

# WATER REGULATORY REQUIREMENTS FOR MAJOR RETAILERS

## WATER INDUSTRY GUIDELINE NO. 2 AMENDMENTS

*Final Decision*

October 2013



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The Essential Services Commission of South Australia is the independent economic regulator of the electricity, gas, ports, rail and water industries in South Australia. The Commission's primary objective is the *protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services*. For more information, please visit [www.escosa.sa.gov.au](http://www.escosa.sa.gov.au).

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## GLOSSARY OF TERMS

<b>Commission</b>	Essential Services Commission of South Australia
<b>Consultation Draft</b>	Water Regulatory Information Requirements for Major Retailers Consultation Draft
<b>ESC Act</b>	Essential Services Commission Act 2002 (SA)
<b>Minor and Intermediate Retailers</b>	A retailer which provides retail services to up to and including 50,000 connections
<b>Major Retailers</b>	A retailer which provides retail services to more than 50,000 connections
<b>RAB</b>	Regulated Asset Base
<b>Retailer</b>	The holder of a licence issued by the Commission under Part 4 the WI Act;
<b>SA Water</b>	South Australian Water Corporation
<b>Water Industry Guideline No. 2</b>	Water Regulatory Information Requirements, Water Industry Guideline No. 2 for Major Retailers
<b>WI Act</b>	Water Industry Act 2012 (SA)



# 1. INTRODUCTION

The Essential Services Commission of South Australia (**Commission**) is the independent economic regulator of a number of industries which provide essential services in South Australia. The Commission is a statutory authority, established under the *Essential Services Commission Act 2002 (ESC Act)* with the primary objective of:

*“...protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services”.*

The Water Industry Act 2012 (**WI Act**) commenced on 1 July 2012. The WI Act establishes the regulatory framework for the water and sewerage industry covering economic regulation, technical regulation, water planning and customer complaint handling. Under the WI Act, the Commission has various regulatory functions in relation to water and sewerage retail services in South Australia; including industry licensing, consumer protection and retail pricing.

The Commission will publicly report on pricing outcomes for water retail services subject to price regulation and will do this through its South Australian Water Industry Annual Performance Report. That Annual Performance Report, which will ultimately report on the performance of all water licensees, will provide South Australian consumers with information on the operation of the water industry – one of the functions of the Commission under section 5 of the Essential Services Commission Act (**ESC Act**)<sup>1</sup>. The Commission also requires financial data from SA Water to inform future price/revenue determinations.

Good regulatory practice requires that information only be collected that is relevant and useful to the regulator. The Commission is cognisant that regulatory reporting requirements place a cost on the regulated entity and has sought to minimise those costs whilst ensuring the Commission is protecting the long term interests of water and sewerage consumers through monitoring and reporting of performance.

This Final Decision has been made having regard to the key issues raised by stakeholders in respect of the *Water Regulatory Information Requirements for Major Retailers Consultation Draft*<sup>2</sup> (**Consultation Draft**), released for public consultation in April 2013.

This Final Decision sets the final financial reporting requirements (incorporating regulatory accounting statement proformas) to apply to SA Water, subject to review when deemed necessary. The final financial reporting requirements have been added to the existing operational reporting requirements and service standards in *Water Industry Guideline 2 – Information Requirements for Major Retailers*.<sup>3</sup> The Commission has also produced an

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<sup>1</sup> Refer sections 5(b), (c) and (d) of the ESC Act

<sup>2</sup> Refer <http://www.escosa.sa.gov.au/projects/197/consultation-draft-regulatory-information-requirements-for-major-water-retailers.aspx>.

<sup>3</sup> Refer <http://www.escosa.sa.gov.au/library/130926-WaterRegulatoryRequirements-MajorRetailers-GuidelineNo2-WG2-2.pdf>.

explanatory memorandum that provides further guidance to SA Water on the reporting requirements in Water Industry Guideline No. 2.<sup>4</sup>

## 1.1 *Financial Reporting for Regulatory Purposes*

The WI Act provides the Commission with the power to require licensees providing retail services in South Australia to maintain and prepare accounts according to specific principles.

Publicly available accounts do not provide all of the information required by the Commission to perform its price monitoring role effectively. The Commission therefore requires Major Retailers to report specific financial information in the form of regulatory accounting statements which will provide the data required for price monitoring purposes and to inform future price/revenue determinations.

