

ADDITIONAL RISK AND COMPLIANCE STATEMENT

December 2015

This Risk and Compliance Statement is provided to respond to Ofwat's concerns about our ability to deliver for our customers in a resilient way during AMP6 and re-confirms that the Board considers that the Company has complied with all relevant statutory, licence and regulatory obligations.

The original Risk and Compliance Statement was published on 15th July 2015, accompanying the annual performance report.

Confirmations

The Board of Bristol Water

- 1) is committed to deliver the outcomes for our customers over AMP6 and to meet our other obligations;
- 2) is confident of our ability to meet our customers' expectations in an efficient manner.
- 3) considers that it has a full understanding of, and is meeting, its obligations and has taken steps to understand and meet customer expectations;
- 4) has satisfied itself that it has sufficient processes and internal systems of control to fully meet its obligations; and
- 5) has appropriate systems and processes in place to allow it to identify, manage and review its risks.

Compliance with legislation and licence conditions

The Board of Bristol Water confirms that it is compliant with the following requirements:

- a) that there are sufficient rights and assets available to enable a special administrator to run the business, in accordance with licence condition K;
- b) that trade with associates is at arm's length, as required by licence condition F6;
- c) a statement is published in the regulatory accounts explaining links between directors' pay and standards of performance, as required by section 35A of the Water Industry Act 1991;
- d) in particular, the Board of Bristol Water confirms that it has complied with Condition F.6A.1, namely:
 - that Bristol Water shall at all times act in the manner best calculated to ensure that it has adequate
 - financial resources and facilities, and
 - management resourcesto enable it to carry out the Regulated Activities (including the investment programme necessary to fulfil its obligations under the Appointment.)

Information included with this Statement gives further details of how Bristol Water has considered its financial resources, management resources and assurance plans, and the reasons why it considers that the assurances provided are appropriate. Sections 1 to 4 below provide a summary of this additional information.

Ofwat has confirmed to Bristol Water that it will be moved to the 'prescribed' assurance category as described in IN 15/01, effective immediately. Ofwat has requested additional information from Bristol Water in respect of how it intends to carry out the necessary extra assurance and what work Bristol Water will do to move out of this category. This additional information is summarised in section 5 below.

1. Our customer commitments and obligations

We are committed to deliver our outcomes for our customers over AMP6 and to meet our other obligations. Whilst the Competition and Markets Authority Final Determination represents a significant reduction in revenue and totex allowances compared to our original business plan, we are confident of our ability to meet our customers' expectations in an efficient manner.

During PR14 we carried out a careful analysis of what our customers value and we asked them to prioritise the different areas of water service we will deliver. This analysis has been used to inform the development of our outcomes, the performance measures and Outcome Delivery Incentives (ODIs) associated with them. Most of our customer commitments and outcomes remain unchanged from our original Business Plan. We are now targeting higher levels of performance for some measures, following the determinations of Ofwat and the CMA.

In addition, we recognise the obligations set out in the Licence and the Water Act, and the Board and management take those obligations very seriously.

The assurances provided by the Board during PR14 and re-confirmed in this additional Risk and Compliance Statement are based on a detailed understanding of what our obligations are. External advisors Osborne Clarke carried out a legal analysis of our obligations and this was presented to the Board and agreed in 2014.

We have a good track record of meeting our obligations under the Water Industry Act 1991.

The next sections describe how we have adapted the plan and developed new options in order to deliver all our outcomes and obligations in AMP6 and beyond. The changes to our approach and our plan have been approved by the Board.

2. Working with the revised cost allowances

Our commitment to our customers is our highest priority and in the event that the risks to customers increased materially as a result of changes in our plans, we would increase investment to reduce risk to an appropriate level.

The largest cost difference between our Business Plan and the final determination was due to the removal of particular schemes. These schemes targeted the needs of population growth and increased resilience, and we had identified at PR14 that there was customer willingness to pay for these improvements, but we believe that this change will not negatively affect customers in the short to medium term and that we can absorb potential shocks if they materialise in the meantime.

Our original plan was our best central estimate of what we would spend to deliver our customer commitments and obligations. In our view, under or out-performance was broadly equally likely in the original plan. Inevitably the targets are now more stretching for us than we assumed in our original plan, as the result of a lower revenue allowances. We remain confident we can deliver our outcomes for customers, but it is now less likely that outperformance can be achieved, implying the Company has taken on more risk. The aim of our revised plan is to continue to deliver our customer commitments and for customers to experience no material increase in risk.

