](#), March 2019

[RAG 4.08 – Guideline for the table definitions in the annual performance report](#), March 2019

[RAG 5.07 – Guideline for transfer pricing in the water and sewerage sectors](#), April 2017

[Discover Water website](#)

[IN19/04: Update on information quality and assurance](#), August 2019

[IN 20/01: Requirements and expectations for ring-fencing certificates](#), February 2020

[Board leadership, transparency and governance – principles](#), January 2019

[Reporting guidelines for SIM proxy and C-MeX and D-MeX in 2019-20](#), April 2020

[Data table template for the PR19 blind year submission](#), Excel template

[Audit Opinion for the Annual Performance Report 2019-20](#), April 2020

[Ofwat’s approach to enforcement](#), January 2017

[2020 annual performance report tables](#), Excel template

[2020 annual performance report tables – small companies](#), Excel template

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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