

Regulatory reporting consultation response
Ofwat, Centre City Tower
7 Hill Street
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19 July 2017

By e-mail: FinanceAndGovernance@ofwat.gsi.gov.uk

Consultation on regulatory reporting for the 2017-18 reporting year

Dear Sir/Madam

Please find attached Welsh Water's response to the consultation on regulatory reporting for the 2017-18 reporting year.

We are broadly comfortable with the proposed guidance and note that most of the revisions seek to promote greater clarity of reporting and consistency among companies.

We have made some specific points on areas where we would like to see greater clarity and, with the proposed extension of the APR to accommodate additional tables, we would urge a review of existing data tables to ensure that all requested data is still required by Ofwat.

Yours faithfully

Owen Hamnett
Financial Controller

Questions relating to 2017-18 reporting

Q1 Appendix 1 contains new tables for:

- **Information on new connections (table 2J)**
- **Information on cost assessment tables (tables 4J to 4W)**
 - a. **Do you agree with expanding the APR with more tables to capture more granular cost data?**
 - b. **Do you agree costs should be captured through a controlled process?**
 - c. **Do we have sufficient guidance and definitions for the additional line items provided?**
 - d. **What line items need further definition?**

We agree that new connections (table 2J) is an area that will benefit from more granular cost data and note that the clarifications and additions to the revenues tables will also help in this regard. It will also be useful to introduce this for the 2017/18 APR process, ahead of the rule change for calculating charges of this type for companies operating wholly or mainly in England.

We can see two areas of potential confusion for reporting which will, at the least, require some explanatory commentary and, ideally, would be backed up by clarifying statements in the final published RAGs. These relate to the start date for any changes to charges rules for new connections services in Wales and the potential for misalignment of grants and contribution recovery contained within wholesale revenue controls, especially in the WRFIM calculation. We understand the reason for including expenditure information in the on-site/site specific capex memo column but think that this would benefit from an explicit definition in RAG 4.07 to ensure comparability.

With regard to the information on cost assessment tables (tables 4J to 4W), we think that the current dialogue with the CAWG and RAWG is working well to ensure that the definitions are adequate. We suggest that the line items are refreshed once the review of the 2016/17 CAT submission has been reviewed and lessons learned.

We believe that a controlled process is appropriate to promote consistency and comparability of data.

As a general point, there are a number of definitions which refer to the JR11 guidance. The JR11 guidance is an historic document and we believe that, where definitions rely on existing definitions, the full definition should be included in the current RAG rather than have a sign post to a very old document. This can easily be achieved by a “cut and paste” exercise and would make the documents more appropriate by being self-contained.

Q2 What are your views on the proposed changes to the existing tables in Appendix 1?

a. Tax and non-appointed revenue (table 1A)

We consider that the proposal to split non-appointed revenue between imported sludge, tankered waste and other is not unreasonable, however we would question why this would be a requirement of the RAGs since the income is by definition non-appointed and therefore outside of the scope of the instrument of appointment.

We agree that it would be helpful to require disclosure of the split between current and prior year tax impacts in order to calculate the effective tax rate; we have disclosed this split by way of note in our 2016-17 Annual Performance Report.

b. Totex analysis (table 2B, 4D and 4E)

We welcome the proposals to improve clarity of definitions and add granularity. We are unsure of the precise nature of the two new lines intended to provide the “ability to create proxy for pre-2015 infrastructure renewals expenditure” and would therefore request that the line definitions be made as clear as possible to avoid any ambiguity.

We question the ongoing need for the reporting of unit cost information on tables 4D and 4E. When these were first included in the table there was no other comparative analysis of costs. Now that the annual return includes new tables capturing appropriate cost drivers it would seem sensible to remove the analysis from these two tables.

c. Other minor changes

We are broadly comfortable with all other changes to the existing tables.

Q3 Do you agree that there will be some residual non-household retail activities (for example, developer services and meter reading) for an incumbent that exits the non-household retail market?

We can see that this might be the case in some instances.

Q4 Do we have sufficient guidance around cost allocations between business units?