The Commission has designed the financial reporting requirements such that they collect only that information that is relevant and useful to the regulator. The Commission is cognisant that regulatory reporting requirements place a cost on the regulated entity and has sought to minimise those costs whilst ensuring the Commission is protecting the long term interests of water and sewerage consumers through monitoring and reporting of performance.

### 1.1.1 *Water and Sewerage Retail Services*

Not all services provided by a retailer will be retail services, as defined under section 4 of the WI Act, and consequently the Commission has no price regulation powers over those services. The retailer must therefore split (disaggregate) its statutory accounts into amounts relating to the provision of retail (regulated) and non-regulated services.

The Commission separates retail services into two categories: direct control services, which are subject to revenue caps, and excluded services, which are to be subject to alternative forms of control, e.g. pricing principles or price monitoring. The Commission therefore also requires Major Retailers to disaggregate their statutory accounts into direct control services and excluded services. The Commission has set out the classification of services in *SA Water's Water and Sewerage Revenues 2013/14-2015/16 Final Determination – Statement of Reasons*.<sup>5</sup>

## 1.2 *Process Adopted in Setting Financial Reporting Requirements for Major Retailers*

In developing the financial reporting requirements, the Commission has drawn on reporting requirements that have existed for other South Australian regulated industries, reporting requirements for water businesses in other Australian jurisdictions, and the National Water Initiative (NWI) National Performance Framework. As the only Major Retailer, the Commission has worked closely with SA Water in developing these Guidelines.

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<sup>4</sup> Refer <http://www.escosa.sa.gov.au/library/130926-WaterRegulatoryRequirements-MajorRetailers-G2-ExplanatoryMemorandum.pdf>

<sup>5</sup> Refer <http://www.escosa.sa.gov.au/projects/186/determination-of-sa-water-s-drinking-water-and-sewerage-revenue-2013-14-2015-16.aspx>.

The South Australian Water Industry Annual Performance Report will draw from the data collected from the annual reporting of financial information required under Water Industry Guideline No. 2.

The Commission has also developed financial reporting requirements for Minor and Intermediate Retailers and intends that there will be a high level of consistency between retailers over the information collected for use in annual performance reporting. However, the financial information requirements for Minor and Intermediate Retailers are less than they are for Major Retailers consistent with the licensing provision under section 25(2) of the WI Act requiring the Commission to 'have regard to the scale and nature of the operations of the water industry entity.' Also, the information requirements are less for Minor and Intermediate Retailers reflecting that the Commission only has a price monitoring role and doesn't currently set prices for Minor and Intermediate Retailers.

The Commission released draft regulatory information requirements for Major Retailers in April 2013. One submission, from SA Water, was received on the Consultation Draft. Further discussions were held with SA Water regarding the regulatory accounting statement proformas.

This Final Decision summarises the key issues raised by SA Water (as the only submitter) in respect of the Consultation Draft and sets the final financial reporting requirements (incorporating regulatory accounting statement proformas) to apply to SA Water, subject to review when deemed necessary.

### *1.3 Updates to Operational Performance*

The Commission has also taken this opportunity to make minor changes to Part C (Operational Performance Reporting) of the Guideline based on issues identified by SA Water and the Commission outside of a formal consultation process. This Final Decision summarises these amendments.



## 2. TIMEFRAME FOR ANNUAL REPORTING

The Consultation Draft specified that regulatory accounting statements would be reported to the Commission within 4 months of the end of the regulatory accounting period. The only Major Retailer has a 30 June year end, so regulatory accounting statements would be due by the end of October.

### 2.1 *Issues Raised in Submissions*

SA Water submitted that it will not be able to meet the end of October deadline for submission of regulatory accounting statements. Its statutory accounts are not publicly available until November following the end of the financial year, and its regulatory accounts cannot be reported until the statutory accounts are finalised.

### 2.2 *Commission's Consideration*

The Commission accepts that the submission date for annual regulatory accounting statements should be set at a reasonable time after SA Water finalises its statutory accounts. The Commission must also allow sufficient time for an audit of the regulatory accounting statements (as required by Water Industry Guideline No. 2).

