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Information notice

April 2021

IN 21/01 Expectations for monopoly company annual performance reporting 2020-21

This information notice is relevant to all large appointees, new appointees and the infrastructure provider (Tideway). The regulatory accounting guidelines (RAGs) set out the form and content of large companies' annual performance reports (APRs) and new appointees' annual returns. This ensures that data is published consistently across the sector which promotes transparency and allows all stakeholders to understand and challenge companies' performance.

This information notice provides clarification and further detail in some areas on what we expect companies to provide in their APRs and contains links to the Excel templates for companies to use when submitting their APR tables. It also sets out some additional information which we would like companies to publish alongside their APRs.

Updates to the regulatory accounting guidelines

We consulted on changes to the RAGs in June 2020. Following the consultation we published IN 20/08 Regulatory accounting guidelines 2020-21 on 30 November 2020, which sets out the RAGs for 2020-21. We allowed companies 30 days to raise any issues. Following some of the comments received from companies following publication, we have made some changes to the RAGs that we published, principally to clarify our expectations and also to correct errors. We set out a list of the changes in Changes to the 2020-21 regulatory accounting guidelines since IN 20/08 which is published alongside this information notice.

Deadline for submission and publication of the APR

In IN 20/08 Regulatory accounting guidelines 2020-21 we said we were considering whether to require publication of tables 3A-3I early in July, with the remaining APR tables submitted on 15 July. Following further discussions with stakeholders and reflecting further on the responses, on balance we have decided to retain the submission date of 15 July 2021 for all APR tables including tables 3A-3I. We still expect there to be two separate submissions (for the reasons described in the 'Reporting for in-period ODIs' section below). But, given that this is the first year for submitting data for 2020-25 and other challenges such as Covid-19, we consider that bringing a submission date forward in 2021 is not appropriate. Should we wish to amend the submission date in the future we will consult and ensure companies have sufficient time to plan for any changes. Companies should ensure that they report against the most recent version of all their performance commitments as the performance commitments set in the PR19 Final Determinations outcomes appendices have been subject to a small number of changes and corrigenda.

Part 3A (Performance Measure Adjustments) of condition B of companies' licences allows for Ofwat or companies to initiate determinations to adjust one or more price controls to reflect performance against certain notified performance commitments during the 2020-25 period (in-period determinations). Consequently, we expect to make in-period outcome delivery incentive (ODI) determinations for all 17 of the large appointees in relation to performance for the 2020-21 reporting year with the exception of in-period per capita (PCC) consumption performance commitments, unless we are otherwise requested to do so (see 'Changes in consumption pattern (impacts on PCC performance commitments)' section below). Companies should submit the populated in-period adjustment model and any other supporting data or information (such as proposals for bill smoothing and bill impacts) alongside their APR submissions.

Reporting for in-period ODIs

By 15 July we expect companies to make two separate submissions. One of these will be the Excel version of tables 3A-3I and the other will contain the rest of the APR tables. This is because we have merged the ODI performance model and tables 3A-3I into one spreadsheet.

We invite all companies to review the spreadsheet, published alongside this information notice, that contains tables 3A-3I and the ODI performance model. We invite companies to provide us with comments on this spreadsheet and confirmation that it correctly represents their performance commitment data. To do so, they should email OfwatPandO@ofwat.gov.uk by 30 April 2021. The outcomes data in this spreadsheet is primarily based on PR19 final determinations outcomes data although we have made a small number of updates. For example, for most companies' leakage and PCC commitments we have altered the desired direction from down to up in the ODI performance model. This is because these targets are expressed as percentage reductions, so an increase in these numbers denotes a reduction in leakage and this change was required for the ODI out and under performance payments to be calculated correctly. Where applicable we have also incorporated any updates covered by changes and corrigenda to the PR19 outcomes appendices. We have not yet made the changes to ODIs that are contained in the Competition and Market Authority's March 2021 determinations for the four appellant companies. We invite the four appellant companies to amend the ODI performance model in line with the CMA findings. We will review these changes and all of the other company feedback we receive by 30 April and incorporate in a final version of the 2020-21 ODI performance model.

