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A sector accountable to its customers

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“The relationship between companies and customers should be at the heart of everything”

Our shared vision for the water sector in England and Wales is one where customers, the environment and wider society have trust and confidence in water and wastewater services, reflecting the vital nature of these public services. We want the companies that provide these services to be accountable to their customers for delivering the services they need and want at a price they can afford.

Until our 2015-20 price review (PR14), we set performance targets for companies directly through price reviews. Each year, regulators monitored companies to check that they were meeting these targets and we could use our enforcement powers under the Water Industry Act as well as adjustments at subsequent price reviews if companies were not performing.

But at PR14, we expected companies to engage with their customers and customer challenge groups to agree the long-term outcomes customers wanted. This resulted in the biggest customer conversation ever in the sector – engaging with over 250,000 customers.

We now expect companies to continue to develop and maintain their relationship with their customers in delivering these outcomes, with customers engaged and empowered to understand and challenge their company on whether or not this is being delivered. This means as a sector, our approach to explaining and monitoring performance needs to change too.

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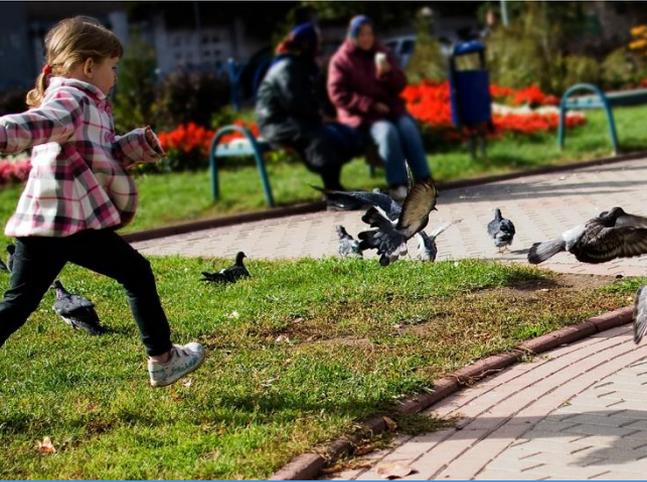
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“Information helps us and others to hold companies to account”

As part of this, we expect companies to report on their performance directly to customers and other stakeholders (including Ofwat) – and engage effectively with their customers to find out what they want to see. Having information that is easy to understand and navigate provides transparency and helps everyone build trust and confidence in the sector. Information forms the basis for conversations so that water companies can listen to their customers and other stakeholders and deliver the outcomes they, the environment and wider society want.

Information also reveals excellence and good practice within the sector. This can provoke all companies to lift their game and deliver the best for their customers. And information helps us and others – such as customer groups, environmental groups and investors – to hold companies to account. We will do this by speaking with and listening to others to identify the biggest risks to trust and confidence – and where we need to take action to avoid problems or make improvements. We want those conversations to enable others to take action too.

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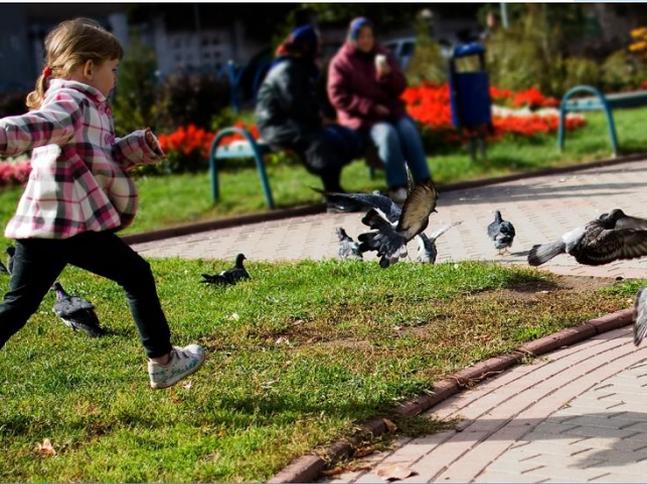
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Our monitoring tools will focus on encouraging companies to take ownership of this engagement and reporting, including the assurance they carry out to make sure this information is accurate and how they are using it in their businesses. Instead of just asking companies to tell us about their performance, we want companies to explain their performance and their leading indicators of risk to their customers and other stakeholders.

We want customer engagement to be an integral part of how water and sewerage companies run their business – not just demonstrating this for the regulator. Companies could consider working with their customers and looking beyond their boundaries to work with other stakeholders (such as NGOs) to deliver their outcomes.

