

PR14 reconciliation commentary

PR19 Supporting Appendix 21

3 September 2018

Pure knowh₂ow

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Executive summary

Key highlights

This paper describes the reconciliation adjustments for PR19 arising from performance during the PR14 period and the 'blind year' from PR09. The main points to note in making these financial adjustments from the PR14 reconciliation are:

- A small downward revenue adjustment for our Outcome Delivery Incentive (ODI) performance of -£0.033m and for retail it is a penalty of -£0.024m (2017-18 FYA¹ CPIH deflated).
- A larger downward adjustment to our Regulatory Capital Value (RCV) to reflect our cost outperformance in this period of -£44.952m² (2017-18 FYA CPIH deflated).
- A large upward adjustment to our 2020 to 2025 revenue to reflect the under-recovery of revenue in the current 2015 to 2020 period of £19.739m for water network plus and £0.139m for residential retail (2017-18 FYA CPIH deflated).

The other material adjustment is a downward adjustment of £25.003m (2017-18 CPIH deflated) to RCV reflecting the CIS indexation issue from the 2010 to 2015 period.

Following the methodology

The PR14 reconciliation submission covers business plan tables, reconciliation models and feeder models for RCV and revenue adjustments. This document provides commentary on the following business plan tables and reconciliation models, and is consistent with the financial modelling we have undertaken for our PR19 business plan:

- APP5
- APP6
- APP9
- APP23
- APP25
- APP27
- APP31

¹ Financial Year Average.

² This includes the NPV effect of interest in land disposals, total RCV adjustment, CIS RCV adjustment, ODI adjustment and totex adjustments.

- WS13
- WS15
- WS17
- R9
- R10
- Totex reconciliation model
- Residential retail reconciliation model
- WRFIM model
- RCV adjustment feeder model
- Revenue adjustment feeder model

External assurance

For this submission we commissioned Frontier Economics to support us on the completion of tables/models and to provide assistance in checking that the data and approach taken is compliant with Ofwat's table and reconciliation rulebook guidance.

In addition we commissioned Jacobs to provide external assurance to conduct a risk based review of our submission relating to the Reconciliation Rule Book – Feeder Models. The assurance focused on your interpretation of the guidance for the PR14 reconciliation rulebook and subsequent application via the feeder models.

The overall conclusion from this assurance process is outlined in section 2.

A full copy of the assurance letter we received from Jacobs is included with this submission.

1. PR14 reconciliation submission

Our submission

Our submission can be grouped into seven key areas, noting that tables and models are interdependent:

- adjustments from the PR09 period (the ‘blind year’³ adjustments’).
- ODI adjustments: APP5, APP6, APP27 and R10;
- totex menu reconciliation: WS15 and totex model;
- wholesale revenue correction (WRFIM): WS13 and WRFIM model;
- retail revenue adjustment: R9 and residential retail model;
- revenue adjustments: APP25, APP27, WS13, WS15, WS17 and revenue adjustment feeder model;
- RCV adjustments⁴: APP9, APP25, WS13, WS15 and RCV adjustment feeder model; and

APP23 inflation is linked to APP9, WS13 and WS15, as well as being consistent with the feeder adjustment models. Oxford Economics forecasts have been used for this.

We have worked with our advisers in this area, Frontier Economics, to ensure that we have followed Ofwat’s methodology correctly. This will mean that our 2015 to 2020 performance, together with other reconciliation issues such as the PR09 blind year, should result in the appropriate financial adjustments being made for the period 2020 to 2025.

1.1 Blind year adjustments

1.1.1 What this includes

This includes CIS and RCM adjustments.

1.1.2 Where the inputs are from and how they are calculated

The inputs are from the Final Determination and any adjustments from actual values from the blind year.

³ The blind year refers to the fact that Ofwat’s final determination is made before data for the last year of the current period is available. Therefore performance in 2014-15 was not fully accounted for the PR14 determination and can lead to an adjustment at PR19.

⁴ APP33 on IFRS16 adjustments is not included as part of the submission, as per Ofwat’s guidelines, but will have an impact on the RCV.

1.1.3 Key financial adjustments made

The blind year values are laid out in the table below.

