

**Dwr Cymru  
Welsh Water**



**Dwr Cymru Welsh Water**

**June Return 2007  
Reporter's Report on the Board Overview  
Public Domain Version**

**September 2007**



**Report by D Arnell, Reporter, on Dwr Cymru Welsh Water Board Overview**

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**Report by D Arnell, Reporter, on Dwr Cymru Welsh Water Board Overview****Introduction**

Mr D Arnell, a Technical Director of Black & Veatch, is the appointed Independent Reporter for Dwr Cymru Welsh Water (DCWW). This report has been prepared by the Reporter from the information gained during the audit of the June Return.

**The Company's process for ensuring that the Board Overview is well founded**

For the report year the Company's Board comprised six non-executive directors and three executive directors, including the Managing Director. During the report year the Board met ten times. As well as the normal Board papers and reports the Board is kept informed through its audit function. This comprises two committees: the Audit Committee and the Quality and Environment Committee (QEC). The Audit Committee meets quarterly and the QEC meets monthly. Central to QEC's agenda is the Monthly Management Report which is discussed in detail at all meetings. This is a comprehensive report giving details of many of the key performance indicators affecting the Company. Many of these indicators are discussed in the June Return Board Overview.

The Head of Economic Regulation, who reports to the Finance Director prepares papers on regulatory matters as required. For the report year two papers on the June Return process were presented to the Board as well as two papers to the Audit Committee, which were then discussed further at the next Board meeting. Ten further papers relating to general regulatory issues were also presented during the report year. In addition the Finance Director submits a monthly report to the Board. This includes regulatory issues. We believe that this system of governance means that the Board is continually appraised of the items covered in the Board Overview.

The Board Overview is administered by the Regulation Department using inputs from the relevant staff members, most of whom are table owners for the main June Return. DCWW's Executive are closely involved and the Executive met on two occasions to make suggestions and give comments. Individual drafts are subject to due diligence from the Regulation Department.

This year the Board met on the 8<sup>th</sup> June. A major item on the Board's agenda for the day was the June Return. The week before the meeting the Board received the draft Board Overview and Board Endorsement. The Regulation Director attended the meeting, allowing the Board to ask any questions it considered necessary.

We believe that the Company's method of corporate governance means that the Board Overview is well founded and based on the information in the main June Return.

### **The effectiveness of the June Return process**

The Company has a formal process for preparing the June Return. This is correctly described in the Board's Endorsement. This process is more formal and rigorous than we have seen elsewhere. Key features of the process are:

1. The preparation by the Regulation Department of a plan defining the process.
2. The preparation of a briefing pack to every table and line owner.
3. The implementation of a company audit of the process carried out by an external organisation, working under a remit from the Audit Committee.
4. The preparation of process maps by this year's table owners, which, while providing information in some cases this year, will primarily assist the preparation of next year's return.
5. The requirement for each table and line to be formally signed off by the line owner, table owner and DCWW manager as being correctly prepared.
6. Due diligence meetings between the staff preparing each table and the Regulation Department.
7. A day long meeting attended by the Managing Director, at which each table owner presents their results. These are discussed and any final amendments made. This meeting is attended by the Reporter, a representative of the external organisation that carries out the internal audits on behalf of DCWW and for the financial tables, a representative of the Company's financial auditors.
8. A presentation on the process made to the Board by the Reporter, the firm carrying out the internal audits and the financial auditor.

We believe that this means that the Company does have an effective process for completing its June Return. We can confirm that we have seen evidence that the above process has been carried out.

**Consistency of the Board overview statements and supporting numerical data**

We have reviewed the entries in tables A to E and the accompanying comments. We have not re-stated here detailed comments that we have made in our main report.

Apart from 11 lines where the Company compiles the information directly the information reported in tables A to E is automatically calculated or copied from other tables in the June Return. We confirm that the process for compiling tables A to E has been followed correctly. Of the 11 lines compiled directly by the Company most of the information is sourced from the DWI report to Ofwat and EA reports. All 11 lines have been reviewed and we believe that they are soundly based. The information provided in Table C has not been audited as it relates to financial information that has been automatically calculated.

We believe that the comments made in the Board Overview give a balanced picture of the Company's accomplishments and are consistent with the June Return.

**Co-operation between the Company and the Reporter**

The Company operates an open policy when preparing its June Return. At the beginning of the audit process the Company provides the Reporter with names of its staff members and their areas of responsibility. Contact details of staff and reporting team are made available to all. Initial meetings are arranged by the Regulation Department. Follow up meetings are also either arranged by the Regulation Department or arranged directly by the Reporter's team and staff members, keeping the Regulation Department informed. The Reporter's team generally meets the table and line owners together, without the presence of any member of the Regulation Department being present.

The Company issues early drafts of tables and narratives so that any point of issue can be identified at an early stage in the audit process. The Reporter gives immediate feedback at the meetings and issues e-mails of "key points" to give early feedback to the Company. The Reporter has found that Company staff come well prepared to the meetings and this year meetings have gone smoothly. The Reporter appreciates the openness and assistance of the Company in the process.

## **Consistency of the Board Overview commentaries with the June Return**

### *General*

We have read the commentaries in the Board Overview. We do not comment on financial indicators and competition, which are outside our remit. Where we do have knowledge we believe that the comments in the Board Overview are consistent with the June Return and also consistent with the information arising out of our audits.

Below we comment on some of the items raised in the Board's Overview.

### *Chapter 1 – Key outputs and service delivery*

#### Customer services

The Company has continued to maintain its high levels of service performance throughout the range of its business activities. Many of the measured figures are now so high that any improvements can only be marginal. During our audit we have seen the Company striving for continuous improvement and so believe that further small improvements may still be possible in the future.