Our original plan delivered improving customer service levels over the AMP and a reduction in risks to future resilience. Some of the long term risk reductions we had planned will now not be carried out in AMP6.

We already possess a resilient network. We are introducing extra monitoring to ensure that risks to customers of non-delivery continue to be at, or below, the levels they experience today.

We are developing new approaches to deliver the level of service our customers want, without a material increase in risk and at a lower level of cost and investment during the period. We expect to deliver totex savings through improvements in our asset management approach. This transformation will introduce (i) a consistent view of asset risk in our operation, (ii) updated decision processes to include business-as-usual use of deterioration models and joint ownership and identification of risks and (iii) clarity of asset strategy and planning roles.

Through our efficiency programme and restructuring work, we are starting to deliver material savings via a number of work streams that cover the full spectrum of the business. We have extended the efficiency challenge we are looking for this project to deliver. After allowing for reductions in scope, the size of the efficiency challenge we face has not increased greatly compared to our original plan.

3. Summary of assessment of adequate financial resources and facilities

We can confirm our belief that our AMP6 Business Plan has sufficient financial resources and facilities to meet our obligations and cope with downside shocks.

We have also sought credit agency views in respect of our current credit ratings and targeted credit metrics. This is to ensure that we can maintain an investment grade rating, as required by our Licence.

To substantiate our confirmation, we have in the accompanying note set out a high level overview of a number of areas. These are:

- an overview of the movement in net borrowings in our AMP6 Business Plan, reflecting the CMA determination and our internal cost efficiency initiative Project Channel;
- a summary of our financial liquidity and credit facilities during AMP6 including the impact of existing covenants;
- an analysis of recent credit rating agencies guidance following the CMA decision, including Moody's confirming our Baa1 Stable rating; and,
- an analysis of the financial resilience of our AMP6 Business Plan to downside shocks, including potential actions we can take to mitigate the effects of any shocks.

We have considered the impact of downside shocks for key risks, such as higher than planned levels of totex, inflation or interest. From our consideration of scenarios, our existing position and future plans, we have concluded that our AMP6 Business Plan is resilient to reasonable downside shocks.

We are confident that we will be able to deliver the necessary savings to remain within targeted expenditure levels for 2015/16. We have performed well operationally over the last six months and we have maintained financial stability by targeting early delivery of efficiencies, reprioritising our capital and maintenance expenditure and restricting shareholder dividends (see our announcement of interim results for the six months ended 30 September 2015 published 30 November 2015.).

We currently have undrawn credit facilities of £70m, which are more than sufficient to address our borrowing requirements.

Our AMP6 Business Plan targets compliance with our debt covenants at all times.

4 Summary of assessment of adequate management resources

We confirm that we have adequate management resources to meet our obligations. We consider both the size and capability of our Board and management team to be appropriate to meet our customer commitments and obligations.

The composition of the Board and Executive management team includes members with a wealth of experience in the water industry and other sectors, at Bristol Water and beyond, with relevant professional qualifications, and diversity between those with longer service to the Board and newer additions.

We also have plans and processes in place to ensure that our Board and management team undergo a process of continual review and refreshing, and that we are resilient to the unanticipated loss of key members of the team.

We recognise the crucial role senior management plays in setting the tone and focus of the Company in relation to business planning, price reviews, change management, continuous improvement, culture and the delivery of business as usual.

Bristol Water is going through a significant period of change, both to the structure of the Company and our approach to risk. We consider that management is well placed to lead the business through this change due to the significant experience already within the organisation and new recruits with specific expertise in business restructuring and delivering risk-based processes in other organisations.

We have implemented Project Channel, our company-wide transformation and efficiency programme that was initiated in 2014 and considers all aspects of how Bristol Water manages and operates its business. It comprises eight broad workstreams and looks to generate savings of c£50m to deliver the required efficiency rates assumed within the CMA determination.

The eight workstreams under Project Channel are:

- 1) Energy: optimising consumption and purchasing;
- 2) Target Operating Model (TOM): transformation of organisational structure;
- 3) Commercial Management: implementing best practise across the company;
- 4) Ways of working: challenging existing policies;
- 5) Working patterns: challenging existing work patterns;
- 6) Contracts: reducing contractor spend and retaining skills in the business;
- 7) Approach to asset management: optimising totex and delivering outcomes; and
- 8) Reporting: improvements to our reporting framework and processes.

