December 2021

Regulatory reporting requirements for new appointees in 2021-22 – Our conclusions

Ofwat

About this document

This document sets out our conclusions relating to our July 2021 consultation on the **regulatory reporting requirements for new appointees in 2021-22**, for submission by **15 July 2022**. It follows from our February 2021 consultation on the monitoring and reporting approach for new appointees.

The new appointments and variations (**NAV**) framework enables new entrant companies (**new appointees**) to replace an existing company (**incumbent**) as the provider of water and/or wastewater services in a specific geographical area in England and Wales.

Alongside this document we publish:

- the responses we received from stakeholders to our consultation;
- the final regulatory reporting requirements for new appointees, including guidelines and line definitions;
- the final reporting tables for new appointees to complete as part of preparing and submitting their annual reports to Ofwat in July 2022 and subsequent years.

Contents

1. Introduction

The new appointments and variations (**NAV**) framework enables new entrant companies (**new appointees**) to replace an existing company (**incumbent**) as the provider of water and/or wastewater services in a specific geographical area in England and Wales.

We previously consulted on our monitoring and reporting approach for new appointees in February 2021 (our **February consultation**). This consultation, which was open until 26 April 2021, set out our high-level proposals and invited early views from stakeholders on a new reporting framework for new appointees.

We also published a number of related consultations on regulatory reporting requirements, primarily aimed at incumbents:

- our May 2021 consultation on regulatory reporting requirements for 2021-22 for incumbent companies – where we said that we would separately consult on requirements for new appointees in the 2021-22 reporting year (from 1 April 2021 to 31 March 2022); and
- our June 2021 consultation on changes to the regulatory treatment of overhead costs.

In July 2021 we consulted on regulatory reporting requirements for new appointees (our **July consultation**) with respect to the 2021-22 reporting year under Condition F of new appointees' licences.

This document summarises the responses we received and our final decisions.

Together with this document, we also publish the resulting reporting requirements for new appointees ('Regulatory reporting requirements for new appointees in 2021-22 – guidelines and line definitions'). New appointees have one month to decide whether to dispute revisions to these requirements. If a new appointee wishes to dispute any revision it must let us know in writing no later than **17 January 2021**.

2. Our July consultation

2.1 Our proposals

We consulted on many substantive policy issues in our February consultation and published our policy conclusions in July 2021.

In our July consultation on new regulatory reporting requirements, which built on our policy conclusions, we proposed the following (with a draft template and line definitions):

- **Documentation approach**. We proposed to simplify and streamline how new appointees' regulatory reporting requirements are documented so that it is clearer what is required when preparing their annual submissions. We proposed a single document distinct from the Regulatory Accounting Guidelines (**RAGs**) that currently apply to incumbents and new appointees. We asked for detailed comments on which elements should apply to new appointees, which we cover in section 3 of this document.
- **Financial reporting tables**. We proposed to implement new financial tables for new appointees, to include tables for revenue and operating costs, a reconciliation between regulatory and statutory reporting, a statement of financial position, a cashflows statement and net debt analysis.
- **Performance reporting tables**. We proposed to implement new performance measures against which new appointees would report, to ensure full coverage of key service areas. This includes measures relating to water operations, wastewater operations and retail services, as well as relevant explanatory data such as number of properties served. We also asked specific questions on unique identifiers and the guaranteed standards scheme, which we cover in section 3 of this document.

Our proposed reporting requirements would apply to the 1 April 2021 to 31 March 2022 reporting year.

2.2 Overview of responses

We received responses from seven stakeholders to our consultation, which was open from 13 July to 30 August 2021. We publish these responses on our website.

Respondents included:

- three new appointees (Independent Water Networks, Leep Water Networks and Severn Trent Connect);
- three incumbents (Affinity Water, Wessex Water and Yorkshire Water); and
- one other stakeholder (ESP Utilities Group).

3. Our assessment and decisions

3.1 Documentation approach

What we said in our consultation

We asked for comments on our proposed documentation approach for the regulatory reporting requirements for new appointees.

This included inviting views on:

- whether we should produce a single set of documents containing the reporting requirements for new appointees;
- whether there were further comments on issues raised in earlier consultations on the Regulatory Accounting Guidelines which may affect new appointees;
- our proposals for which parts of the existing Regulatory Accounting Guidelines should apply to new appointees, our proposed adjustments and draft text, including a streamlined requirement for an accounting policy and methodology note; and
- our proposed approach for allocating regulatory overhead costs.

