

August 2014

Setting price controls for 2015-20
Draft price control determination notice:
technical appendix A9 – assurance, monitoring
and reporting obligations



OFWAT

Contents

Overview	2
A9.1 Background and approach	4
A9.2 Our assurance framework for 2015-20	8

Overview

This document sets out the approach to assurance, monitoring and reporting we have used in setting the draft determinations and will employ throughout the five-year period.

Accurate information reporting and the use of robust assurance processes by companies during the five-year price control period will allow Ofwat, along with other stakeholders, to have confidence that we can rely on information about whether companies are delivering outcomes and complying with the price control framework.

The key results of our review of the companies' business plans are as follows.

- Companies have engaged positively in the 2014 price review (PR14) process and, in particular, have subjected their plans to review by customer challenge groups without exception. On a forward-looking basis, companies have developed robust self-reporting and assurance processes.
- In our final methodology we required each company's Board to own and be accountable for the business plan they submit, and said that plans should include a statement from the company's whole Board that the plan is of a high quality, will ensure that it meets its statutory obligations, and that estimates and data have been arrived at appropriately and independently of other companies and competitors.
 - Companies' boards have taken real ownership of their business plans and have in general provided a high level of assurance.
 - However, we have written to some companies asking them to provide third party assurance in relation to certain elements of their business plan proposals before our final determinations.
- We are proposing three levels of assurance requirements in the 2015-20 price control period related to the monitoring and reporting of business plan commitments and the price controls: self assurance, selected assurance and strong assurance.

- The level of assurance required from companies will depend on the confidence we have in the quality and accuracy of the information on which that company’s performance commitments are based, and our assessment of the risks associated with lighter touch reporting of actual performance by each company.

The material we have published today sets out our draft proposals. Stakeholders now have the opportunity to comment on the proposals and the approach we have adopted in reaching our decision. We will consider carefully all of the representations ahead of making final determinations in December. In particular, companies will review whether to include further evidence as a result of the feedback we have given them. And we will maintain our high evidential bar to make sure that our final decisions represent the best possible deal for customers.

A9.1 Background and approach

The price controls we set in December 2014 will include the outcomes the companies' boards will have committed to deliver over the next five-year period from 2015 to 2020.

In 'Setting price controls for 2015-20 – final methodology and expectations for companies' business plans' (our 'final methodology statement'), we explained that companies' boards needed to take more ownership and accountability for what they will deliver. We also explained in the risk-based review that where companies had not already developed plans for the measurement, recording and governance of outcomes we would be looking for them to address this ahead of draft and final determinations.

A9.1.1 Companies are accountable for delivery against their plans

Companies' boards need to subject final revisions to their business plans to sufficient review, testing and challenge to ensure that they are focussed on delivering the outcomes that their customers want for today and for the future, including protecting the environment. This should include challenge from their customer challenge group (CCG).

Following our final determinations, companies' boards will be accountable for the delivery of these outcomes. This means that the measurement, recording and governance arrangements agreed as part of the price control must be delivered.

We will continue to regulate according to our risk-based approach. This means that we will only step into these arrangements where we have concerns that the companies' boards are not taking appropriate ownership and accountability for the delivery of the commitments that they have made to their customers.

Where we need to make significant interventions in our final determinations or the reporting and/or delivery of historical performance is poor, we may have less confidence that a company will deliver for its customers in future and we may require a higher level of assurance to ensure those customers are properly protected.

This appendix sets out our proposed framework for the level of assurance we will seek from companies during the 2015-20 period in relation to the delivery of their commitments for the price review. It sets out three categories of assurance requirements and the way we will determine which category to apply to each company through the finalisation of the price controls and during the regulatory period itself.

We will require certain information from all companies to help meet regulatory requirements and incentive mechanisms on a consistent basis across the sector.