Blind year adjustment	£m	Price base
CIS: RCV adjustment	0.60	2012/13 FYA
CIS: revenue adjustment	0.16	2012/13 FYA
RCM: revenue correction required	4.47	2012/13 FYA
RCM: billing incentive adjustment	0	2012/13 FYA

The CIS RCV indexation correction is not included in the RCV carry forward in table A13 because it will be applied separately at PR19 in accordance with the PR14 reconciliation rulebook

Our view of this calculation is set out below:

March 2020 RCV midnight adjustment	£m
FD position	7.464
Impact of CIS RCV indexation adjustment	(25.778)
Offsetting impact of RCV runoff 2015-2020	4.480
Corrected FD position	(21.298)

1.2 ODI adjustments

1.2.1 What this includes

APP5 forecasts the performance level for each ODI and whether this results in deadbands, rewards or penalties for 2018-19 and 2019-20. APP6 forecasts performance levels for the sub-measures for N2 above ground asset performance. APP27 has the yearly rewards and penalties from ODIs, where 2018-19 and 2019-20 are consistent with APP5.

1.2.2 Where the inputs are from and how they are calculated

To calculate the financial adjustments we use the incentive rates from our PR14 final determination. Data from APR table 3A has been used for 2015-16, 2016-17 and 2017-18 and business planning forecasts for the remaining years in order to calculate the payments. We note that these are not net of tax, but are consistent with APR tables.

APP6 assumes no change from 2017-18 levels for the N2 sub controls on above ground asset performance.

ODI penalty and rewards have been calculated in line with detailed methodology provided by Ofwat and set out in the Final Determination. This includes the application of deadbands, caps and collars on individual incentive measures, as well as the overall cap and collar expressed as a percentage of return on regulatory equity (RoRE). Penalties and rewards which are relevant for both wholesale and retail have been split to be consistent with the Final Determination.

The financial adjustment for each ODI is shown in the table below as is consistent with APP27 (2012-13 FYA).

£m in 2012-13 FYA	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Wholesale: A1:H1 - Customer satisfaction	0.000	(0.032)	(0.008)	0.043	0.043	0.047
Wholesale: C2 - Leakage	0.846	0.409	0.189	0.189	0.000	1.633
Wholesale: F2 - Pressure	0.002	0.003	0.004	0.004	0.004	0.017
Wholesale: G2 - Interruptions	(0.932)	0.000	(1.331)	0.266	0.266	(1.731)
Wholesale: N1 - Discolouration	0.000	0.000	(0.358)	(0.179)	0.000	(0.536)
Retail: A1:H1 - Customer satisfaction	0.000	(0.018)	(0.015)	0.005	0.005	(0.024)
Revenue adjustments for water network plus/ wholesale	(0.084)	0.381	(1.146)	0.503	0.314	(0.033)
Revenue adjustments for residential retail	0.000	(0.018)	(0.015)	0.005	0.005	(0.024)
RCV adjustments for water network plus	0.000	0.000	(0.358)	(0.179)	0.000	(0.536)

The revenue adjustment from wholesale network plus is a penalty of -£0.033m and for retail it is a penalty of -£0.024m. The RCV adjustment for wholesale network plus is a penalty of -£0.536m, leaving an overall ODI adjustment of a penalty of -£0.593m. The revenue and RCV adjustments for the whole period are in APP27, and the rewards/penalties for 2018-19 and 2019/20 are in APP5.

SIM adjustments are included in APP5, APP6 and APP27, as well as in R10. We are not forecasting any revenue adjustment from SIM for 2015 to 2020. Overall revenue adjustments are discussed in section 1.6.

1.3 Totex adjustments

1.3.1 What this includes

WS15 includes menu totex, adjustments to totex, PAYG ratio and business rates. The totex model calculates the water revenue and RCV adjustments with the same inputs as WS15, as well as the PAYG.

Where the inputs are from and how they are calculated

In applying Ofwat's methodology for the Totex adjustment we have used the following data sources and evidence:

- APR tables 2B and 4B for 2015-16 to 2017-18 and WS1 forecasts for 2018-19 and 2019-20 for all in Block D.
- There is no IDoK triggered in line 23. The business specific rate in line 17 is 75% from the PR14 Final determination letter. This is also the source for the water business rate constants in line 20. Because no IDoK was triggered we have entered 50% as the business specific rate in the rulebook model which ensures that no impact of any IDoK is modelled.
- PAYG is from the Final Determination company appendix.