“We want customer engagement to be an integral part of how water and sewerage companies run their business”

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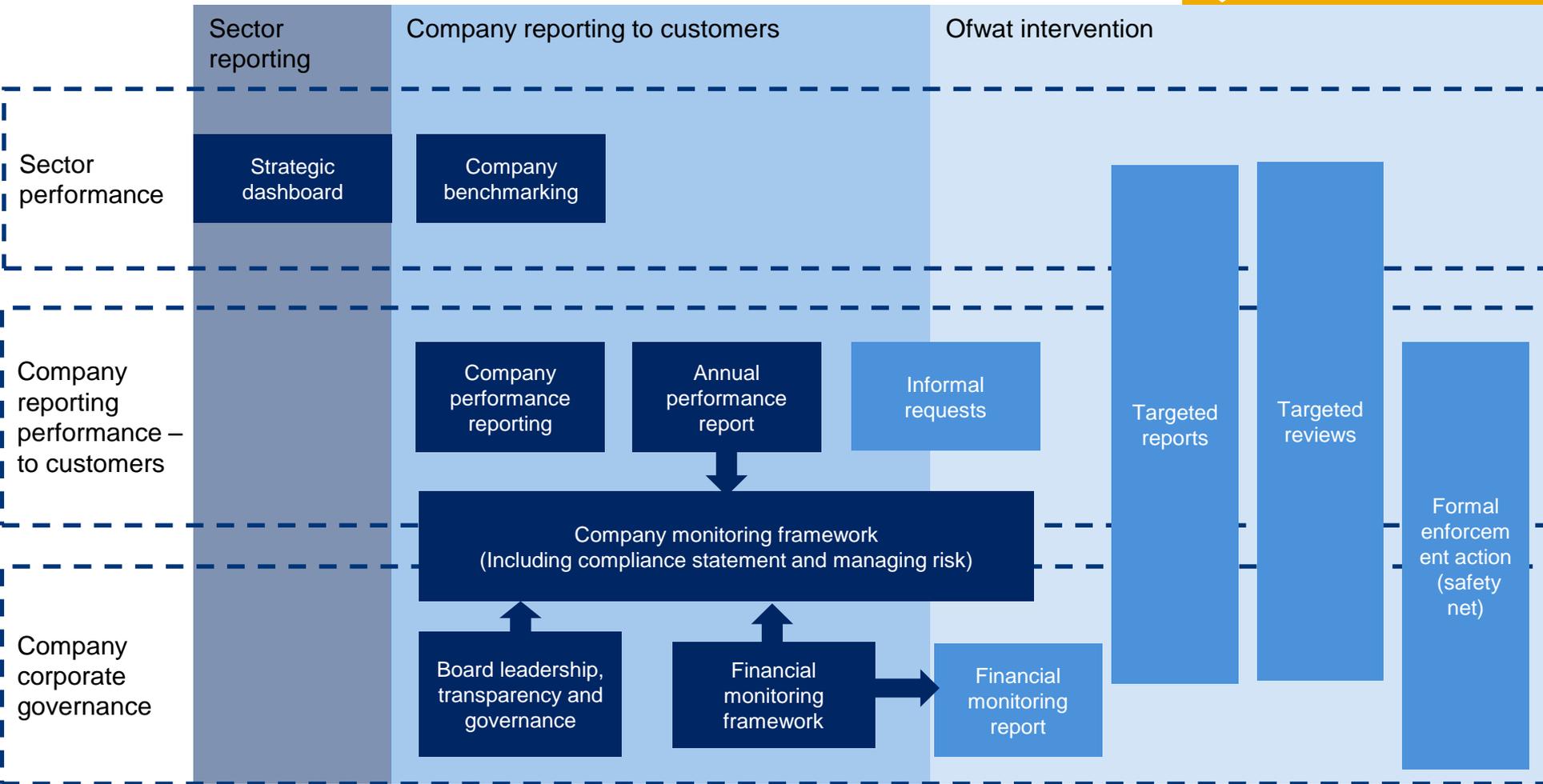
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Click on the boxes to find out more about each tool



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“Comparative information can help companies demonstrate where they are performing well and assess areas where they may need to improve”

We expect companies to work together to provide comparative information – both for their own benchmarking, but to explain their performance better to their customers and other stakeholders. This type of comparative information can help companies to demonstrate where they are performing well and assess areas where they may need to improve. This also helps their customers and stakeholders put performance in context as well as better understanding and being able to manage risk.

We do not expect this to be presented as a ‘league table’. But we do think this should prompt discussion and companies should be able to explain their relative positions. It is also important to look at comparisons with other sectors for best practice and benchmarks – water sector benchmarks alone are not sufficient to create the sort of challenging conversations the sector needs.

