

C2 COST BASE, BENCHMARKING AND EFFICIENCY STUDIES

Reporter guidance

Introduction

Reporters should refer to the general and company guidance for a general introduction to the cost base submission, the cost base objectives, the methodology and the format of company submissions including the cost breakdown structure (CBS). Section 2 of the company guidance describes the CBS and includes examples (one for infrastructure and one for non-infrastructure) of completed CBS spreadsheets.

Role of reporters

Reporters shall give the company cost base submission focused scrutiny and comment on aspects that are material to the cost base objectives (see section 1 of the company information requirements). Reporters shall provide a general commentary (see section 2 below) and answer the specific questions detailed below in section 1 in relation to each CBS, making it clear the table(s) to which their answers refer. Where the same answer applies to more than one CBS, it need not be repeated. However cross reference(s) to the CBSs to which the commentary refers should be included in the commentary.

1. Questions on company CBS submissions

The CBS is divided into blocks, and reporters should address the questions on each block shown in bold below. The remaining bulleted text provides further explanation and guidance. Where the answer to any of the questions is 'no', the reporter should estimate the adjustment required to make the submitted standard costs compliant.

Block 1 General information:

The reporter shall:

- Check the company's reference to standard practice documents / generic solutions or completed similar projects and confirm or otherwise whether the proposed solution is the company's normal practice. For example, is this the process design the company would typically choose?
- For non-infrastructure, comment on the suitability of process choice eg is it likely to work, and on whether it is the least whole life cost solution where the process is appropriate to be used (the process might not always offer the least whole-life cost solution).

Block 2a. Direct costs:

The reporter shall:

- Confirm whether the cost data represents the company's typical costs.
- Comment on the link between the data used in the cost base and that being used to develop the draft business plan.
- Where the company has not been able to extract direct costs from its cost capture system, examine and comment on the company's method for estimating these costs. The estimating method should be appropriate in detail for the scale of investment expected in PC15; for minor investment, the quality of estimating may be less important.

Block 2b. Adjustments and exclusions:

The reporter shall:

- Confirm whether the items included, assumptions and methods are consistent with standard cost definition and table guidance?
- Confirm whether adjustments are typical or representative of actual costs.
- Check and confirm whether direct cost adjustments or exclusions have been derived in

accordance with the methodology described in section 2 of the company guidance and the specific guidance on each sub-service in sections 4 to 7.

- Comment on factors the company cannot control that affect costs, eg being limited to sub-optimal lengths for pipe / sewer laying. Are these material and do they mean that standard costs do not comply with the definitions?

Block 3. Indirect costs:

The reporter shall:

- Confirm whether the indirect costs are representative of actual costs.
- Confirm whether comparable costs are being used to develop the draft business plan.
- Where the company has not been able to extract indirect costs from its cost capture system, examine and comment on the company's method for estimating these costs.
- Confirm whether the company has used a suitable averaging method (eg across water infrastructure or water non-infrastructure) for indirect costs such as asset management, design, supervision and commissioning costs.
- Check and confirm whether the company has not adjusted indirect costs based on the argument that the standard costs represent 'easy' projects.
- Where costs are based on tender data, confirm whether a tender to outturn adjustment factor has been applied, based on the average tender to outturn ratio.
- Where costs are based on outturn costs, confirm whether the company has allowed for the typical level of risk eg by including an appropriate contingency allowance.
- Examine how risk allowances in standard costs align with risk allowances in business plan estimates.
- Confirm whether where applicable a pain / gain adjustment has been made at project and programme levels.

Block 4. Corporate overheads:

The reporter shall:

- Confirm whether all corporate overheads been allocated. And whether the same overheads being used to develop the draft business plan.
- Verify and confirm whether percentage allowances for overheads in the standard costs include all capitalised overheads eg non-project staff, buildings, vehicles etc.
- Check and confirm that the company has not reduced the percentage on the grounds that projects used to derive standard costs are 'straightforward'.

Block 5. Confidence grades: Reporter assessment:

- Reporters should confirm the confidence grades provided by the company or, where they do not agree, submit their own assessments. Refer to table 2 in section 2 of the company guidance.

2. General commentary in written report

The reporter shall provide general commentary under the following headings:

Sources of data and methodology

The reporter shall:

- Confirm or otherwise whether the data sources, unit cost data, estimating systems and procedures used to derive all standard costs are consistent with those being used for providing the capital expenditure estimates in developing the company's draft business plan.
- Confirm or otherwise whether any capitalised opex (in salaries etc) has been included in the cost base and/or in expenditure estimates in the company's business plan.
- Verify and confirm whether the company has completed the CBS in line with the information requirements. Where the company's cost breakdown does not align with the CBS, check and

- confirm or otherwise whether the company has clearly explained where the costs are included.
- Verify and confirm whether the company has completed standard costs only for those categories that represent 2% of more of planned expenditure for the activity area (see section 2 of the company guidance). Where the company has not completed such a standard cost, confirm or otherwise whether the reasons given by the company for non completion are in line with the company guidance.
- Consider whether there are any material differences in the data sources, unit cost data, estimating systems and procedures and/or accounting policies used to derive the standard costs from PC10's cost base and whether these variations in how the standard costs were built up are in keeping with the guidance.
- Tabularise and list recommendations which would improve the company's cost base submission.

Company-specific special factors

Where the company claims that special factors affect the comparability of standard costs, the reporter shall review these claims critically and comment on the company's answers to the questions under this heading in section 2 of the company guidance. The company itself should **not** make any adjustments to standard costs to reflect company special factor claims; the reporter shall check whether this is the case.

Independence of company estimates

The reporter shall:

- Confirm or otherwise that the company has compiled its standard cost submissions largely independently of other water and sewerage companies.
- Where there have been exchanges of technical information between companies on design and processes, identify whether amendments to standard costs are also reflected in the investment projections submitted by the company.
- Identify whether this transfer of information has resulted in lower unit costs assumptions in capital expenditure projections than would otherwise have been the case.

Balance of workload

Reporters should focus on those standard costs that represent a larger proportion of the company's capital programme and on those aspects of the methodology and those company-specific special factors that are the most material.

Reporters should balance their workload on the cost base report as follows:

Sources of data and methodology	60%
Company-specific special factors	15%
Confidence grades	15%
Independence of company estimates	10%

Following company and reporter submissions, we expect to raise queries to ensure comparability across the industry. This will require additional input from reporters, and they should allow for this in their plans.