Stakeholders' responses

All respondents agree with our proposed documentation approach.

No respondents provide comments on issues raised in previous consultations on the Regulatory Accounting Guidelines that may affect new appointees.

Respondents are supportive of the parts of the existing Regulatory Accounting Guidelines that we proposed apply to new appointees. Severn Trent Connect says it is concerned about the level of precision proposed for allocating 'other operating costs' for retail services. The respondent also disagrees with disaggregating operating costs for metered and unmetered customers due to the high metering penetration for new appointees.

ESP Utilities observes that allocating costs could be onerous for new appointees and asks how the non-household retail activities of new appointees should be reported. The respondent also says it is concerned about the level of detail of the accounting policy and methodology note requirements.

Respondents are supportive of our proposed approach to allocating regulatory overhead costs. Independent Water Networks suggests splitting retail costs further by water and wastewater services.

Our assessment and decisions

We confirm our proposal for a single set of documents which set out the reporting requirements for new appointees and which we publish on our website.

As we set out in our July consultation, we are mindful of maintaining the overall proportionality of reporting requirements for new appointees. We want to avoid the full reporting requirements that currently apply to incumbents from applying to new appointees as they grow in size, except where it is appropriate to do so. As such, and as proposed in our February consultation, we are removing the 'small company threshold' which is based on turnover.[1] We will differentiate between new appointees and incumbents based on condition B of the company's licence (which establishes whether or not it is subject to full price controls). We consider this offers sufficient flexibility over time.

Our July proposals principally maintain existing reporting requirements for new appointees (such as on cost allocation) while making it clearer and more transparent which parts of the main Regulatory Accounting Guidelines apply to new appointees. We have also adapted them to the circumstances of new appointees, for example clarifying that requirements relating to our expectations on executive pay and dividends from the 2019 price review (PR19) do not apply to new appointees at this time. We summarised this in a table, with references to the corresponding requirements in the Regulatory Accounting Guidelines (see pages 7-8 of the July consultation).

In response to the specific issues raised by respondents:

- We consider it is important to allocate operating costs between household and non-household customers, and between metered and unmetered customers. As well as being consistent with existing requirements, this will support effective comparisons and help to identify efficient service delivery among new appointees, which could be used to inform our price controls for incumbent companies, a key potential benefit of the new appointments and variations framework.
- While there are relatively few unmetered customers served by new appointees, we do not consider it disproportionate for new appointees to separately report retail costs for these two customer types. Given their relatively low numbers we consider it should be manageable to do this and will reveal useful cost information.
- We note the need to allocate costs is an existing reporting requirement for new appointees. We do not consider it to be onerous given the relatively simple nature of new appointees' businesses. Where new appointees have more significant variation in the types of services they provide, this added transparency is important. The accounting policy and methodology note that we require is highly streamlined compared to the requirement for incumbents and we consider it is appropriate to ensure trust and confidence in new appointees' reporting.

[1] The 'small company threshold' was originally set in 2016, in the Regulatory Accounting Guidelines, and was based on the thresholds for defining a small entity as set out in the Companies Act 2006.

- For the non-household retail activities of new appointees, for clarity our proposals included reporting of costs relating to non-household retail activities in table F1. Performance measures include services to non-household customers where relevant (for example, water supply interruptions).
- In terms of splitting retail costs further by water and wastewater services, we consider this would add undue complexity. We do not currently collect cost information at this level of granularity for incumbent companies and do not intend to do so in our early thinking for the 2024 price review (PR24).

We therefore decide to maintain our proposed approach, subject to the final drafting of RAGs 2 and 3 with appropriate adjustments, which we set out in the final guidelines and line definitions document for new appointees.

3.2 Financial reporting information

What we said in our consultation

We asked for comments on the format and draft line definitions for the financial reporting tables that we proposed to apply to new appointees.

This included the following tables, to replace the existing table (S1):

- F1: Analysis of revenue and operating costs
- F2: Reconciliation of Regulatory to Statutory reporting
- F3: Statement of financial position
- F4: Statement of cashflows
- F5: Net debt analysis (appointed activities)

We also included information relating to the reporting of transactions with associated companies.