Our expectation is that companies' submitted data will comply with the PR19 common performance commitment definitions. This use of common, converged methods for reporting data increases transparency for all stakeholders and makes comparisons across the sector more meaningful. If the data submitted is not based on a fully converged methodology then companies should clearly state this and demonstrate that not being fully compliant does not have a material impact on the reported performance. If the move to convergence affects baselines for any performance commitments then companies should also show this clearly.

Companies should provide a proportionate level of evidence and reasoning in their commentaries that allows us to clearly understand their performance and associated ODI payments. For example, performance commitments with enhanced ODI rates require knowledge sharing, so we expect companies to include evidence and insight about knowledge sharing.

Reporting on and accounting for the impacts of Covid-19

When communicating with companies throughout the Covid-19 pandemic (for example in our March and July 2020 letters) we have been clear that we expected companies to work flexibly and innovatively to deliver the best possible outcomes for their customers. We have emphasised that we did not want achieving targets or other incentive mechanisms in the wider regulatory regime to be a barrier to doing the right thing. We explained that we would consider any need for an adjustment in the round as part of our normal reconciliation processes, which would include the in-period ODI process for 2020-21 performance.

Companies may choose to explain in their 2020-21 APR how they have worked flexibly and innovatively to deliver services for customers due to Covid-19 and any influence this has had on their performance. In light of this, companies may also choose to make the case for an intervention where they consider there has been a material impact.

The onus will be on the company to set out clearly its reasoning and its supporting information for this. The collaborative work led by Frontier Economics during 2020, and our subsequent engagement with stakeholders, identified some of the wider sector issues and some company specific issues that might be relevant for performance reporting this year. In light of this we considered whether there were any areas where we needed to intervene now in order to retain incentives on companies to deliver, or to re-align incentives with our original policy intentions. Overall, we considered that there was only one area (PCC) where we needed to intervene at this time and a small number of issues where specific additional reporting guidance for all companies was necessary. We set these out below, followed by our expectations for considering other issues.

Changes in consumption pattern (impacts on PCC commitments)

The sector-wide work with Frontier Economics and, in many cases, the conversations we have had with individual companies, highlight concerns around the impact of the shift in consumption from non-household to household customers on the common PCC performance commitment.

We wrote to companies on 22 March 2021 with our proposed approach for this performance commitment. We set our out position that water efficiency and associated incentives remain a high priority but that significant uncertainties remain about the impact Covid-19 has had and to what extent impacts might persist in the medium and long term. We therefore advised that, for those companies with in-period ODIs on these performance commitments, we are considering delaying any decisions on incentive payments for this particular performance commitment until PR24. Our decision for each company at that point would take account of how well companies have risen to the challenges of promoting water efficiency and considering any implications for long-term planning. We have welcomed companies' views on this proposal and will subsequently consult with them and with other stakeholders on any changes.

We now confirm that, unless companies ask us to do so, we do not expect to make in-period determinations in November 2021 to adjust revenue for companies' performance on PCC. However, as we set out in our March 2021 letter, we expect companies to continue to report each year, in their APRs, against the performance commitment level set out in the final determination, and to report what the expected financial payments associated with this would be.

Water industry national environment programme (WINEP), National Environment Plan (NEP) and bathing water

Companies have raised with us that, due to the impacts of Covid-19, the Environment Agency has extended year one WINEP delivery dates by six months and will not produce a bathing water quality assessment for 2020. Each of these changes has implications for performance reporting and determining incentives for associated performance commitments. We expect companies to explain in their commentaries what, if any, impact either of these issues has had on their reported performance, how they have dealt with the issue and the basis of their reported figures for the 2020-21 reporting year. We are aware that Natural Resources Wales has also agreed to a number of National Environment Plan (NEP) scheme delays on the Water Quality programme and we will adopt a comparable approach if companies in Wales are affected by Covid-19.