For example:

- the information reported on the service incentive mechanism (SIM) by individual companies will affect all other companies subject to the SIM incentive; while
- consistent application of regulatory accounting requirements will provide important information to stakeholders engaged in the new national markets promoted by the reforms enabled by the Water Act 2014; and
- all companies will need to report consistently on their actual regulated wholesale revenues to enable our sector-wide forecasting incentive to be applied as set out in the [risk and reward technical appendix](#).

These reporting requirements will be further detailed in our proposed approach to regulatory reporting, and our proposals for financial monitoring, given our framework of allowed returns based on appointees' notional capital structures. We will be consulting on both of these sets of proposals this autumn.

The assurance framework applied to individual companies, which we outline below, will work alongside those basic sector requirements. It will also sit alongside ongoing wider licence enforcement, the operation of competition law as it applies to the affected companies, and their other ongoing statutory responsibilities.

A9.1.2 Some companies have not so far provided sufficient assurance

In our final methodology statement, we said that that we wanted companies to own and be accountable for the business plan they submit. We said a high-quality business plan would (among other things):

- have a coherent narrative, based on sound reasoning and containing proportionate evidence;
- be cost efficient, containing accurate projections and estimates;
- be based on good-quality engagement with customers and consumers; and
- come with a high level of assurance – in the form of a statement from the company’s whole Board that the plan is of a high quality, will ensure that it meets its statutory obligations, and that estimates and data have been arrived at appropriately, and independently of other companies and competitors.

We have seen variability in the quality of companies’ information submissions to us and the assurance of that information.

Some companies, for example South West Water, have provided us with extensive assurance that their plans are robust as a whole or in specific parts. So we consider that there is little or no need for us to intervene to ensure that they deliver outcomes that their customers want and are prepared to pay for.

For a number of companies where we have identified gaps in their plans or questioned their proposals – for example, during our risk-based review of the December business plans – they have provided additional evidence that justifies their proposed approach, including from customers and third party experts. Accordingly, we have been able to reflect such proposals in our draft determinations with relatively limited changes. They represent a sound basis against which reporting, monitoring and assurance can be undertaken during the next regulatory period, from 2015 onwards.

We continue to have concerns about the quality of a very limited number of business plans or elements of those plans. Two areas of particular concern that we identified through the setting of August draft determinations were on financeability and the allocation of costs.

We wrote to companies to identify these shortcomings and require them to provide third party assurance that gives us sufficient confidence in the affected business plan proposals before we complete the price review process¹.

¹ [‘Letter from Sonia Brown to a number of water companies – PR14 June business plan: Concerns regarding quality of data and assurance’](#), August 2014.

These issues have occurred after we issued further guidance on both [cost allocation](#) and our approach to [assessing financeability](#) earlier this year and after we have held workshops and bilateral discussions with some of the companies on these issues. More information on these issues can be found in the [household retail and financeability and affordability](#) technical appendices.

Not only do these failures create additional issues that will need to be resolved in the limited time available ahead of final determinations, but they reduce the weight that we can place on these companies' assurance as a whole and make interventions in companies' business plans more likely.

A9.2 Our assurance framework for 2015-20

Accurate information reporting and the use of robust assurance processes by companies in the 2015-20 period will allow Ofwat, along with other stakeholders, to have confidence that we can rely on information about whether companies are delivering outcomes and complying with the price control framework. It also provides information to use as a basis for setting future price control incentives, and further reduces the costs of regulation. We set out in '[Future price limits – statement of principles – Appendix 1: Impact assessment](#)', which we published in May 2012, that we expect there to be longer-term benefits from such reduced regulatory burdens.

Consistent with this, companies' boards will need to satisfy themselves that they are delivering against their plans. They should be able to demonstrate, for example, consistency and accuracy of reported actual financial and non-financial data, and appropriateness of the assumptions and estimates used in updated projections.

