

Workshop Discussion Paper

Economic Regulation of the Victorian Water Sector

PERFORMANCE MONITORING AND REPORTING

1. Purpose

In Consultation Paper No.1, the Commission proposed developing a performance monitoring and reporting regime to apply to each of the 24 water businesses in the Victorian water sector. In doing so, it outlined the key principles that it considered should guide the development of the performance reporting regime, the information it should have regard to and the broad areas of coverage that the performance indicators should relate to.

Most submissions received in response to the Consultation Paper generally supported the development of the performance regime and provided a number of suggestions on the matters the Commission should have regard to in developing it.

The purpose of this workshop is to confirm the principles underpinning the design of performance monitoring and reporting framework, and to provide a starting point for discussing the detailed coverage, content and process for establishing the performance indicator set to apply to each of the Victorian water businesses.

The workshop will assist in advancing the issues identified in the first stage of the consultation process. In doing so, the Commission has summarised the responses to the issues raised in the Consultation Paper.¹ It has also provided a draft set of performance indicators for the metropolitan and regional water businesses that can be used as the basis for further discussion with working groups (see attachment A).

In view of the differences in the nature of services provided by rural businesses, a separate consultation process is proposed to identify the relevant performance indicators to apply to those businesses.

It should be noted that the Commission also proposes to release a separate paper outlining its approach to specifying and or approving the nature of service standards to apply over the first regulatory period, including the nature and extent to which the regulatory regime will provide further incentives for businesses to enhance their performance against the specified standards.

¹ Copies of the submissions are available on the Commission's website. A summary of responses will be made available at the workshop to facilitate discussion.

2. Introduction

On 1 January 2004, the Essential Services Commission became responsible for the economic regulation of the Victorian water sector. This responsibility involves regulating prices, service standards and conditions of service for each of the 24 Victorian water and sewerage businesses.

In carrying out this regulatory role, the Commission is guided by its legislative framework. The broad framework is set out in the *Essential Services Commission Act 2001*, the *Water Industry Act 1994* as amended by the *Water Legislation (Essential Services Commission and Other Amendments) Act 2003* and other water industry specific legislation. A more detailed framework is set out in a Water Industry Regulatory Order (WIRO) made by the Governor in Council in December 2003.

The WIRO sets out the nature of the water services that the Commission now regulates in terms of price and service standards and its functions in terms of these services. The WIRO provides an explicit function for the Commission to monitor and report on the performance of the regulated water industry and to audit the performance of water businesses including among other things the quality of performance information. The *Water Industry Act 1994* also provides that the Commission may by written notice require regulated businesses to provide information that it needs to perform its functions and to specify the timelines, manner and form in which the information must be provided.

In February 2004, the Commission released a Consultation Paper (*Consultation Paper No.1: Economic Regulation of the Victorian Water Industry*) that proposed, among other things, establishing a performance reporting regime to apply to each of the 24 water businesses. In doing so, it noted that the basis for establishing performance monitoring and reporting is to:

- inform customers about the level of service they are receiving and identify reasons for performance
- make comparisons between businesses by gauging relative performance within an industry (comparative competition) or with businesses performing comparable operations in other industries
- identify baseline performance of individual businesses and provide incentives for improvement over time
- provide information and data for developing regulatory standards (or targets) where required and for ongoing assessment of compliance with such standards
- inform the decision making processes of regulatory agencies, water businesses and government.

Most of the responses to the consultation paper supported the establishment of the performance reporting regime. However, a number of respondents expressed concerns about the broad timelines for establishing the regime, particularly given the range of other issues that need to be resolved including those related to the Commission's process and approach to approving proposed Water Plans. Other respondents, such as Yarra Valley Water, emphasised the importance of reviewing the 'dimensions or attributes of customer service that are to be measured'. Yarra Valley further noted that 'these matters need to be clarified in order to provide each company with a sound foundation for the development

of its expenditure proposals and the finalisation of its Water Plan' and that this work should be expedited.²

The Commission considers that the performance reporting framework has an important and complementary function to the establishment and ongoing monitoring of performance against key aspects of the Water Plans. In addition, performance reporting is likely to provide an important focus and driver of performance in the water sector, particularly in this first regulatory period.

For example, Water Plans will need to identify the key performance related outcomes that businesses propose to achieve over the regulatory period. This includes service standards related to among other things, service reliability (number of planned and unplanned interruptions), water efficiency (for example, leakage reduction targets), environmental management, water quality, as well as other relevant customer service outcomes.