1.3.2 Key financial adjustments made

The revenue adjustment from the totex model, and populated in WS15, is -£1.192m in 2012-13 FYA (RPI). The RCV adjustment is -£17.744m. The outputs in 2017-18 FYA CPIH deflated prices from the feeder models are in sections 1.6 and 1.7 respectively. This reflects the level of totex outperformance (i.e. underspend) that the company is projecting for the period.

1.4 Wholesale Revenue Forecast Incentive Mechanism adjustments

1.4.1 What this includes

WS13 includes the allowed revenue, RCM adjustment, revenue recovered and variance of grants and contributions. The WRFIM model uses consistent inputs to calculate the revenue adjustments, penalty adjustments WRFIM adjustment and the total WRFIM reward/penalty at the end of AMP6.

Where the inputs are from and how they are calculated

In applying Ofwat's methodology for the WRFIM adjustment we have used the following data sources and evidence:

- APR table 2I for 2015-16 to 2017-18 and the latest company forecasts for 2018-19 and 2019-20.
- The RCM adjustment is consistent with 2010 to 2015 final reconciliation data. The RCM adjustment of £4.465m feeds into the WRFIM adjustment in the WRFIM model, and is applied at PR19. In our response to the Ofwat

consultation on this matter we stated that we intend to apply this adjustment in 2019/20, however, would retain the option to defer part or all of this until PR19 should our assessment of charges for 2019/20 show this would be in the best interests of customers. We have now concluded our position on this adjustment and intend to defer all of this for inclusion in the 2020-25 price control. We are making this adjustment at PR19 in order to maintain long term bill stability for our customers as including this adjustment in our 2019/20 revenue would cause our bill increase to exceed 5%. In parallel with this submission we have written to David Black outlining the research we have undertaken with customers that provides support for this adjustment.

- Discount rate is equal to the AMP6 WACC at 3.6%
- Inflation is consistent with APP23.

The WRFIM model shows that more detailed variance analyses is not needed, as performance is within the 6% variation threshold.

1.4.2 Key financial adjustments made

The main WRFIM outputs are below. The positive adjustment at PR19 reflects the material under-recovery of revenue in the current period as a result of outturn consumption less than predicted and restrictions of price increases to 5% in nominal terms, consistent with Ofwat guidance.

Output	Value - £m	FY	Price base	Comment
AMP5 RCM including financing rate adjustment	5.521	2019-20	2012-13	
RCM adjustment for PR19	6.599	2019-20	Outturn	
WRFIM adjustment at the end of AMP6	14.405	2019-20	Outturn	
WRFIM Total adjustment at the end of AMP6 ~ water	21.004	2019-20	Outturn	WS13 line 30
WRFIM Total adjustment at the end of AMP6 ~ water network plus	20.984	2019-20	2017-18 FYA CPIH deflated	WS13 line 31

1.5 Residential retail revenue adjustments

1.5.1 What this includes

R9 includes forecast, reforecast and actual customer numbers, as well as actual revenue, revenue sacrifice, modification factors and the materiality threshold and discount rate. These are consistent with the inputs to the residential retail model.

1.5.2 Where the inputs are from and how they are calculated

In applying Ofwat's methodology for the residential retail revenue adjustment we have used the following data sources and evidence:

- APR table 2F for actual customer numbers for 2015-17 to 2017-18 and the latest company forecasts for 2018-19 and 2019-20.
- There has been 0 revenue sacrifice
- Discount rate is equal to the AMP 6 WACC at 3.6%

1.5.3 Key financial adjustments made

The total adjustment at the end of AMP6 (outturn prices) is £0.174m.

With the 2% materiality threshold, there are no financing cost adjustments required.

1.6 Revenue impact 2020 to 2025: revenue adjustment feeder model

1.6.1 What this includes

The revenue adjustment feeder model includes totex, WRFIM, residential retail, ODI and further reconciliation adjustments.

1.6.2 Where the inputs are from and how they are calculated

All inputs are consistent with APP23 (inflation), APP27, WS13, WS15 and R9. The further reconciliation adjustment is consistent with the Final Determination.

The non-zero inputs are outlined in the table below.