### 2.3 *Final Decision*

#### **Final Decision**

**The Commission will require that audited regulatory reporting statements are submitted to the Commission by 30 November following the end of the financial year.**

### 3. AUDIT REQUIREMENTS

The Consultation Draft stated that Major Retailers were required to procure an audit of their regulatory accounting statements, and although the auditor is appointed by the retailer, the auditor has a duty of care to the Commission in the conduct of audits, so that in the event that the auditor is placed in a position of conflict between their duty to the retailer and their duty to the Commission, the auditor's primary duty is to the Commission.

The Commission requires a regulatory audit report in a prescribed format which states that, in all material respects, the regulatory accounting statements are presented fairly in accordance with the regulatory accounting principles and policies and the requirements of the Commission.

#### *3.1 Issues Raised in Submissions*

SA Water expressed concern that an audit of the regulatory accounting statements would need to duplicate much of the audit work performed by the Auditor General on the statutory accounts, and recommended that the Auditor General be consulted regarding auditing protocols. The regulatory audit will need to consider how the statutory accounts have been translated into regulatory accounts, including any regulatory adjustments made.

SA Water also sought clarification from the Commission on the treatment of any variance from the statutory accounts and how this would impact the auditing requirements.

#### *3.2 Commission's Consideration*

The Commission has required audits of regulatory accounting statements for a number of companies in other regulated industries. The Commission has also engaged auditors to complete regulatory accounting audits, and is confident that the audit requirements in the Guideline are appropriate and that audits undertaken in accordance with these requirements will provide the Commission with a suitable level of assurance over the fair presentation of the regulatory accounting statements.

The Auditor-General has indicated to SA Water that it will be unable to perform an audit of their regulatory accounts. SA Water will therefore need to appoint a separate auditor of its regulatory accounts. The Commission does not expect the regulatory accounts auditor to re-audit the statutory accounts, although the auditor may wish to carry out limited audit procedures on the statutory accounts.

Australian Auditing Standards exist for the auditing of special purpose accounts (such as regulatory accounting statements), and therefore the Commission can be confident that appropriate guidance is in place for auditors on how to complete such engagements.

With respect to regulatory accounting adjustments, the Commission expects SA water to clearly disclose all accounting adjustments made to the statutory accounts. The proformas in Schedule 1 of Water Industry Guideline No. 2 set out minimum disclosure requirements of

these adjustments. Water Industry Guideline No. 2 also sets out the circumstances under which regulatory adjustments can be made, and the explanatory memorandum provides further guidance on the types of adjustments required. The SA Water Final Determination also details the regulatory adjustments required for the regulatory years 2013/14 to 2015/16.

Water Industry Guideline No. 2 allows for a pre-regulatory audit tripartite meeting between the Commission, SA Water and the regulatory accounts auditor. This will allow SA Water to explain the regulatory adjustments it has made and will allow the auditor to detail the audit process it will undertake regarding these adjustments.

### *3.3 Final Decision*

#### **Final Decision**

**The audit requirements for regulatory accounting statements remain unchanged. The Commission has made minor changes to the wording of the proforma regulatory audit report in Annexure A of Water Industry Guideline No. 2.**

## 4. FINANCIAL REPORTING PROFORMAS

The Consultation Draft included 13 financial reporting proformas that Major Retailers will need to complete annually. These proformas required the disclosure of revenue, cost, asset and liability information. The proformas required the retailer to disclose:

- how the statutory accounts have been disaggregated between water and sewerage retail services (regulated services) and unregulated services;
- what different regulatory accounting treatment has been applied to items relating to regulated services (regulatory adjustments); and
- income, operating costs and asset information in specified formats.

### 4.1 *Issues Raised in Submissions*

SA Water commented that the data requirements in the Consultation Draft should be less onerous in the first instance, and could be revised and refined as needed. SA Water also submitted that the level of detail in some of the proformas was too granular and wouldn't adapt well to changes in business structure or organisational change. SA Water wished to align the level of granularity of data to that of the statutory accounts.

### 4.2 *Commission's Consideration*

The Commission accepts that data reporting requirements should be limited to the data that is required to effectively monitor and report on performance and to support price/revenue determinations. The Commission has reviewed the draft data requirements and, in further discussions with SA Water, has proposed some changes.