Further, there are also likely to be a number of key financial indicators relating to outcomes proposed in Water Plans that will need to be monitored. Examples include, actual versus proposed operating and capital expenditure, and actual versus proposed returns. To do this, it is important to provide clarity about what is to be measured and how these measures are to be defined.

In some cases, the introduction of performance monitoring, reporting and auditing arrangements (including the upgrading of IT systems where necessary) may impose additional costs on businesses. This is more likely where businesses do not currently collect the required performance information or need to enhance their systems to facilitate improved reporting. To the extent that the performance reporting regime imposes increased costs on businesses, they should clearly identify the nature and extent of these costs as part of their Water Plans.

The Commission proposes to continue with the establishment of a meaningful and relevant performance reporting regime to apply to the Victorian water sector. The remainder of this paper sets out its further thinking in relation to the key principles and matters of coverage.

3. Principles to guide development of indicators

In Consultation Paper No.1, the Commission set out a number of principles that it proposed should guide the development of the performance reporting regime including that:

- performance indicators need to be relevant to the nature of the services provided by each business
- performance indicators need to be meaningful and relate to key issues of concern to both businesses and their customers
- performance indicators need to be defined and collected on a consistent basis across businesses to provide a valid measure of actual performance and to aid reasonable comparisons
- the costs associated with collecting information and data need to be balanced against the benefits of collecting that information. That is, it will be necessary to ensure that

² Yarra Valley Water, Submission to Consultation Paper No.1.

the framework is not excessively onerous or costly to implement by focusing on a reasonable range of meaningful indicators

- the accuracy and reliability of information provided by businesses must be verifiable
- it is desirable to identify whether there is scope for greater national consistency in reporting and comparison, to facilitate national assessment of relative performance.

Most submissions in response to the Consultation Paper generally considered these principles were appropriate. Barwon Water suggested that the Commission should also seek to ensure that performance indicator definitions are *stable over time* to facilitate the collection of time-series performance data to allow trends in performance to be identified over time. The Commission agrees with Barwon Water's comments and considers that the establishment of meaningful and consistently applied definitions is a key objective of its consultation process.

4. Information sources

In its Consultation Paper, the Commission noted that there were already a number of existing sources of performance indicators and information that it considered should be taken into account in developing its performance reporting regime. This included the performance indicators collected and reported by:

- industry associations such as VicWater (as part of its Urban Water Review) and the Water Services Association of Australia. (WSAAfacts)
- other relevant jurisdictional water regulators (such as IPART and the WA Economic Regulatory Authority) that report on aspects of price, service and financial performance.

Generally, respondents agreed that the information sources identified by the Commission were appropriate. Several also noted that they already report to a number of agencies, with Barwon Water identifying the Department of Sustainability and Environment (DSE), Department of Treasury and Finance, Department of Human Services (DHS), Environment Protection Authority (EPA), Southern Rural Water, WSAA, and Victorian Water Industry Association. VicWater suggested that a 'comprehensive' effort be put in to 'rationalise the process'.

It was also suggested that the Commission have regard to performance indicators developed by other groups. South West Water recommended consideration of Linqage International, which has been used for intra-industry benchmarking for a number of years.

The Commission will endeavour to have regard to as much information that already exists as possible, with a view to minimising any inconsistency or duplication in the development of its performance reporting regime.

5. Indicator scope

In Consultation Paper No.1, the Commission proposed that the performance reporting framework should broadly cover the following key areas:

- baseline explanatory data (eg. customer numbers, system length)
- quality of supply (eg. drinking water quality and effluent quality)
- water and sewerage network reliability and efficiency (eg. interruptions, leakage)

- water consumption, reuse and recycling
- other environmental and conservation initiatives
- customer responsiveness and service (eg. complaint handling, restrictions and legal actions)
- financial performance (eg. actual capex and opex relative to forecasts, return on assets, gearing levels)
- prices (eg. average prices and price movements)
- audit findings, including compliance with regulatory instruments and accuracy of reported information.

Respondents generally agreed with the Commission's broad coverage of performance indicators and supported the inclusion of environmental and conservation initiatives. For example, Yarra Valley Water stated that it 'welcomes the Commission's recognition of the importance of conservation and environmental initiatives, and strongly supports the concept of introducing performance indicators in these important areas.'³ The Consumer Utilities Advocacy Centre (CUAC) stated that they 'strongly believe that water authorities should be required to report to the ESC on measures to monitor performance with environmental objectives.'⁴

6. Coverage of metropolitan, regional and rural businesses

In its Consultation Paper, the Commission proposed that the existing performance indicator set used for metropolitan retailers be used as a starting point for considering the nature of indicators to be developed for the regional urban water businesses in particular and to a lesser extent, Melbourne Water and the rural businesses. As noted rural water issues will be subject to a separate consultation process.