We consider that there is sufficient guidance around cost allocations between business units.

Q5 Do we have sufficiently defined boundaries for water resources and bioresources?

As Q4, we consider that there is sufficient definition of the boundaries for water resources and bioresources.

Q6 Have we provided sufficient guidance for Average Pumping Head in table 4P (wholesale water non-financial data)?

Chapter 12 of the June Return Reporting Guidance provided in-depth guidance for the Average Pumping Head. We believe it would be useful to review this guidance and include in within the RAGs. Reviewing the June Return guidance, we believe that further guidance on the measurement of the 'lift' at each site would be beneficial. An extract from JR11 guidance is shown below and the definition of 'lift' is not clear to us.

June Return Chapter 12 Line 5: Average pumping head

The key reason we collect this data is as an explanatory factor for power costs. Therefore the variable needs to reflect the amount of pumping that a company needs to do. In order to do this we need to know, in effect, how much each megalitre of water is pumped through the process, from abstraction to supply. Obviously this cannot be measured in practice so a calculation is used instead.

$$\text{Average pumping head} = \frac{\sum_i (l_i * WP_i)}{V_p + V_g}$$

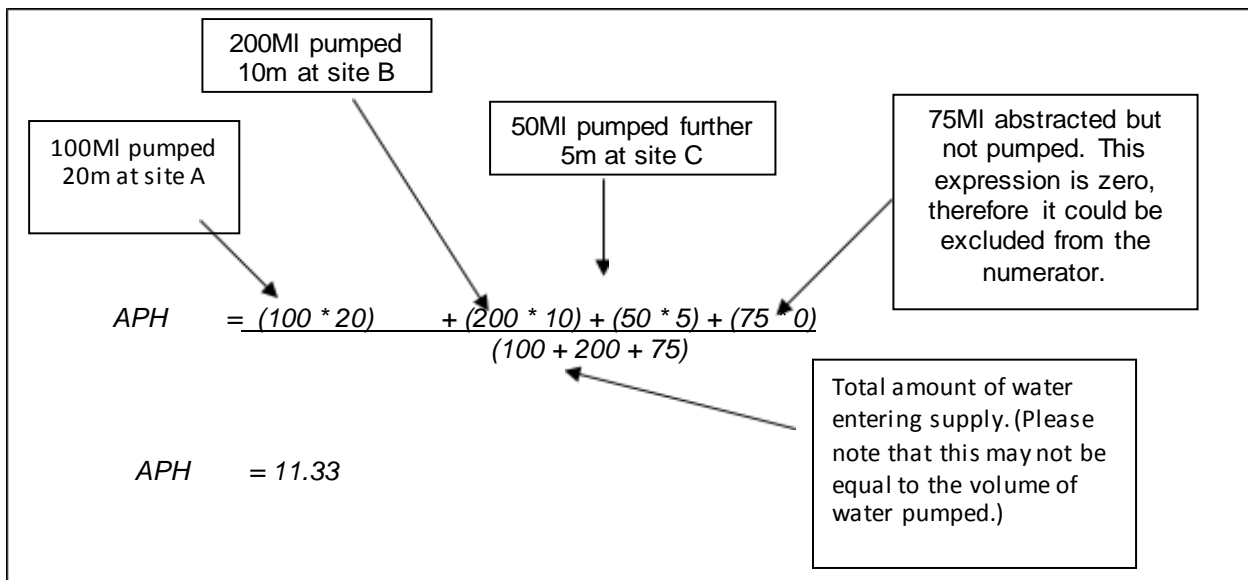
where: l_i = annual mean lift at site i
 WP_i = volume of water pumped at site i
 $V_p + V_g$ = total volume of water that enters supply (pumped and gravity fed)

Included below is an example of how average pumping head should be calculated (the numbers are not representative of a real life situation, just for illustrative purposes.)

A company has the following processes:

- 100 MI of water is pumped 20m at site A
- 200MI of water is pumped 10m at site B, then 50MI of this water is pumped a further 5m at site C (a booster station). The remainder of the water is gravity fed to customers
- 75MI of water is abstracted and reaches supply without ever being pumped.