Input name – water network plus	Value - £m	Price base	Source	Comments
Further 2010-15 reconciliation total adjustment carry forward to PR19 ~ Water network plus	0.16	2012-13 FYA	Company specific appendix – table A13	
Net performance payment / (penalty) applied to revenue for end of period ODI	(0.03)	2012-13 FYA	Consistent with APP5 & APP27	

Input name – water network plus	Value - £m	Price base	Source	Comments
adjustments ~ Water network plus				
Water: revenue adjustment from totex menu model	(1.19)	2012-13 FYA	WS15	
WRFIM total reward / (penalty) at end of AMP6 ~ Water	21.00	November 2018-19	WS13	This includes the balance of the RCM as applied to PR19 (line 13 of WS13 converted to November 2018-19 price base), as is consistent with the WS13 WRFIM table.

Input name – residential retail	Value - £m	Price base	Source
Net performance payment / (penalty) applied to revenue for end of period ODI adjustments ~ Residential retail	(0.02)	2012-13 FYA	Consistent with APP5 & APP27
Residential retail revenue adjustment at end of AMP6	0.17	2012-13 FYE	R9
SIM forecast revenue adjustment	0	November 2018-19	R10

WS17 is zero as we have no new water trades to reconcile.

1.6.3 Key financial adjustments made

The outputs from the feeder model are in the table below.

Revenue adjustment feeder model output	Value - £m	Price base	Business plan table
Further 2010-15 reconciliation total adjustment revenue carry forward to PR19 ~ Water network plus	0.18	2017-18 FYA CPIH deflated	APP25
ODI end of period revenue adjustment ~ Water network plus	(0.04)	2017-18 FYE CPIH deflated	APP27
ODI end of period revenue adjustment ~ Residential retail	(0.03)	2017-18 FYE CPIH deflated	APP27
WRFIM total reward / (penalty) at the end of AMP6 ~ Water network plus	20.98	2017-18 FYA CPIH deflated	WS13
Water: Totex menu revenue adjustment	(1.39)	2017-18 FYA CPIH deflated	WS15

Residential retail revenue adjustment	0.17	2017-18 FYA CPIH deflated	R9
SIM forecast revenue adjustment	0	2017-18 FYA CPIH deflated	R10

1.7 Regulatory Capital Value (RCV) impact: RCV adjustment feeder model

1.7.1 What this includes

The RCV feeder model includes inputs from totex, CIS, total RCV and ODI adjustments. It also includes NPV from interest in land sales and the wholesale water closing RCV at AMP6.

Inputs from the RCV feeder model come from business plan tables, the PR14 final determination and other sources including business planning. Indexation is consistent with APP23.

IFRS16 adjustments in APP33 have not been included at this stage, but will affect the RCV adjustment.

1.7.2 Where the inputs are from and how they are calculated

All inputs are consistent with APP9, APP23 (inflation), APP27 and the FD.

Non-zero inputs are outlined below.

Input name	Value - £m	Price base	Source	Comments
Wholesale water closing RCV at 31 March 2020 (from PR14 FD)	1,181.76	2012-13 FYA	PR14 FD	
Water ~ Total Adjustment RCV carry forward to PR19	0.60	2012-13 FYA	Company specific appendix – table A13	
Water ~ CIS RCV inflation correction as at 31 March 2015	(21.30)	2012-13 FYA	Ofwat CIS calculation	Company specific appendix – table A13 minus RCV run off
Net performance payment / (penalty) applied to RCV for end of period ODI adjustments ~ Water network plus	(0.54)	2012-13 FYA	APP 5	
Water: RCV adjustment from totex menu model	(17.74)	2012-13 FYA	WS15	
Water ~ NPV effect of 50% of proceeds from disposals of interest in land	0.40	2017-18 FYA	App 9	

Input name	Value - £m	Price base	Source	Comments
% of RCV to index by RPI - water services	50%	n/a	Ofwat	
Water resources % of total wholesale water RCV ~ 31 March 2020	5%	n/a	SEW RCV allocation submission	
Water network plus % of total wholesale water RCV ~ 31 March 2020	95%	n/a	SEW RCV allocation submission	

1.7.3 Key financial adjustments made

The outputs from the feeder model are in table below.