We said in our forward programme that we would consult on a strategic assessment framework for monitoring the state of progress against our shared vision both for the sector as a whole and for Ofwat as a regulator. We see the framework being made up of two complementary parts; one for the sector as a whole (strategic dashboard) and one focused on how Ofwat itself is progressing.

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“Comparative information can help companies demonstrate where they are performing well and assess areas where they may need to improve”

We expect the strategic dashboard to be a collaborative tool owned by both the sector and those involved in its regulation – a common understanding of our progress means that we can reflect different perspectives, and we can all contribute to achieving public trust and legitimacy in a coherent way.

This dashboard helps us and others to assess whether the sector is getting closer to or further away from public trust and confidence in water and wastewater services. It aims to help monitor progress on a sector-wide basis, rather than using this to assess compliance with legal obligations or individual company performance commitments.

There are many other mechanisms for reporting performance – from [annual performance reports](#) published by companies and our [financial monitoring framework](#) to benchmarking and performance information published by Water UK and sector regulators – but none of these tools contains everything we need to have an informed strategic debate about the state of progress in the water sector.



We expect the strategic dashboard and the resulting strategic conversations to complement companies' and their Boards' ownership of the customer relationship, including reporting their own performance to their customers and identifying risks to trust and confidence . It will help a wide variety of stakeholders – including customers and their representatives, NGOs, and investors - to hold the sector to account for progress towards our shared vision. It will also help those who regulate the sector – Ofwat, EA, DWI, NRW, and Natural England – to be better informed as to any action we may need to take to help progress towards our vision.

“It will help a wide variety of stakeholders to hold the sector to account for progress towards our shared vision”

We have already spoken to regulators and industry bodies about how the sector might deliver this strategic dashboard, and Water UK will be taking this forward with us and other stakeholders and will engage more broadly on a prototype dashboard in the next few months.



In [Towards Water 2020](#), we identified that more should be done to genuinely empower customers. We said that this might involved providing comparative information to help companies, stakeholders and customer challenge groups (CCGs) make decisions about performance and future targets – and we recognise the efforts already made by the industry, such as the Water UK publications on [developer services](#) and [comparative information](#). We want to encourage the industry to continue to work together to provide more information for customers and stakeholders, and are prepared to engage with and support this activity.

As part of this approach, we will also work towards being more transparent – and will play our own part in making as much information available as possible to the public.

“We want to encourage the industry to continue to work together to provide more information for customers and stakeholders”

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We have prescribed some common content and assurance for the annual performance report, allowing customers and stakeholders to compare the performance of individual companies to the rest of the sector.

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We expect companies to decide how they report on their performance each year. But we also expect companies to publish some common content in an **annual performance report** – this is important as it allows customers and stakeholders to compare the performance of individual companies to the rest of the sector, and sets out a minimum we would expect companies to report on.

Delivery of these reports and stakeholder engagement will be the responsibility of the individual companies and their Boards. A high performing company will ensure that this information is accessible and engaging for customers and wider stakeholders.

We expect companies to publish each year:

- an [annual performance report](#) which will provide specific information on progress on delivery of customer outcomes, service levels, transparent cost information and financial performance – including a [summary of key performance parameters](#);
- a statement that the company has complied with all its **relevant statutory, licence and regulatory obligations** and is taking appropriate steps to manage and/or mitigate any risks it faces; and
- a summary of the results of the **data assurance** that has been carried out to evidence that the information provided is accurate.



We expect companies to report on their performance to customers in a transparent and clear way, and have set out our minimum requirements for companies to do so. But we also need to make sure that customers can trust and understand this information - so we require companies to assure their information.

Our **company monitoring framework** will help us to make sure that water companies provide high-quality assurance on their performance to customers. It will also challenge water companies to put processes in place so that the underlying data can be trusted.

Where there is a lack of confidence in the information individual water companies provide about their performance, we will step in to protect customers by increasing assurance requirements. At PR14, we have placed companies into one of three initial categories: self-assurance, targeted and prescribed.

Most companies are in the **targeted** and **prescribed** assurance categories and we expect them to carry out an exercise with their customers and other stakeholders to identify and address issues, and publish this each year. For the issues a company targets, we expect them to publish draft assurance plans and speak with and listen to stakeholders before confirming final plans – but only in those targeted areas.

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For **prescribed** assurance only, we expect companies to publish their assurance plans for all information before reporting. This is so stakeholders, including us, can gain confidence and if necessary provide comments or guidance. For the areas with the most significance or of greatest risk to customers, we expect companies to incorporate independent external assurance.