The average pumping head for this company would be calculated as follows:



The average pumping head should be calculated using data from all sites if possible.

Pumping of **non-potable water** into supply (for example for stream support) should not be included in the average pumping head calculation.

Pumping of water that is exported to another company (**bulk supply exports**) should not be included in the average pumping head calculation.

We would expect all other pumping used in the abstraction, treatment and supply of water to be included in the pumping head calculation. This includes pumping as part of the treatment process and the pumping of process water.

Questions relating to Outcomes reporting

Q7 Should companies accrue for future ODI revenue rewards/penalties?

With regard to the accounting treatment, we do not consider that companies ought to accrue for ODI rewards/penalties that will be realised through adjustments to future revenues.

The mechanism is similar to the over- or under-recovery of revenues; in our case, an over-recovery in 2015/16 has resulted in a compensatory tariff adjustment in 2017/18. We did not accrue or otherwise provide for this in our 2015/16 or 2016/17 financial reports.

Q8 Do you have any comments on our proposed shadow reporting of leakage, supply interruptions and sewer flooding according to the new consistent reporting guidance?

Over the last two years we have been involved in an UKWIR-led project to review the consistency of reporting for these three key measures (leakage, supply interruptions and sewer flooding). The working groups have largely agreed a set of reporting guidelines for shadow reporting. We will report our 2016/17 performance using the latest guidance and will follow an assurance process broadly similar to our 2016/17 APR assurance process. In our 31 August 2017 return, we will however point out that for supply interruptions we are unable to report our 2016/17 performance explicitly in line with the guidance as we did not have our full area covered by data loggers. For 2017/18, we now have those loggers in place and are recording and reporting in line with the convergence measure guidance.

It is paramount that all companies report performance using the new shadow reporting guidance, which must have clear definitions; if it is found to contain any inconsistencies or anomalies then the guidance should be updated accordingly.

Question relating to small companies (RAG3)

Q9 Do you agree with the proposal to raise the small company turnover threshold to £10.2m?

We consider this to be appropriate and in line with statutory reporting requirements.

Questions relating to transfer pricing guidance (RAG5)

Q10 Does RAG5, in its current form, inhibit efficient bioresources trades from happening? If so, please explain why and if possible, provide evidence.

We think that the RAG 5 in its current form, in particular the suggested addition of the clarifying sentence in 9.8: *“In cases where a company considers that a marginal costing technique is the most suitable means of charging for a particular service within a group, it will be expected to justify its reasons for using this technique”* will be sufficient to allow companies to ensure that transfer prices can be set to allow efficient trades.

Q11

- a. **Which of our proposed two options (Option A: incremental cost or above and Option B: incremental cost or above plus a margin) do you prefer and why?**
- b. **In the case of Option B, do you agree with our proposed approach to specifying an appropriate margin? Please explain your reasoning and provide evidence where possible.**

We consider that option B, together with the clarity provided by the explanation of the considerations for setting an appropriate margin, is preferable to avoid ambiguity. The explanation of the approach to specifying an appropriate margin makes clear what should be taken into account when arriving at the share of the margin.

Q12 What implications or concerns (if any) do you foresee for new entry to the bioresources market, as a result of our proposals on transfer pricing for bioresources?

The proposals should ensure that charges can be offered in the market that allow rational choices to be made between in-house treatment or exporting indigenous sludge which would allow companies to compete on a level playing field

Q13 Are there any other ideas that you propose, to improve our regulation of transfer pricing for bioresources? If so, please provide analysis and where possible, evidence, to support these.

We welcome the positive approach that Ofwat has taken in dealing with industry concerns with regard to the previous RAG 5 guidance and would suggest that the development of the market place is monitored and a similar collaborative process undertake if unforeseen issues arise.

Q14 Are there any other matters which we should be taking into consideration regarding transfer pricing for bioresources?

We have not identified any other matters which should be taken into consideration at this time.

Q15 Do our changes have any implications for the rest of RAG5 or for activities other than bioresources?

We have not identified any such implications at this time.