RCV adjustment feeder model output	Value - £m	Price base	Business plan table
Wholesale water closing RCV at 31 March 2020 before midnight adjustments	1,387.34	2017-18 FYE CPIH deflated	APP8
Water ~ Total adjustment RCV carry forward to PR19	0.70	2017-18 FYA CPIH deflated	APP25
Water ~ CIS RCV inflation correction as at 31 March 2015	(24.79)	2017-18 FYA CPIH deflated	APP25
Water ~ NPV effect of 50% of proceeds from disposals of interest in land	0.42	2017-18 FYA CPIH deflated	APP9
ODI end of period RCV adjustment allocated to Water network plus	(0.62)	2017-18 FYA CPIH deflated	APP27
Water ~ Totex menu RCV adjustment	(20.66)	2017-18 FYA CPIH deflated	WS15

2. Assurance

2.1 Assurance overview

We have adopted the same approach for completion and assurance of the early issue tables, Rulebook reconciliation models and feeder models as we have used for our Annual Performance Report, which is in line with our Company Monitoring Framework.

2.1.1 Our internal controls and board oversight

This submission draws upon data from across the business. For example, the 2014 final determination, annual performance reports, our PR14 reconciliation submission (and subsequent Ofwat publications) and preliminary work on the 2019 business plan.

Our governance and assurance process for each of these submissions is based on our well-established systems of internal control for all regulatory and performance reporting and incorporated oversight by the board and scrutiny by the audit and risk committee following reviews by the executive team, and heads of department and manager level sign off.

The assurance structure that we have adopted is in line with our approach set out in our company monitoring framework with the three levels of assurance as described below:

Level 1

- *Peer review – data and information is checked by a separate individual*
- *Manager review/sign off – data and information is checked by the line manager responsible for the individual completing the submission*

Level 2

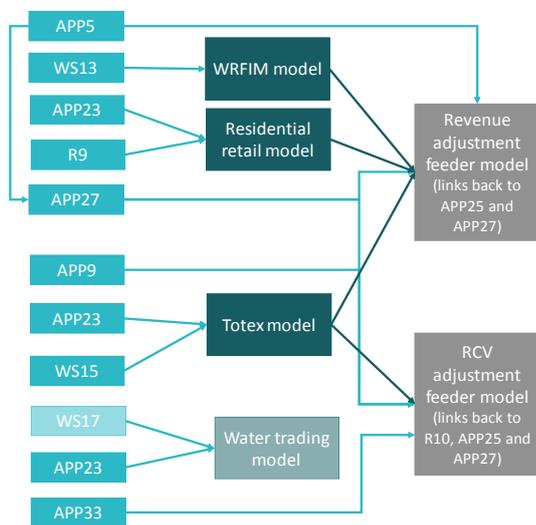
- *Internal data and process audit – data validity is tested through taking a sample and verifying the data*
- *The methodology document is reviewed to ensure that the process and internal controls are complete and being followed*
- *External data, process and submission audit – This process is undertaken by an external assurance partner*
- *A review of methodology, data sampling and internal controls is undertaken*
- *Meetings undertaken with senior managers and those who produce the data to ensure a thorough understanding is obtained*

Level 3

- Director/executive approval – final review of submission information
- Audit and risk committee review
- Board approval – overall review of assurance and auditing undertaken
- Discussion and approval of external assurance partner findings

2.1.2 Summary of key source data

There is a complex interaction between the tables, rulebook models and the feeder models. The tables include both input data and results returned from the rulebook and feeder models. This is summarised in the diagram below.



The results presented in this report rely on previously reported and assured information and company forecasts for future years.

The key source documents and the associated external assurance is summarised below.

1. Table 1 Key source data and associated external assurance

Table/Model	Data Source	External Assurance
APP5 ODIs APP6 ODIs APP27 ODIs	Regulatory accounts 2015-16 Regulatory accounts 2016-17 Regulatory accounts 2017-18 Company forecasts	Jacobs
WS13 Revenue WRFIM model	Regulatory accounts 2015-16 Regulatory accounts 2016-17 Regulatory accounts 2017-18 Company forecasts	Deloitte Jacobs