Responses by urban water businesses and customer groups to the consultation paper generally agreed with this proposition. For example, North East Water suggested that the indicators for the metropolitan retailers are 'essentially the same and are appropriate' for regional businesses. However, it also noted the importance of exercising caution in comparing the performance of regional businesses with that of metropolitan businesses. Several regional businesses noted that they already collected much of the performance information used to monitor the performance of the metropolitan retailers. Several regional businesses also identified difficulties in collecting a small number of the indicators.

The metropolitan retailers strongly supported the development of performance indicators to apply to Melbourne Water. In particular, South East Water argued that currently 'the reporting framework for Melbourne Water is inadequate'.⁵ Yarra Valley Water suggested that key performance indicators set out in existing Bulk Service Agreements could form the basis of a more comprehensive suite of performance indicators for Melbourne Water. The Energy and Water Ombudsman (Victoria) (EWOV) also argued that Melbourne Water should be included in the reporting framework.

In contrast, Melbourne Water noted that the logical objectives for monitoring its own performance are limited to facilitating assessments of the efficiency of expenditure with

³ Yarra Valley Water, Submission to Consultation Paper No.1.

⁴ CUAC and CLCV, Submission to Consultation Paper No.1.

⁵ South East Water, Submission to Consultation Paper No.1.

the periodic review of prices and facilitating a comprehensive view of the sector. It did not consider that the objectives of ‘protecting the interests of final customers in regard to service quality’ or ‘supporting competition by comparison’ were relevant to its situation.⁶

The Commission considers that it is important that Melbourne Water be subject to performance monitoring and reporting arrangements, particularly given its important role in delivering bulk services and operating and maintaining critical trunk infrastructure as part of the integrated supply chain. In addition, it also has an important role in protecting coastal and bay waters from the adverse impacts of effluent disposal and sewage spills. Further, its performance impacts directly on that of the metropolitan retailers (and a number of other bulk service purchasers) in providing services to end use customers and in ensuring that customer related service standards can be met.

Melbourne Water already provides a small set of performance data that the Commission includes as part of its annual performance report for the metropolitan retailers. However, the existing indicator set does not fully capture all aspects of Melbourne Water’s performance.

It was suggested by the retailers that the requirements of the Bulk Service Agreements would be an appropriate basis for performance indicators for Melbourne Water. Melbourne Water highlighted its existing reporting — in publications such as, WSAAsfacts, the Victorian Urban Water Review and its annual report — as mitigating the need for the Commission to monitor their performance. Melbourne Water suggested that any performance reporting should be based on current indicator sets.

The Commission is of the view that performance indicators for Melbourne Water will need to address:

- the reliability of its water and sewerage networks
- whether key aspects of Bulk Service Arrangements are being complied with
- compliance of its treatment plant with EPA requirements and compliance with discharge requirements at sewerage outfalls
- the recycling of effluent and biosolids
- other aspects of environmental performance
- financial performance.

The Commission confirms that it will expand the monitoring and reporting framework to include regional urban water businesses and Melbourne Water. The indicators outlined in attachment A provide a starting point for doing so.

7. Process for developing the performance indicators

In Consultation Paper No.1, the Commission proposed that the detailed list of indicators and definitions to apply to each of the water businesses be developed through a working group(s) made up of water industry representatives, government agencies, customer representatives and other stakeholder groups.

Responses to the consultation paper appeared to strongly support the establishment of working groups to progress the development of the performance reporting framework. In particular, water businesses, consumer representatives and other technical regulators

⁶ Melbourne Water, Submission to Consultation Paper No.1.

(such as EPA and DHS) supported the joint development of the reporting framework to ensure that the resulting indicators were meaningful, relevant and drew on existing information sources and knowledge of the sector. This would also assist in facilitating greater clarity and consistency of definitions.

The role of the working group will be to assist the Commission in ensuring that any new performance indicators are consistent with the guiding principles and to advise on suitable performance indicators and definitions.

The Commission is encouraged by the cooperative attitude expressed by various respondents to the Consultation Paper and their willingness to participate in such a process. The Commission has sought nominations from water business representatives (through VicWater) and its Customer Consultative Committee. It has also invited other regulatory agencies (such as EPA, DHS and DSE) and EWOV to participate in the process.