This framework helps us to ensure that our assurance requirements are proportionate and targeted at the areas where the risks to customers are greatest. We want companies to engage with their customers and consider where they need more assurance – or where they need to think about how they report performance. Where companies have met the high standards that customers and other stakeholders expect, they will have discretion to put assurance in place that will give confidence about their performance.

In our [Towards Water 2020](#) publication, we identified a need for customers to trust companies and have confidence that their views will be reflected in the decisions companies make on an ongoing basis, rather than just at the five-yearly price reviews. The company monitoring framework will help customers to have confidence in the information companies publish.

We expect companies to consider ongoing assurance and improvement – not just at price reviews. We will look at ongoing assurance when assessing business plans at PR19.



“We expect companies to be transparent about their performance and engage with their customers”

The results of our price review for 2015-20 (PR14) mean that customers in England and Wales will get more from their water companies while paying less for services over the next five years.

At the price review, we also made sure that companies consulted customers about how progress against their outcomes and performance commitments should be rewarded or penalised – in some areas, customers said they were willing to pay more if their company delivered more than its stated performance commitments. And if companies fall short of some of their commitments, they will be penalised financially.

We expect companies to be transparent about their performance against these outcomes and engage with their customers – so we would also expect a reputational impact on companies depending on their performance. Around 40% of the performance commitments across all water companies had no financial incentives attached and for these the reputational impact is particularly important.

In the [previous section](#), we explained how this transparency helps us and others – such as customer groups, environmental groups and investors – to challenge companies and hold them to account. We adopt a **risk-based approach** to assess where we need to be more involved in challenging company performance, and this section sets out the tools we will use to highlight issues and challenge companies.

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We adopt a [risk-based approach](#) to deciding where we need to be more involved in challenging company performance. This means that our decisions on where to focus our action and how we carry out our work are informed by an assessment of risks and will:

- a) ensure we focus on those areas that will provide the best outcomes and value for customers; and
- b) choose the right ways to go about our work.

We expect companies to be accountable for managing the risks to trust and confidence in provision of their services, including the risks to the delivery of the outcomes customer and society expect. Companies should explain significant new risks to customers – as well as the steps they are taking to manage and mitigate these risks.

Our risk-based approach helps us to make sure that we do our job in a proportionate and targeted way – minimising the regulatory burden but still looking at the high risk areas.

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“Where we think there are risks to customer trust and confidence that are not being managed, we will step in.”

We also gather intelligence from a range of sources – including information companies report to their customers, but also through building our relationships with stakeholders (including other regulators), customer complaints and enquiries, market research, and investors.

Where we think there are risks to customer trust and confidence that have not been identified or are not being managed, we will step in. This could mean challenging a company on its performance. But this could also include highlighting poor practice or exploring issues in more depth where there are concerns. We may also highlight good practice or draw attention to particularly good performance where this is warranted.

We may also challenge companies to look at other sectors to provide challenge and share experiences.

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There are a number of possible actions that we could take in response to a particular risk or issue:

Informal requests for further information or explanation – if we cannot understand published information and explanations, or we have concerns about a company not meeting its obligations, we may from time to time ask for more information or explanation on a particular topic.

We expect companies to be able to provide us with further information in areas where they have previously provided assurance, but do not necessarily expect this to be routinely published.

If we still have concerns we may decide to investigate further.

Targeted reports – we will look at specific sector wide topics across the industry to highlight good performance as well as areas that need work. This could be prompted by performance concerns and/or customer or stakeholder interest. But this could also just be routine analysis or updates.

“We expect companies to be able to provide us with further information in areas where they have previously provided assurance”

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An example of a targeted report is our [affordability and debt report](#). We said in our forward programme for 2015-16 that we will publish our work on customer vulnerability in early 2016, and most companies have provided some information to help us do this.

Where appropriate, we may work with the sector or other stakeholders to analyse some of these sector-wide topics. And we will encourage and support others to carry out similar analysis.

Targeted reviews – this type of review is likely to involved a much more detailed examination of the sector’s approach to a particular topic, but we think that this is a proportionate response where:

- there are significant concerns identified by stakeholders;
- there is a high risk to customers or other stakeholders; or
- there is an opportunity for major benefits for stakeholders.

An example of a targeted review is the [targeted review of the 2011-12 accounting separation data and methodologies](#) across all companies in 2013. This review provided us with more confidence that companies’ accounting separation data was robust enough to set retail price controls, and helped us to make sure that future reporting requirements were fit for purpose.