Stakeholders' responses

Respondents are supportive of our draft proposals with the following comments:

- Leep Water Networks suggests the cashflow statement (table F4) could be sensitive and that the level of detail required on net debt (table F5) is greater than what is required in statutory requirements and could also be sensitive.
- ESP Utilities considers the reporting requirements are onerous and would lead to additional work where they differ to statutory requirements.
- ESP Utilities considers our proposed threshold of £10,000, above which new appointees would report transactions with associated companies, is unduly low. It suggests this will capture hundreds of transactions, including payroll recharges.

- ESP Utilities also observes that overhead cost reporting could be commercially sensitive.

Our assessment and decisions

We do not consider the reporting of new appointees' cashflows, net debt position or overhead costs is commercially sensitive given the regulatory context of their operations. This information will be aggregated and therefore will not reveal costs at a site-specific level. Reporting this information is consistent with requirements for incumbent companies.

While this may involve additional work, we consider this is a necessary part of the regulatory framework and commensurate to regulated companies' roles as monopoly providers of essential services. We note that the cost of regulatory compliance is allowed for within the revenue controls we set for incumbents, which in turn provides an implicit allowance for new appointees because they are subject to relative price controls.

In terms of the threshold above which new appointees are to report transactions with associated companies, we proposed that this would be, for single transactions, 0.5% of the turnover of the appointed business (or £10,000 if greater). We consider this is an appropriate threshold, reflecting the relative scale of new appointees in contrast to the £100,000 threshold that currently applies to incumbents. We note that for payroll charges, the management charge for payroll services is relevant, not the total payroll.

We therefore decide to maintain our proposed format and line definitions for the financial reporting tables that are to apply to new appointees.

3.3 Performance reporting information

What we said in our consultation

We asked for comments on the format and draft line definitions for the performance reporting tables that we proposed to apply to new appointees. We proposed to implement new performance measures to ensure full coverage of key service areas.

This included the following tables, to replace the existing table (S2):

- P1: Performance – non-financial information
- P2: Performance – retail
- P3: Performance – water
- P4: Performance – wastewater

In line with existing requirements, and our July policy conclusions, we proposed that these measures would be reported on a site-specific basis.

We proposed to use the explanatory data in P1 (i.e. property numbers, length of mains and length of sewers) in calculation blocks in tables P2, P3 and P4 to automatically calculate standardised values against each performance measure so that the new appointee's performance is in line industry definitions and could be effectively compared.

We asked whether we should prescribe an approach for producing unique identifiers, to help with long-term data management, or enable new appointees to develop and maintain their own unique identifiers.

For the statutory Guaranteed Standards Scheme, we noted that new appointees were required to provide a summary of payments under this scheme for the 2020-21 reporting year. This was at a company level, broken down by each standard. We did not propose to increase the granularity of this reporting, with new appointees able to continue to provide this information in their narrative performance summaries in a format determined by them. We invited views on whether we should go further.

Stakeholders' responses

On our proposed line definitions and reporting tables, respondents are supportive of our draft proposals with the following comments:

- Leep Water Networks expresses concerns with site-specific reporting, suggesting it may be misleading. ESP Utilities says this would be overly onerous and suggests instead providing this at a company and at a water supply or wastewater collection zonal level. The respondent also suggests the data capture systems required for site-specific reporting would be disproportionate. Independent Water Networks also says it prefers national or regional reporting instead of site-specific reporting.
- Severn Trent Connect supports site-specific reporting but suggests removing the performance summaries as part of this.
- Leep Water Networks says new appointees should only report incidents wholly within their control. The respondent says it does not consider it to be reasonable to assess a company's operational performance based on upstream supply issues.
- Severn Trent Connect queries whether sewers in use prior to adoption should be counted in the length of sewers to be reported in table P1.
- Yorkshire Water proposes including the target number of connected properties on each site, to help indicate the development progress of each site.
- Yorkshire Water identifies an issue with the line definition relating to per capita consumption.

In terms of unique identifiers for each site served by new appointees, Leep Water Networks proposes new appointees use their own identifiers while Severn Trent Connect, ESP Utilities and Affinity Water say they would prefer us to prescribe an approach.

In terms of the Guaranteed Standards Scheme, all respondents agree with maintaining the current approach. Wessex Water says the requirement for new appointees should be the same as for incumbents.

Our assessment and decisions

As set out in our July conclusions, we consider site-specific reporting is appropriate because it reflects the newness of the reporting framework and will support greater trust and confidence in the data provided by new appointees. It should help to facilitate effective comparisons with each incumbent, enabling stakeholders to aggregate performance data from individual sites to the level of the regions served by incumbents. It is also proportionate because new appointees should already be collecting information at this level (in line with their applications to serve individual sites, where in most cases they committed to match or exceed the level of service provided by the incumbent they replaced).