As a precursor to establishing working groups the Commission invited interested parties to identify any relevant indicators, in addition to those outlined in Consultation Paper 1. Several respondents provided suggestions in their submissions.

The EPA suggested that indicators relating to sewage treatment plant performance, sewerage transfer system performance, trade waste management, water and biosolids recycling, and broader activity areas such as greenhouse gas reduction programs and water conservation initiatives would be relevant for monitoring performance of the sewerage network and the environmental performance.

Melbourne Water, EWOV and CUAC all noted the work being undertaken by the Commission in reviewing affordability and hardship measures in the energy sector and suggested that the outcome of this work be reflected in the monitoring arrangements for the water sector. In addition, DHS's Concessions Unit suggested the following potential indicators:

- tracking water businesses with a no-restriction policy
- measuring duration of restrictions until full water access is restored, differentiated by concession and non-concession status. There should be a target that full access be restored within a suitable timeframe — within the electricity industry the timeframe is same-day reconnection
- measurement of debt levels for domestic households, differentiated by concession and non-concession status.

The Commission has also reviewed the performance indicators collected by WSAA and VicWater, as well as information collected by other regulators to identify whether there are additional measures currently used in the water industry that should be considered. Generally, the information reported by WSAA, VicWater and to a lesser extent those collected by other economic regulators is similar to that used by the Commission to monitor the metropolitan water businesses. This review has also identified a number of broadly adopted performance measures not currently reported by the Commission, which may be desirable as part of an expanded monitoring framework. Additional performance measures could include:

Environmental

- Various Victorian and interstate water businesses have introduced reporting on their ecological footprint in annual sustainability reports. WSAA is collecting and publishing information on greenhouse gas omissions.

Network efficiency and reliability

- Within metropolitan Melbourne, current reporting identifies customers receiving more than 5 water interruptions and 3 sewerage blockages per year. This information can be disaggregated to identify 1, 2, 3, 4 and 5 water interruptions, as WSAA currently collects, and 1, 2 and 3 blockages per year. IPART collects information on multiple interruptions and multiple sewerage blockages for Sydney Water.
- Water pressure is used by IPART in monitoring Sydney Water's performance. The Commission previously monitored the level of pressure complaints for Melbourne but this was found not to be an issue for Melbourne. It may, however, be an issue elsewhere in Victoria and may need to be reconsidered as part of the monitoring framework.
- Service response times for sewerage spills and blockages, based upon time to respond to a report of a sewer spill. The equivalent measure is reported for the water supply system and is collected and reported by Sydney Water under its operating licence.
- Sewer spills to customer's properties — used by Ofwat in England and Wales. EWOV has raised this with the Commission as an issue of concern. Given the particular impact a sewerage spill has on customers, it may be appropriate to monitor.

Customer service and responsiveness

- Responses to written enquiries are a broadly used indicator adopted by both IPART and Ofwat.

Affordability

- The increased emphasis on hardship policy suggest that an indicator could be used to measure the number of field visits to customers with payment difficulties and the number of applications approved under a business's hardship policy.

As part of the review, the working group will need examine these potential indicators to see whether they are consistent with the guiding principles and assess the merit of including these indicators in the reporting framework.

Further details about the Commission's proposed process and next steps are outlined in section 7.

8. Process for reporting information

In Consultation Paper No.1, the Commission proposed using the current process for reporting information by the metropolitan retailers as the basis for coordinating performance reporting for the other water businesses. As part of that process:

- the businesses report information in accordance with performance indicators and definitions specified by the Commission
- each business submits information to the Commission electronically on a quarterly and annual basis using standardised templates
- the Commission summarises and analyses the reported data in its annual performance report. In doing so, it provides each business with an opportunity to comment on the

draft report to enable it to verify and explain performance outcomes and details of service innovations. Following this, the Commission publicly releases its report.

There was general support for this approach in response to the Consultation Paper. However, concerns were raised regarding the potential duplication of reporting and auditing. These comments are summarised below.

Reporting

A number of respondents noted that they already report performance information to a range of agencies such as DSE, EPA, DHS, EWOV and industry associations (such as VicWater and WSAA) and encouraged the Commission to, wherever possible, streamline or rationalise reporting frameworks to minimise duplication and overlaps.

The Commission is conscious of the potential additional information collection burden that may be placed on businesses and is seeking to work collaboratively with other agencies to ensure that information collection and reporting arrangements are aligned as much as possible.

