

Consultation on overhead cost reporting – revising RAG2

Response on behalf of Severn Trent Water &
Hafren Dyfrdwy

2 August 2021

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Contents

Executive Summary	2
Responses to questions 1-4	3

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This response is provided on behalf of both Severn Trent Water and Hafren Dyfrdwy. In the document, references to “we” or “our” should be read as referring to both companies. Where necessary we have referenced the individual companies within our response to make clear where the response is not relevant to both companies.

Summary Response

We welcome this opportunity to comment on Ofwat’s proposals for “Overhead cost reporting – revising RAG2” and have set out our responses below.

We have provided answers to the four consultation questions below.

We are supportive of the updates to RAG2 and the introduction of Developer Services as a price control for PR24 and AMP8. The proposed updated RAG 2.09 includes developer services as a price control, although such a change will not take effect until AMP8. We believe that the RAGs for reporting during AMP7 should only reference those price controls that exist during AMP7. Information on Developer Services that is required to support the shadow reporting for PR24 should be collected under an information notice.,.

If you have any queries or wish to discuss the response in more detail, please do not hesitate to contact.

Rob McPheely
Group Financial Controller

Q1. Do you agree with the guidance that we propose adding to RAG2?

We support the updated structure and additional clarity to RAG2, as it provides a more logical and consistent layout to the document.

However, we do not consider it to be appropriate to require reporting of a new price control that was not included in the previous Price Review, (Developer Services) during the AMP. Companies are required to prepare their APRs in accordance with the RAGs in force at the time. If Developer Services is included in RAG2 as a price control, Companies will be required to prepare the APR with Developer Services as its own price control. This would not be in line with the PR19 Final Determinations.

Based on the wording in the consultation, our interpretation is that it is not Ofwat's intention for companies to report in the APR with this additional price control from APR22. As such, we do not believe it is appropriate for the line item in table regulation costs to be updated to tenths.

In our view section 6 should reflect the price controls covered by the PR19 Final Determination. However, we do support the collection of Developer Services data for shadow reporting for PR24 and believe that this could best be achieved in a separate process outside the APR

For more information, please see our response to question 4.

Q2. Are the 'general and support' categories carried over from RAG 2.08 still appropriate? If not, then what should we use instead?

We consider the list of general and support categories to be comprehensive, with no obvious omissions.

The presence of "Other general and support costs" provides the flexibility if a new category was required, and we do not believe any further updates are required.

Q3. Are there any areas that we have not covered by these proposals that we should?

As discussed in section 1, we do not believe it is appropriate to treat developer services as its own price control in AMP7, and that the proposals should only relate to potential shadow reporting.

The updated cost allocation for regulation costs is sensible for large companies and companies with a relatively even split between water and waste customers. For companies with a large differential in the customer base, then these splits may not be appropriate.

For example, Hafren Dyfrdwy is a water and wastewater company, but the water business is much larger than the waste water business. This, along with Hafren Dyfrdwy being a small company, means that allocating the regulation costs as set out in table 1 of the consultation disproportionately impacts the waste water and bioresources price controls. This has the potential to make these price controls look inefficient at a price review. We believe that WASCs should be permitted to adopt a more appropriate allocation methodology where there is a significant difference in the sizes of their water and waste water businesses.

Q4. For 2021-22 we are considering asking companies to report costs on both their existing approach and the new approach so that we can understand the impact that this has on the allocation of costs across controls. Would you agree with this approach? If not, then how could we assess the impact of this in advance of the PR24 business plan submissions?

We agree that there is benefit in collecting this data prior to PR24 submissions so that there is the opportunity to develop and refine processes, as well as to assess the consistency between the companies. We are also supportive of the creation of the developer services price control, as set out in our previous response.

There may be technology challenges in producing both sets of data. For example, our cost allocation process is driven from a system. When there are changes or updates then these can be reflected in the system (for example, the addition of a new price control or data table) and this is a relatively straightforward process. With this proposal, we would be reporting in two separate ways using two different approaches; this would require a solution that may involve two systems or a copy of the system and this is not necessarily straightforward.

Given the time and resource constraints related to producing the APR, and that the shadow reporting is required for a different purpose, we believe that the timetable for submitting the shadow reporting on the new approach should be separate from the submission of the APR. In our view this would result in better quality data in both the old and the new approach.