We expect to use these tools to highlight information – challenging companies to improve; and adding to the information available to customers and stakeholders.



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We expect companies to comply with their obligations. In the section on [‘targeted action’](#), we set out the tools we will use to highlight any risks to customer trust and confidence – whether this aims to highlight where companies may need to improve, or simply to explore a possible issue in more depth.

Where we have concerns that companies are not complying with their obligations, we will pursue informal regulatory action where that is the most appropriate means of making sure that they meet their obligations. Formal enforcement action (such as our powers under Section 18 of the Water Industry Act) is likely only to be required to deal with the more serious and/or persistent breaches.

We have set out our [approach to enforcement](#) and have previously used these formal enforcement powers across a [range of areas](#) including customer service, leakage, sewer flooding, and regulatory reporting.

“Formal enforcement action is likely only to be required to deal with the more serious and/or persistent breaches”

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Companies are responsible for determining their management and financing structures - recognising that accountability and the associated risks lie with investors, not customers. The Water Act 2014 gave Ofwat a new resilience duty – as well as resilience of systems and services, this also includes corporate and financial resilience of companies.

We have placed some requirements on companies in the past to protect customers from these financial risks, such as requiring companies to maintain credit ratings and the regulatory ring-fence. These measures protect customers who would otherwise be at risk if companies did not have this level of resilience, but also protect investors by encouraging corporate resilience.

We also expect companies to explain to their customers and stakeholders how they maintain financial and corporate resilience. Customers, investors, and other stakeholders should have confidence that their water company is well managed and resilient to unforeseen shocks.

We already expect companies to report on their approach to managing risk as part of their annual performance report.

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We have now reviewed each regulated company's 2014-15 reporting in order to understand how it is meeting our principles in practice.

As companies take more ownership and accountability, we need to make sure that companies are operating to high standards of board leadership and governance. Effective leadership and governance of the water and sewerage sectors, where boards operate to high standards, take full accountability and report transparently, helps build trust and confidence in how water companies operate and meet their obligations and commitments.

We published our [Board leadership, transparency and governance principles](#) for regulated companies in January 2014, with the expectation that companies would put in place their own governance codes which would allow them to meet our principles by April 2015.

The principles set out minimum expectations covering:

- transparent reporting, including of the group structure; board and board committee composition, including the independence of the chair; and
- how a company acts in relation to its parent and wider group.

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[! Companies' performance 2014-15: Board leadership, transparency and governance](#)

Financial monitoring framework



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We consulted on a proposed [financial monitoring framework](#) in July 2015, having said that we would do this in our methodology for PR14. Alongside the company monitoring framework and annual performance reports, this represents a key component in building trust and confidence in the sector.

We are introducing this to:

- enhance visibility and transparency of financial and capital structures in the sector;
- enable Ofwat to monitor the financial resilience of the businesses that we regulate;
- identify financial, structural or systematic risks which may impact on service delivery over time and prove harmful to customers; and
- help us in determining when we need to use the regulatory tools available to us to intervene to protect customers' interests.

We will publish financial information on the sector annually, and will include a high-level review of that information which identifies key trends and significant changes..

This will enable other stakeholders, including investors, to scrutinise and challenge companies on financial risk and risk management.

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We are also giving further consideration to expecting companies to stress test their business plans and provide us with information on the outcomes – we [consulted on this](#) in July 2015. This could help us to assess industry financial resilience and any risks to customers posed by financial structures – and identify when it might be appropriate to intervene to protect customers.

At the moment, our financial monitoring framework only applies to regulated companies. We will also consider whether we need to look beyond the regulatory ring-fence to examine the financial arrangements for holding companies.

We published [Board leadership, transparency and governance principles](#) for holding companies in April 2014 to complement our principles for regulatory companies. Although this goes beyond the regulatory ring-fence, we have limited the principles to those areas where we consider the activities of the holding company could have the greatest direct impact on the regulated company.



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Based on the information we collect through the **financial monitoring framework**, other information we receive or conversations with companies or other stakeholders we may identify a company which may be experiencing some form of financial distress. If this is the case we may need to step in to ensure that customers continue to receive water and wastewater services at a level they expect.

Although we are improving the information we collect to inform our view of risk, it is the responsibility of companies and their investors to identify, understand and manage risk.

We have recently completed a review of our processes and procedures for dealing with a company in financial distress, and will continue to keep them under review so that they remain up to date and fit for purpose.

We have now [published the outcomes of this review](#) and the steps we will be taking to address the lessons coming out of it.

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