For DG2 this year the Company has opted to exclude 608 properties on the basis of abnormal demand. This has been done using Ofwat's criteria for allowable exclusions which we accept. While there is evidence of abnormal demand in a number of its water resource zones it is not true for all zones. In some of the zones with exclusions the evidence of abnormal demand is marginal.

The Company has not imposed any water restrictions in the reporting year, although we accept the evidence of abnormal demand in a number of zones. In the reporting year the Company has improved its estimates of those water resource zones which are near their target headroom. These are mainly small zones in the north of Wales. The Company remains concerned that the EA's current review of abstraction licences under the Habitats Directive may adversely affect its larger water resource zones in the South.

#### Serviceability and capital maintenance

The Company states that it believes that its high level serviceability trends for the water service reported in Table A are improving. Mains bursts are the main indicator of water infrastructure serviceability and there has been a significant improvement since 2003/4. However, more recently improving trends are not as marked and bursts could always

increase with a bad winter. We note that when the S19 programme is complete the Company may have to increase its general capital maintenance spend on its water infrastructure assets.

The Company states that its water non infrastructure assets are stable. We believe that this a reasonable conclusion, although reactive maintenance jobs on the company's water treatment works is up from last year's low. It will be instructive to see if the upward trend continues next year or whether this year's results are within normal variation.

Sewer collapses have risen this year by approximately 25%. The Company has kept its assessment of its sewerage system as stable. The Company has not yet fully investigated possible reasons for the increase but half the increase relates to a doubling of bursts on its sewage pumping mains. While still significant, this means that the increase in sewer collapses is less extreme than the raw figures suggest. We do not believe that it is correct to infer an overall reduction in serviceability from one year's results. However, we do recommend that the Company reviews the figures carefully to try and explain why and where the changes have occurred. We also note that pollution incidents on the sewerage network have risen this year, although they have not returned to levels seen in 2003/4. The Company gives details of its improvement plan. It will be instructive to see next year's results which will help to establish whether there is a possibility of any real deterioration in the Company's sewerage assets.

The Company has shown its sewerage non infrastructure assets as stable. We consider that this is a reasonable conclusion from the data available. There is a possible slow deterioration in reactive jobs on the Company's sewage pumping mains which will need careful monitoring.

#### Water service quality programme

The Company describes its S19 programme, noting that current studies indicate that the agreed programme can be reduced. This is currently being discussed with the DWI. The Company wishes to complete the reduced programme over the original time scale in order to retain expertise within the business. However, this is not the position of the quality regulator, which would like the current rate of rehabilitation to continue.

#### Sewer flooding

Currently the company is late in delivering its programme and is also in discussion with Ofwat over its register and priority system. We are assured by the Company that this year's programme is planned and targets will be met. DCWW plans to make up current shortfalls and complete the programme by the end of Year 4. Given that it takes time to

investigate and design some of the larger sewer flooding schemes it is essential that current discussions with Ofwat are rapidly and satisfactorily concluded and any revisions to the programme are agreed by all parties.

### *Chapter 2 - Financial performance measures*

#### Operating Costs

The Company's commentary reports on its current operating costs and recent rapid increases in power costs. We note that the Company has finalised its power tariffs for the current year which gives it some short term security. We do not audit the Company's operating expenditure in any detail.

#### Capital expenditure

The Company has generally underspent against its determination in the first two years of the price review. This is largely due to under delivery of expected outputs, not all of which are under the Company's control. The Company has also identified upward cost pressures on the Section 19 and water quality programme which are reflected in the explanation of variance provided in Table 35b. The Company is also concerned about increasing costs of its sewer flooding programme. The Company believes that this will be offset through efficiencies in other parts of the programme.

### *Chapter 3 – Key supporting information*

#### Water Treatment Works

The Company reports that 2 quality improvement projects have been completed at its water treatment works. Work on Court Farm WTW has been delayed as the Company is waiting for the EA to agree a new abstraction licence. The DWI has agreed this and a revised undertaking should shortly be signed. The Company has agreed to accelerate work at Talybont WTW to offset the delay at Court Farm.

#### The Water Balance

The Company reports a reduction in leakage of 15 Mld and is on target to meet its ELL in 2009/10. The fall in leakage has not been seen in a reduction in Distribution Input (down by 6Mld). This can be partly explained by an increase in unmeasured per capita consumption of 2.35 litres per capita per day and an increase in minor components.

Household metering

We note that there is a declining trend in meter optants.

Security of supply

The Company reports an increased security of supply against its planned levels of service. This is due to a re-evaluation of a number of components in its water resource plans plus the success of a leakage control initiative in one of its deficit zones. The Company has only one capital programme for supply demand balance in this price review period and this has yet to be implemented.

We believe that the revised water resource plans are more accurate than previous plans. It should be noted that the security of supply index is lower at critical periods and the Company remains concerned that studies currently underway by the EA under the Water Framework Directive may reduce abstractions in its larger water resource zones in the South.

*Chapter 4 – Efficiencies*

Largely based on our audits for the procurement Plan we can confirm that the Company and its service providers are actively working to make efficiencies in the procurement system.

In the section on capital expenditure we note some of the upward cost challenges that face the Company.

*Health and safety*

From our audit of Table 41 we can confirm that the Company is actively working with its service providers on promoting good health and safety practices throughout its business. We were particularly impressed by the levels of communication between all parties and the use of cross audits, where health and safety staff from one service provider audits the practices of another service provider in the presence of one of the Company's health and safety specialists.

*Sustainable procurement*

We confirm the Company's statements on sustainable procurement. The Company

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now works closely over periods of up to 10 years on programmes of works with relatively few designers and contractors. This allows procurement efficiencies to be made. We can also confirm that the Company works in a very open and collaborative way with its service providers.