For WINEP, for example, if a company reports based on forecasts of whether the Environment Agency will sign off all of its year one WINEP schemes at the end of September 2021 then it should make it clear that the reported number is a forecast. In this case the company should then confirm its actual WINEP delivery in the autumn and, assuming we receive it in time, we will review this as part of the in-period determinations process, looking across the sector. We would expect any such update to be provided no later than the deadline for the consultation we will run on the draft in-period determinations, otherwise we will not be able to account for this information in our 2021 in-period determination.

Business void properties

Some companies have performance commitments which incentivise them to reduce business void properties. Performance is measured using vacant flags in the Central Market Operating System. Between April and August 2020, to account for the impacts of Covid-19, this vacant flag was used to mark a business as temporarily closed. Companies should explain how they have accounted for use of the vacant flag during this period in arriving at their reported performance for 2020-21.

Other issues raised

We are mindful that companies have also raised a number of bespoke issues with us. As we explained in our letters to companies, we will consider the need for any adjustment in the round. This is because the potential influence of Covid-19 is not limited to performance commitments, it may affect other aspects of company activities as well. In addition, the net impact on any specific activity may not become clear in a single reporting year. For example costs are reconciled once at the end of the period as part of the next price review, in contrast to the annual in-period ODI process.

Companies have raised particular issues on the cost of bad debt and, beyond those discussed above, performance commitments. On bad debt specifically, we are aware that whilst many companies have reported increases to bad debt provisions during 2020-21, the impact on cash collection is not yet clear. We welcome companies' commentary on the impacts Covid-19 has had on bad debt charges, debt management costs, levels of provision, cash collection rates and the actions they are taking to manage these impacts efficiently for their customers.

For performance commitments and ODIs, there will be a high bar for any adjustments, particularly where comparison across the sector demonstrates there is scope for flexible and effective delivery. If a company considers we should intervene as a result of material impacts on its performance in 2020-21 due to Covid-19, then it would need to:

- evidence the impact and that this is caused by circumstances arising from restrictions imposed due to Covid-19;
- evidence how it has adapted and responded in a way that it considers is in the interests of customers;

- explain how it has sought to overcome any shortfall in service provision in order to deliver the relevant outcome and how it will bring the performance commitment back on track in subsequent years;
- identify and explain interactions with, or influences on, other performance commitments;
- demonstrate clear understanding of the potential long term implications for planning and investment; and
- demonstrate how intervening (and what type of intervention) would be in customers' interests and retain incentives on the company to deliver the relevant outcome.

To inform our assessment in the round, companies would also need to demonstrate that an intervention now is timely and consistent with the allocation of risk assumed within the regulatory framework. So if proposing adjustments, we also expect companies to identify within the wider regulatory framework:

- favourable circumstances which have arisen or are anticipated – including those that may result from unexpected impacts of Covid-19 – and their impact on the company's performance; and
- any relevant protections or reconciliation mechanisms.

Ring-fencing certificates and long term viability statements

When preparing their ring-fencing certificate, companies should continue to follow the guidance set out in IN 20/01 Requirements and expectations for ring-fencing certificates, published in February 2020. As a reminder, we expect companies to set out how 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 the assurance report provided by the auditors specifically on the ring-fencing certificate as agreed with Ofwat.

For preparing long term viability statements, IN 19/07 Expectations for companies in issuing long term viability statements published in April 2019 still applies.

Bioresources reporting

We launched our review of the bioresources market in October 2020 after identifying potential issues in our market monitoring report. We will consult on our findings in May 2021. The following two areas are related to this work as they will support the bioresources market, but are being progressed now.

Market information and market monitoring

After initial engagement with the sector, on 17 March we published a consultation on proposals to amend the existing Direction that we issued to companies in relation to information they are required to provide on bioresources. This consultation sets out our proposal for obtaining additional information in relation to:

- **market information** – in particular, supply and demand information, transport routes and renewable energy incentives; and
- **market monitoring** – in particular, more disaggregated data to better reflect the levels of market activity across the different bioresources activities.

This consultation closes at 5pm on 15 April 2021. Our amended guidance would require companies to produce specified information under Condition M1 (Information remedies) of their licences. Therefore, we would not require companies to provide this information as part of their APRs.