These projects have already begun to deliver operational cost savings during 2015/16.

Key drivers of the restructure included the need for increased accountability and improvement in asset management, including separating the asset management and regulatory teams. As a result, one of the most significant changes introduced by Channel is a new structure, which embraces a totex approach and features an asset planning function outside the Strategy and Regulation team to address long-term planning and functional teams to consider shorter-term delivery issues.

5 Summary of assurance plans

We welcome the opportunity to share with you our approach to assurance planning in detail, including how we will act on the results of our assurance exercises and use them in developing our engagement with stakeholders.

In discussions with you we have agreed that we should submit the risks, strengths and weakness analysis alongside our response to your letter. It was agreed that we would not yet publish our draft assurance plan, as it would be beneficial for it to be informed by stakeholder engagements on the risks, strengths and weaknesses consultation. We therefore plan to publish our draft assurance plan in February 2016. We note that our first opportunity to move out of prescribed status is likely to be in the Autumn of 2017 and set out our aim to achieve that.

5.1 Strengths, Risks and Weaknesses consultation.

Accompanying this letter is our consultation on risks, strengths and weaknesses that we intend to publish on our website on 15th December 2015 with responses due by 15th January 2016. This consultation will be supported by proactive engagement with key stakeholders. Following this consultation period we will publish a draft of our assurance plan on our website, incorporating the feedback received on our assessment of risks, strengths and weaknesses. We will again engage with stakeholders, including Ofwat, on their views of this draft plan.

We will then publish a final version of our assurance plan by 31st March 2016. This plan will support the publication of our reports on our performance in 2015/16, which will be published in the Summer of 2016.

5.2 Assurance plan

The assurance plan will cover all information that Bristol Water reports and publishes. This includes information reported for regulatory purposes, and that produced for the benefit of customers.

Specifically, the plan will include our assurance proposals for:

- i. 2015/16 Annual Performance Report
- ii. 2015/16 Regulatory Accounts
- iii. 2017/18 Wholesale and Retail Charges and Charges Scheme
- iv. Guaranteed Standard Scheme Payments for 2015/16
- v. Data on performance on New Connections, reported monthly via Water UK
- vi. Complaints reporting to CCWater
- vii. Water quality information provided to the Drinking Water Inspectorate
- viii. Information provided to the Environment Agency

We have attached an overview of our draft assurance plan to this letter to clarify:

- the assurance we will set out;
- who the assurance will be performed by;
- timings of the assurance;
- how we will take into account the views of our customers and stakeholders;
- what actions we will set out in the plan; and,
- accountability.

5.3 How we propose to move from the ‘prescribed’ category to ‘targeted’ or ‘self-assurance’

The Company Monitoring Framework stipulates that companies classified as ‘prescribed’ should retain that status for a minimum of 18 months. This effectively means that the earliest point at which Bristol Water could change category would be when Ofwat makes its annual assessment in the Autumn of 2017.

Ofwat has set out two specific criteria by which it will assess whether a company can move from prescribed to targeted assurance after 18 months:

- there is no evidence of behaviour that leads to a reduction in the trust and confidence stakeholders can place in it; and
- there is an absence of significant problems with its audit plans in the previous year.

We expect that Ofwat's assessment will take into account companies' Annual Performance Reports in 2016 and 2017, as well as Regulatory Accounts and Charges Schemes published in those years, and the information provided for the 2016 Retail Non-Household price control. Our intention is that each of these submissions should be compiled and assured in accordance with the Final Assurance Plan that we will publish in March 2016, subject to any revisions made to that plan in March 2017.

Our aim is that through continued delivery of our outcomes for customers, providing good quality information and following appropriate assurance processes during this period, we can rebuild Ofwat's trust and confidence in us and move out of the 'prescribed' category.

To provide Ofwat with confidence that we have followed our published Assurance Plan, we propose to provide a statement from our Board to confirm that the plan has been followed for production of the Annual Performance Report. This statement would incorporate the views of our external assurance providers on the quality of the data, and confirmation that they are not aware of any material errors in the published data.

We will demonstrate our achievement of our AMP6 performance commitments through information reported in our Annual Performance Report and made available on our website. Demonstrating achievement of our commitments should provide additional comfort to stakeholders that the forward-looking statements made in this additional assurance statement were appropriate.

Signed for and on behalf of the Board:



Luis García
Chief Executive



Keith Ludeman
Chairman