However, the lower the confidence we have in the accuracy of companies' forecasts and assumptions, and in their ability to monitor and accurately report on their actual performance, the greater will be our need for specifying the requirements for robust assurance processes to protect consumers during the period.

Building on our experiences to date and in particular during the PR14 process, we propose that the level of assurance required from companies in relation to their compliance with price review obligations will differ according to the confidence we have in the quality and accuracy of the information on which that company's performance commitments are based, as well as our assessment of the risks associated with lighter touch reporting of actual performance by each company. We consider that this will provide incentives for consistently high-quality reporting and assurance across the sector in the longer term.

To assist with achieving this objective, we are proposing three categories of assurance requirements during the next regulatory period (from 2015) related to the monitoring and reporting of business plan commitments and the price controls:

- strong assurance;
- selected assurance; and
- self assurance for outcome delivery.

Figure A9.1 Assurance requirements in the 2015-20 period



A9.2.1 Three levels of assurance

Companies subject to **strong assurance** will be required to provide third party assurance to a standard specified by Ofwat for the carrying out of their plans. These will be the companies that have not been able to provide Ofwat with confidence about their ability to deliver, monitor and report performance against business plan commitments, or to have taken full account of the price control methodology and the balance of risk and reward between investors and customers.

Companies that are subject to **selected assurance** will be able to choose how they assure Ofwat for some of the aspects of their business plan commitments, but for those commitments which business plan evidence indicates are most important to customers the companies will be required to provide Ofwat with appropriate third party assurance as specified by the regulator.

Companies asked to provide **self assurance** will have no additional regulatory requirements for outcome delivery over those agreed at the time of setting final determinations. These companies will have already satisfied us that their business plans (if necessary, following revisions submitted in June) are robust and well-evidenced. They will have given us confidence that, with the exception of minimum sector-wide requirements as indicated above, their consumers will be protected through monitoring, reporting and assurance arrangements proposed by the companies concerned, without our further intervention. This is consistent with our proportionate regulatory approach.

Transfer between these three categories during the 2015-20 period will be possible. If a company in the strong category proves able to meet performance commitments, and to accurately monitor and report on that performance, it can be moved to selected and then self assurance. Similarly, if Ofwat has concerns about a company in the self assurance or selected category (for example, there is evidence of misreporting), the company can become subject to a stronger level of assurance.

We propose that a company subject to strong assurance would be required to remain in that category for a minimum of two years. A company would be in the selected category for a minimum of one year before it could be moved to self assurance.

A9.2.2 Next steps

Our final determinations will indicate which of the above categories each company will fall into. We recently wrote to a number of companies suggesting that they provide further independent assurance for elements of their plans as part of their representation on the draft determinations².

We will consider the representations made by all companies, including the companies we wrote to. We will then hold a further discussion with companies before determining which companies have provided sufficient assurance and where additional assurance will be required during the period to 2020. We expect to confirm these requirements in December having considered responses to our forthcoming consultation on industry-wide monitoring, reporting and assurance arrangements in the autumn.

² ['Letter from Sonia Brown to a number of water companies – PR14 June business plan: Concerns regarding quality of data and assurance'](#), August 2014.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We are responsible for making sure that the water sector in England and Wales provides customers with a good quality and efficient service at a fair price.



Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7699
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gsi.gov.uk

Photograph © freepixels.com
Printed on 75% minimum de-inked post-consumer waste paper
August 2014

© Crown copyright 2014

You may reuse this information (excluding logos) free of charge in any format or medium, under the terms of the Open Government Licence v2.0. To view this licence, visit <http://www.nationalarchives.gov.uk/doc/open-government-licence/version/2> or email psi@nationalarchives.gsi.gov.uk.

Where we have identified any third party copyright information, you will need to obtain permission from the copyright holders concerned.

Any enquiries regarding this publication should be sent to us at mailbox@ofwat.gsi.gov.uk.

This document is also available from our website at www.ofwat.gov.uk.



www.ofwat.gov.uk