Accounting for sludge liquor costs

Alongside this information notice we have published our final decisions on how companies should account for the costs of treating sludge liquors going forward. Our position is unchanged from our draft proposals; companies should shadow report the costs of liquor treatment using the standard methodology developed by Jacobs for the remainder of the 2020-25 period, and use the standard methodology when agreeing sludge trades from 2021-22 onwards. We will review company submissions as the 2020-25 period progresses to ensure this reporting is accurate and consistent and may issue additional guidance as appropriate.

Companies should also continue to use their current methodology for accounting for liquor treatment costs for the remainder of the 2020-25 period and clearly state the methodology within the 2020-21 accounting methodology document submitted to us. Further details can be found in our final decisions document.

Financial flows

Following feedback from companies, and as discussed at the Financial Flows workshop on 27 January 2021, we are making two amendments to Table 1F as shown in Changes to the 2020-21 regulatory accounting guidelines since IN 20/08.

Board statement on accuracy and completeness of data

We confirmed in our Consultation on regulatory reporting – Responses document, published in November 2020, that we would proceed to introduce a requirement for companies to provide a board statement on accuracy and completeness of data and information as part of their APRs. The requirements for this statement are set out in paragraphs 4.41 to 4.44 of RAG 3.12.

As we explained in our Consultation on regulatory reporting for the 2020-21 reporting year the intention is that this statement builds on and replaces what was achieved through the company monitoring framework (CMF). For the avoidance of doubt companies are **no longer required to fulfil any of the requirements of the CMF**. Companies may choose to continue with some of the specific mechanisms which they employed under the CMF, for example the use of risks, strengths and weaknesses statements. However, there is no expectation that they must do so and it will be for boards to determine the approaches which best work for their individual company.

Audit opinion wording for the 2020-21 APR

We are publishing Audit Opinion for the Annual Performance Report 2020-21 alongside this information notice. This sets out the wording of the audit opinion that we expect all auditors to provide on companies' 2020-21 APRs. The template has been updated to reflect the new audit requirements arising from ISA (UK) 570 and ISA (UK) 700 and has been shared and agreed with the audit firms.

Greenhouse gas emissions

Our Consultation on regulatory reporting – Responses document, and the accompanying information notice (IN 20/08 Regulatory accounting guidelines 2020-21), outlined the reasons for and changes to how we would like companies to report on their Greenhouse Gas (GHG) emissions for 2020-21. In summary, we proposed adopting a voluntary approach to begin with, with the intention being for reporting to become standardised and mandatory in future, in relation to both operational and embedded emissions.

Alongside this document, we have published IN 21/02 Regulatory accounting guidelines 2020-21: Further guidance on reporting of greenhouse gas emissions providing further guidance on how we would like companies to report on operational GHG emissions. It would be helpful if companies provided this reporting alongside and at the same time as they submit their APRs. A brief update on embedded emissions is also provided.

Un-invoiced revenue in the event of a business retailer failure

We have previously confirmed that, in the event of a business retailer's unplanned exit from the business retail market, a wholesaler should be able to recover relevant un-invoiced revenues for services that the wholesaler has provided to that retailer, but which were not due for invoicing until after the point of retailer failure. This is referred to in Covid-19 and the business retail market: Proposals to address liquidity challenges and increases in bad debt – decision document and Questions raised in response to Ofwat's final decision published on 30 April 2020. Relevant un-invoiced amounts will be reconciled through the Revenue Forecasting Incentive (RFI) mechanism.

We are consulting separately on the relevant licence changes and PR19 Reconciliation Rulebook changes and will make any changes that are needed as a result of this in the 2021-22 RAGs. If, due to a business retailer failure in the 2020-21 period, a company wishes to apply for reconciliation of relevant un-invoiced amounts through the RFI mechanism we will set out reporting requirements to the wholesalers concerned as soon as possible.

New appointee reporting requirements

Under the new appointments and variations (NAV) framework, new entrants can enter the water sector to serve household and non-household customers instead of incumbent companies. There are currently eight such new appointees which have different reporting requirements to incumbent companies due to their size and because they are not subject to full price controls. Instead of producing full APRs, new appointees complete a 'small company return' in line with requirements set out in the RAGs.