WS15 Totex Totex model	Regulatory accounts 2015-16 Regulatory accounts 2016-17 Regulatory accounts 2017-18 Company forecasts	Deloitte Jacobs
APP9 RCV	PR14 final determination Regulatory accounts 2015-16 Regulatory accounts 2016-17 Regulatory accounts 2017-18 Company forecasts	Ofwat Deloitte Jacobs
WS17	No relevant inputs	Jacobs
APP25	Summary output from rulebook and feeder models	Jacobs
R9	PR14 final determination Company tariff models – for reforecast numbers Regulatory accounts 2015-16 Regulatory accounts 2016-17 Regulatory accounts 2017-18 Company forecasts	Ofwat Frontier Economics Deloitte Jacobs
R10	PR14 final determination Regulatory accounts 2015-16 Regulatory accounts 2016-17 Regulatory accounts 2017-18 Company forecasts	Ofwat Jacobs Jacobs
App31	Regulatory accounts 2015-16 Regulatory accounts 2016-17 Regulatory accounts 2017-18 Company forecasts	Jacobs
App23	ONS Oxford economics forecast Company forecasts	Jacobs
Revenue feeder model	Tables/models as above	Jacobs
RCV feeder model	Tables/models as above	Jacobs

2.1.3 External assurance

For this submission we commissioned Frontier Economics to support us on the completion of tables/models and to provide assistance in checking that the data and approach taken is compliant with Ofwat's table and reconciliation rulebook guidance.

In addition we commissioned Jacobs to provide external assurance to conduct a risk based review of our submission relating to the Reconciliation Rule Book – Feeder Models. The assurance focused on your interpretation of the guidance for the PR14 reconciliation rulebook and subsequent application via the feeder models.

The summary conclusion from this assurance was:

“Overall, we consider that we have worked constructively with the team to identify any key reporting risks and issues associated with the inputs to, and outputs from, the feeder models.

The PR14 reconciliation rule book is complex and the models have been subject to a number of updates.

Your team informed us that it expects Ofwat to review the consistency of companies' interpretation of the guidance and the extent to which the Ofwat's models are fit for purpose.

You will need a continued focus on this process, in order to address any issues that Ofwat might identify as a result of its review of this relatively early submission.

Based on the findings of our risk based approach, as set out in this report, and subject to final first and/or second line assurance of final data, we see no reason why you should not submit the required models and associated tables to Ofwat.”

A full copy of the assurance letter we received from Jacobs is included with this submission.

Annex A Jacobs assurance letter

JACOBS[®]

SEW APR assurance

South East Water

PR19 Reconciling for past performance

24 July 2018

Final



PR19 Reconciling for past performance



SEW APR assurance

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PR19 Reconciling for past performance

JACOBS

Letter of Assurance

Attention: Oliver Martin
South East Water Ltd

2017-18 APR assurance

Scope of the work

Part of the 2019 price review (PR19) will be the calculation of adjustments to take account of AMP6 performance and incentive mechanisms. This is particularly important given the potential materiality of the adjustments and the fact that the way adjustments are calculated can be complex and open to different interpretations.

Ofwat has produced the PR14 reconciliation rulebook which helpfully describes the way that it intends to reconcile companies' 2015-20 performance against the PR14 final determinations at PR19, through the following mechanisms:

- Outcome delivery incentives (ODIs), which provide companies with rewards for achieving stretching performance targets and compensate customers if performance is below performance targets;
- Wholesale total expenditure (totex) sharing, where company over and underperformance is shared with customers;
- Wholesale revenue forecasting incentive mechanism (WRFIM), which provides financial incentives for companies to provide accurate forecasts, and ensures under and over recovery is reconciled;
- PR09 reconciliation (blind year adjustments); and
- Household retail, where the total revenue allowance is adjusted for actual customer numbers.

You engaged us to conduct a risk based review of your submissions relating to the Reconciliation Rule Book – Feeder Models. Our assurance focused on your interpretation of the guidance for the PR14 reconciliation rulebook and subsequent application via the feeder models. As agreed you have managed the resolution of any actions and issues.

The risks identified do not reflect the robustness of the data relating to actual costs that input to the feeder models as these are subject to separate assurance.

When reviewing your models, our risk based sampling approach assessed the completeness of the data and your interpretation of the process. We have assigned an overall grade of A, B, C or D.

Overall, for the Reconciliation Rule Book – Feeder models we consider:

- your team has good understanding of the data required to populate the feeder models, in line where appropriate with other PR19 tables;
- your team has good understanding of your processes required to populate the feeder models, in line with Ofwat guidance; and,
- your team has good understanding of how the outputs of the feeder models provide data required for the financial model and other relevant PR19 tables.