The changes to the Consultation Draft are mainly to reduce the granularity of the data required in the financial reporting proformas. The Consultation Draft required operating costs to be broken down to department-level function, but the Commission will now require a higher level disclosure of operating costs based on business activity; however, all amounts will still need to be supported by working papers. This ensures that data will be comparative from year to year even if there are business structure changes. The required headings are now largely activity based and are better aligned with the data requirements for Minor and Intermediate Retailers.

The Commission has also decided to remove the requirement for Major Retailers to fully disaggregate their balance sheets. The Consultation Draft required each balance sheet line to be split into balances relating to either direct control services, excluded services or unregulated services. At this time, the main interest of the Commission in retailers' balance sheets is on the regulated asset base (**RAB**). The asset values included in the RAB are all incorporated in one line of the balance sheet (Infrastructure, property, plant and equipment).

The final financial reporting proformas require only the Infrastructure, property, plant and equipment balance sheet line to be disaggregated. The Commission has, however, increased the RAB disclosure requirements to require the RAB to be broken down into ten infrastructure categories, and each category must be analysed by movements in the year to gross asset value, accumulated customer contributions and accumulated depreciation. The Commission also now requires a RAB to statutory accounts asset value reconciliation. The Commission feels that there is no benefit, at this time, to receiving other disaggregated balance sheet information and will therefore not be requesting this data. The Commission reserves the right to amend these requirements if different data will be more useful, and the Commission has powers under the ESC Act and WI Act to request any information from retailers which it deems necessary.

The financial reporting proformas are provided in Schedule 1 of Water Industry Guideline No. 2 and further guidance on completing the proformas is in the explanatory memorandum.

### *4.3 Final Decision*

#### **Final Decision**

**The Financial Reporting requirements for Major Retailers have been amended from the Consultation Draft and are provided in Schedule 1 of Water Industry Guideline 2.**

## 5. UPDATES TO OPERATIONAL PERFORMANCE

The Commission has taken this opportunity to make minor changes to Part C (Operational Performance Reporting) of the Guideline based on issues identified by SA Water and the Commission outside of a formal consultation process.

### 5.1 Annual Return Requirements (clause 5.3.1)

It was noted that the current wording of the Guideline required SA Water to submit a June quarter return for operational performance reporting by 31 July and then a draft annual return by 31 August. As there is no reason to receive the June quarter data before receiving the annual return, the Commission has amended the Guideline to require the annual return, draft due 31 August, to also set out the June quarter data.

### 5.2 Financial Support Measures (Proforma OP2.2)

SA Water sought guidance on the indicator ‘total number of instalment plans operating during the quarter’ under Proforma OP 2.2 – Financial measures.

The Commission clarified with SA Water that the purpose of this indicator is to distinguish between hardship customers and those utilising ‘flexible payment plans’ under clause 24.1.1 of the Water Retail Code – Major Retailers. The Commission does not want to capture short-term payment extensions.

The Commission noted that amendments to the definition would be required to reflect this purpose.

The Commission has renamed ‘instalment payment plans’ as ‘flexible payment plans’ to reflect the Water Retail Code and inserted the following definition:

*‘Flexible payment plan means an arrangement under which customers are given more time to pay a bill or to pay arrears (including any restriction, disconnection or restoration charges) in accordance with clause 24.1.1 of the Water Retail Code. For the avoidance of doubt it does not include:*

- a. customers participating in a financial hardship program;*
- b. arrangements with only 1 or 2 instalments; or*
- c. short term payment extension (including extensions of time)’*

Further, the Commission noted that the following indicators incorrectly required data to be reporting as ‘during the quarter’: total number of residential customers participating in a financial hardship program; total number of instalment plans; and total number of residential customers receiving a concession. The Commission has taken this opportunity to clarify that the numbers should be reported ‘as at the end of the quarter’. The Commission has amended the Guideline to correct the reporting of these indicators.

### 5.3 Statistical Information – Sales (OP4.1(B))

SA Water sought confirmation on how to calculate the indicator ‘total volume of water supplied – other’. The Commission confirms that it should be calculated as follows: *total water supplied – residential water supplied – non-residential water supplied = other water supplied*. The Commission has included this interpretation in the Guidance Notes for this indicator.

### 5.4 Other updates

A number of general updates have been made throughout Part C of the Guideline to reflect the Water Industry Act terminology (i.e. drinking water and non-drinking water) and minor typographical/grammatical corrections.







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