In this section we provide feedback on the 2019-20 reporting produced by new appointees and reiterate our expectations and new requirements for reporting on 2020-21 and beyond.

Feedback on 2019-20 reporting

We reviewed the 2019-20 returns and other information submitted by new appointees. We have engaged with individual new appointees on the specifics of their submissions. To improve future submissions, we are also sharing our high-level findings.

Our review considered the timeliness and completeness of the information submitted, and the quality and accuracy of the data. New appointees should produce and publish data and information accurately, to a high quality and in a timely manner so that customers, developers, regulators and other relevant stakeholders are able to hold them to account for their performance and resilience. This is increasingly important as the small company returns are to be published from 2020-21.

We noted the following areas for improvement:

- The majority of submissions were not complete by the 15 July deadline set out in the RAGs and two new appointees failed to submit any information at all by 15 July 2020. Several other companies failed to submit all the required information by 15 July and further information was only submitted after queries.

- We received no proactive communication from the relevant new appointees to inform us of any potential delays or discuss issues with us. We are concerned about the timeliness of regulatory financial submissions and will continue to monitor this area closely.
- We also uncovered some examples where costs were not allocated in accordance with the line definitions for table 1 of the small company return. For example, we consider some wholesale costs were incorrectly reported as retail costs, and some financing costs were reported as wholesale costs.
- We are aware that some new appointees are part of larger groups and make use of support services from other group companies. In line with RAG 5.07, new appointees need to ensure that an appropriate level of costs are allocated to the regulated business and that any recharges are included within operating costs in the small company return.

We have engaged with individual new appointees on specific issues and broadly reiterate our high expectations for all new appointees. New appointees are required by their licence to comply with our reporting requirements and ensure the timeliness and accuracy of information that they provide. Where new appointees fall short, we will take action where necessary, in line with our approach to enforcement.

Reporting requirements for 2020-21 and beyond

As set out in the RAGs, new appointees have some new reporting requirements for the 2020-21 reporting year. This includes a customer-focused performance summary, site-specific detail on leakage and residential PCC, and a statement confirming that the company maintains sufficient financial security. New appointees are also to publish their small company returns for the first time.

The details, including line definitions, of these new requirements are set out in the final RAGs – see section 5 of RAG 3.12 (pages 26-27) and section 15 of RAG 4.09 (pages 135-137).

In terms of the customer-focused performance summary, we have not been prescriptive other than to say new appointees are to include a summary of incidents and payments made under the guaranteed standards scheme, and provide narrative on how they have delivered the 'no worse off principle' when serving their customers. We encourage new appointees to consider what measures will best reflect the levels of service delivered and overall benefits realised when providing services to their customers. This could include key performance metrics, discounted charges for customers and wider social or environmental benefits.

For the 2021-22 reporting year and beyond, we published a consultation on our monitoring and reporting approach for new appointees in February 2021. Our decisions will be informed by stakeholders' responses and the quality and consistency of reporting that is provided by new appointees in July 2021 with respect to the 2020-21 reporting year.

Enquiries

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

More information

RAG 1.09 – Principles and guidelines for regulatory reporting under the 'new UK GAAP' regime

RAG 2.08 – Guideline for classification of costs across the price controls

RAG 3.12 – Guideline for the format and disclosures for the annual performance report

RAG 4.09 – Guideline for the table definitions in the annual performance report

RAG 5.07 - Guideline for transfer pricing in the water and sewerage sectors

Changes to the 2020-21 regulatory accounting guidelines since IN 20/08

2020-21 annual performance report tables (excluding tables 3A-3I) (incorporating small company return tables), Excel template

2020-21 annual performance report tables: tables 3A-3I and the ODI performance model, Excel template

Audit Opinion for the Annual Performance Report 2020-21

IN 20/01 Requirements and expectations for ring-fencing certificates

IN 19/07 Expectations for companies in issuing long term viability statements

IN 21/02 Regulatory accounting guidelines 2020-21: Further guidance on reporting of greenhouse gas emissions

Reporting of sludge liquor treatment costs - final decisions