Observations

Within our scope we completed reviews covering a range of data tables and feeder models as per table 1. Due to the volume of tables and models we note that our review was risk based and we focused on your interpretation of the guidance and completed sample checking of input data and outputs to data tables.

PR19 Reconciling for past performance



Table 1

Data table	Content	Calculation Models	Financial model feeders
App5	PR14 reconciliation – performance commitments		
App6	PR14 reconciliation – sub-measures		
App27	PR14 reconciliation – financial outcome delivery incentives summary		Revenue adjustments feeder model RCV adjustments feeder model
App23	Inflation measures	All models	All models
App9	Adjustments to RCV from disposals of interest in land		RCV adjustments feeder model
App25	PR14 reconciliation adjustments summary	This is an output from the other models and tables	
App31	Past performance	This is a statement of operational performance with no impact	
WS13	PR14 wholesale revenue forecast incentive mechanism for the water service	WRFIM PR14 reconciliation	RCV adjustments feeder model
WS15	PR14 wholesale total expenditure outperformance sharing for the water service	Totex menu PR14 reconciliation	RCV adjustments feeder model Revenue adjustments feeder model
WS17	PR14 water trading incentive reconciliation		Revenue adjustments feeder model
R9	PR14 reconciliation of household retail revenue	Residential (household) retail PR14 reconciliation	Revenue adjustments feeder model
R10	PR14 service incentive mechanism		Revenue adjustments feeder model

We note the following general observations. We provided more detailed observations on our findings to your team in our feedback.

- You have explained that due to the prescription and automation of the feeder models supplied by Ofwat, you have not prepared Individual methodology statements for each feeder model and associated tables. Instead we understand that you have prepared a Board paper that contextualises and summarises the processes and the resulting data.
- We recognise that the PR14 reconciliation rule book is complex and that the and models have been subject to a number of updates by Ofwat. Where we identified potential issues, for example with interpretation of guidance we understand that you have taken steps to resolve ahead of submission.
- Although this submission covers a broad section of the business, you have provided a single focal point for to the population of the models. You informed us that you were aware of all of the changes to the models and have been fully involved in the evolution of the models' development.

PR19 Reconciling for past performance

**Conclusion**

Overall, we consider that we have worked constructively with the team to identify any key reporting risks and issues associated with the inputs to, and outputs from, the feeder models.

The PR14 reconciliation rule book is complex and the models have been subject to a number of updates. During our review we did identify a limited number of issues across the various models although understand that following our feedback your teams were able to satisfactorily address any material actions.

Your team informed us that it expects Ofwat to review the consistency of companies' interpretation of the guidance and the extent to which the Ofwat's models are fit for purpose. We recommend that you will need a continued focus on this process, in order to address any issues that Ofwat might identify as a result of its review of this relatively early submission.

Based on the findings of our risk based approach, as set out in this report, and subject to final first and/or second line assurance of final data, we see no reason why you should not submit the required models and associated tables to Ofwat.

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PR19 Reconciling for past performance

JACOBS

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Appendix A. Summary of assessment framework

As we note in the letter above, our assurance approach focuses on the level of risk associated with the review of your submissions relating to the Reconciliation Rule Book – Feeder models. The result of our approach is a score of A, B, C or D. In assessing your data, we used a standard scoring framework to produce results. Table A.1 below summarises this framework.

Table A.1 Summary of scoring framework for the data stage of our assurance approach

Score	Meaning
A	Low risk – no weaknesses or deviations from methodology in production of data.
B	Low to medium risk - no material weaknesses or deviations in production of data.
C	Medium to high risk - material weakness or unjustified deviations (or number of minor ones with material effect).
D	High risk – two or more of: material weakness or deviation (or number of minor ones with material effect).

Table A.2 below sets out the results from our assurance including summary rationale

Table A.2 data score for the Reconciliation Rule Book – Feeder models and tables

Reconciliation Rule Book – Feeder models	Score	Summary rationale
PR14 Reconciliation Rule Book	B	<p>This is a complex element of the business plan and the and models have been subject to a number of updates. This means that there is risk that either the company has misinterpreted part of the guidance or Ofwats models might not prove to be as fit for purpose as Ofwat originally intended</p> <p>Your team has demonstrated a clear understanding of the guidance to date. Any emerging issues have been resolved</p> <p>The team has good understanding of the data required to populate the feeder models, in line where appropriate with other PR19 tables;</p>

south east water

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