To this end, it has invited both EPA and DHS to participate on the working group with a view to identifying opportunities to coordinate reporting requirements on environmental and water quality performance. For example in the gas industry, the Commission and the Office of Gas Safety have established a consolidated set of performance indicators and definitions that meet the needs of both organisations. Another potential approach is to draw on the existing information collected by agencies such as EPA and DHS in relation to performance against environmental and water quality standards. In its submission, EPA supported adopting such arrangements.

Wherever possible, the Commission also proposes to coordinate performance monitoring arrangements with other Australian water industry regulators to facilitate achieving greater national consistency in performance reporting.

Auditing

In the Consultation Paper, the Commission expressed the view that the performance reporting framework should be complemented by independent auditing to ensure that the information collected and reported by the businesses is accurate and consistent with the established definitions. It also proposed that the audit framework be broadly based on that currently used in the metropolitan water sector, but tailored to meet the needs of auditing a greater number of businesses in a more diverse operating environment.

In response to the Consultation Paper, South East Water supported the need for auditing 'to ensure accuracy and verifiability'. However, City West Water, South East Water, Yarra Valley Water, Gippsland Water, Glenelg Water, Melbourne Water, North East Water, South West Water, VicWater and Western Water expressed concern relating to the potential cost and frequency of audits. City West Water, Yarra Valley Water, Melbourne Water, VicWater and Western Water suggested that either biannual or triennial audits be adopted or that only a target subset of indicators be audited each year.

Melbourne Water noted the potential for duplication of the auditing required by the Commission and the audits undertaken to verify industry association data. The metropolitan retailers and the regional businesses also expressed a preference for reducing the burden of the audit program. Cost and capacity were also identified as issues of concern. North West Water also questioned 'whether the costs of auditing correspond

with the benefits of improved data quality' — a concern shared by a number of regional businesses as well as Melbourne Water. Yarra Valley Water also questioned whether there would be sufficient suitably skilled auditors to audit the 24 water businesses on an annual basis.

The Commission notes that the WIRO places obligations on the Commission to monitor, report and audit the performance of water businesses. These are not discretionary functions that the Commission can avoid undertaking because industry associations are also performing some similar tasks.

It acknowledges the concerns expressed by many of the businesses regarding the potential costs associated with an overly onerous or frequent auditing regime. It considers that most of these concerns can be addressed in the process of consulting on the frequency and scope of the audits to be undertaken. As the first regulatory audits under the new performance reporting regime will not be required until the second half of 2005, the Commission proposes that detailed discussion on auditing arrangements be deferred until the performance reporting framework is sufficiently advanced.

Other issues

DHS administers government concession programs and the Utility Relief Grants Scheme (which provides one-off financial contributions towards customers' bills in the case of payment difficulties). The Department provides summary information on these programs for inclusion in the Commission's performance report. It is intended that this will continue and be expanded to include summaries of the regional water businesses.

Since April 2001, EWOV has been responsible for investigating complaints relating to the water industry. EWOV's function is to receive, investigate and facilitate the resolution of complaints and disputes between consumers and the providers of electricity, gas and water services in Victoria. EWOV provides a summary of the water issues handled by the scheme for inclusion in the Commission's performance report. It is intended that this reporting will continue and be expanded to include summaries of the regional water businesses and Melbourne Water.

The Commission has noted that performance indicators should cover price and financial performance. These indicators will be developed as part of the water plan and pricing arrangements rather than through the performance monitoring working group.

Attachment A sets out a number of performance indicators that could be used to as a starting point for identifying the appropriate range of indicators for the metropolitan and regional businesses as well as Melbourne Water. In particular, it draws on the existing metropolitan performance indicators, others collected by various agencies and other suggestions made in response to the consultation paper.

9. Next steps

Following this workshop, the Commission will establish a working group(s) to assist in developing the detailed performance indicators, definitions and performance thresholds (where appropriate).

The Commission anticipates releasing a draft performance reporting framework in May 2004 to provide an opportunity for all interested parties to comment on the appropriateness and clarity of the proposed performance indicator set and definitions.

After the performance framework has been finalised, the Commission proposes to hold an implementation workshop in order to ensure that definitions and reporting arrangements are clearly understood by all water businesses. It is envisaged that the review of the regulatory audit framework will occur in early 2005, with the first audit of Melbourne Water, followed by the regional water businesses (August through to November 2005). Subsequent to the completion of audits, the first statewide performance report will be released. The intention at this stage is for reporting and auditing of the Melbourne retailers to continue on an annual basis.