While we are introducing further standardised performance measures, we consider there is merit in maintaining the requirement for a high-level performance summary. This will support companies to explain their performance in the round to their customers and other stakeholders, providing further context where appropriate.

In terms of specifying measures that are wholly within the control of new appointees, we consider it is important to clarify our expectations. New appointees choose to enter the water sector, which involves complying with their legal obligations and meeting the expectations of our NAV policy. Some new appointees arrange bulk supply or discharge agreements while others provide their own upstream services. In either case, new appointees are responsible for complying with their legal and regulatory obligations as well as meeting their customers' expectations. While we recognise that some performance issues may result from upstream incidents, new appointees can mitigate this through terms in their bulk agreements and seek to explain this to their customers. In addition to the above measures, new appointees can explain their performance in the high-level performance summary, which is part of the reporting requirements for new appointees.

In terms of including sewers in use prior to adoption in the reported length of sewers, we consider this should be consistent with the existing requirements for incumbents. We would not expect this to include sewers that are not owned or and maintained by the new appointee.

We do not consider the annual performance report is the best place to capture the stage of development sites served by new appointees at this time. We correct the line definitions for the per capita consumption measure in line with Yorkshire Water's suggestion.

On unique identifiers, we are content for new appointees to use their own approach provided they are internally consistent and logical. New appointees could consider using their Ofwat acronym followed by an ascending number (for example, for a company with the Ofwat acronym ABC, its first two sites would be ABC000001, ABC000002, and so on).

In light of respondents' comments, we maintain our approach for the Guaranteed Standards Scheme. We will not prescribe a format or further granularity and expect new appointees to continue to provide this information in their narrative performance summaries in a format determined by them that is accessible to their customers and other stakeholders. We do not consider it appropriate or proportionate for new appointees to have the same reporting requirements as for incumbents at this time.

3.4 Other comments

We received additional comments which we address below.

3.4.1 Overall framework

Independent Water Networks asks us to clarify whether the small company threshold, above which new appointees would be subject to full reporting requirements in line with incumbent companies, will be removed from April 2022.

Wessex Water asks when new appointees will be expected to submit full regulatory returns.

Our view

We confirm that we will remove the small company threshold, as currently set out in the Regulatory Accounting Guidelines, and link the basis of reporting requirements for new appointees with the status of condition B of their licences (which establishes whether or not a water company is subject to full price controls).

We consider our current approach is appropriate and proportionate for the current size and scale of new appointees' operations. We have no plans to require new appointees to be subject to full reporting requirements, equivalent to those of incumbent companies, at this time. We consider our approach provides sufficient flexibility to refine the reporting requirements for new appointees as they grow and the market evolves.

3.4.2 Financial security requirements

Independent Water Network says that it understands the rationale for requiring new appointees to maintain one year's annual operating costs to mitigate risks of failure but requests that we review the requirement as new appointees become more established.

Our view

We consider the financial security requirement for new appointees to be out of scope of this consultation on regulatory reporting requirements as it is derived from our NAV policy.

3.4.3 Quality of submissions

Independent Water Networks says that while it initially suggested these new reporting requirements should apply to 2022-23, all required information will be available for 2021-22. The respondent asks for reassurance that we would act proportionately if some data items are not available in the correct format for 2021-22.

Our view

Companies should complete their annual performance reports in line with the requirements set out in the Regulatory Accounting Guidelines, as required by their licence.

4. Next steps

Companies have one month to decide whether to dispute revisions to the regulatory reporting requirements for new appointees by asking for a reference to the Competition and Markets Authority (CMA). If a company wishes to do so, it must let us know in writing within one month of receiving notice that a revision will take effect. We expect to receive any such notification no later than **17 January 2022**.

In light of comments that we receive, we may reissue the regulatory reporting requirements for new appointees, and any associated documents and templates, in early 2022. In line with previous years, we expect to produce an information notice reminding new appointees of their annual reporting obligations in spring 2022.

New appointees will then submit and publish their annual performance reports in line with our regulatory reporting requirements for 2021-22 by **15 July 2022**.

We will revise the regulatory reporting requirements as necessary in future years, in line with the process set out in companies' licences.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales.

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