
Consultation on how companies should demonstrate their long term financial resilience – a summary of consultation responses

1. Introduction

On 27 January 2016 we published a consultation setting out our proposals for how water and waste water companies should [demonstrate their long term financial resilience](#).

That consultation set out how companies could use the existing requirements of the [UK Corporate Governance Code \(September 2014\)](#) to provide a statement in their regulatory and statutory accounts which explains the process that company Boards have followed to satisfy themselves that each company is financially resilient over the longer term.

The purpose of these proposals is to provide information about the financial resilience of the sector in line with our primary statutory duty in respect of resilience over the longer term.

Prior to the consultation, in October 2015, we held workshops where we discussed these proposals with the companies and others.

Interested parties had until 25 February 2016 to respond to these proposals.

We received formal responses to the consultation from 17 regulated water companies and the Welsh Government.

In chapter 2 we summarise:

- the key themes of the consultation responses
- our response; and
- the next steps for our proposals, including areas where additional guidance will be issued.

Next steps

We will issue an Information Notice, before the end of March 2016 confirming that in line with the requirements of the UK Corporate Governance Code, all regulated companies should include a long term viability statement in their statutory and regulatory accounts for the financial year ended 31 March 2016.

The Information Notice will also explain how we would expect companies to approach the preparation of that statement.

Following our review of the statements included in the statutory and regulatory accounts of each company for the year ended 31 March 2016, if we believe that the statements provided are not of an appropriate standard, then we will consider whether further guidance is required for 2017 or whether the approach needs to be amended or become more prescriptive.

2. Summary of Consultation responses

The responses to the consultation were broadly supportive of the proposal that companies should use the requirements of the UK Corporate Code to demonstrate long term financial resilience.

Companies also commented positively about the way in which Ofwat had considered and addressed the concerns that they had raised about the original proposals that been put forward to address the issue of demonstrating financial resilience in July 2015. They welcomed the revised proposals that had been set out in this consultation.

Respondents to the consultation did raise some issues regarding the level of detail that we are asking companies to publish, as the approach that we had set out in the consultation was considered to be more onerous than that required under the UK Corporate Code.

Theme	Background and summary of consultation responses	Our response
Form and content of the statement on long term viability to be included in company accounts	<p>In the consultation document we set out that we expect companies to include an explicit statement in their financial statements which sets out the steps that they had taken to satisfy themselves that the company is financial resilient over the longer term. This required companies to :</p> <ul style="list-style-type: none"> • prepare a forward looking plan; • to stress test that plan, using an appropriate set of sensitivities, including stating why they have selected the sensitivities that they have used; • to make a statement about how far forward they have looked and why they consider that period to be appropriate; and, 	<p>It is our view that companies should include sufficient information within the statements that they make in their accounts for a reader to understand the approach that the Board have taken when assessing the company's financial viability and in reaching their conclusion.</p> <p>We do not expect companies to publish information that is commercially sensitive in nature but we want to be clear about our expectation that companies should be transparent about the basis on which they have reached their conclusions and how they have satisfied themselves that the statement they are making is appropriate.</p> <p>For the 2015/16 financial year we do not intend to be prescriptive about the contents of the statements on</p>

	<ul style="list-style-type: none"> to outline any action that management would need to take in the event that the scenarios used for stress testing were to result in an unacceptable level of deterioration in the company's financial metrics. <p>We explained that we would not expect companies to publish the detailed results of the stress tests, however we consider it important that companies make an explicit statement about the processes that they have followed, disclose the risks assessed and over what period and to confirm that the Board have satisfied themselves that the company is financially resilient.</p> <p>A number of respondents expressed concerns about the level of detail that we were asking companies to provide, particularly where we were asking for an explicit statement that went further than the requirements of the UK Corporate Governance Code.</p>	<p>long term viability. However, if, once we have reviewed the statements that companies have published for that year, we do not feel that companies have set out clearly the approach they have taken to assessing their financial viability then we will stipulate more prescriptive requirements for subsequent years.</p> <p>We will publish an Information Notice before the end of March 2016 which clarifies these requirements.</p>
<p>Third party assurance</p>	<p>The consultation set out that we expect companies to obtain appropriate third party assurance on the long term financial viability statements that they are making.</p> <p>A number of respondents requested clarification as to the level of third party assurance that is required. Other respondents stated that the responsibility for making the statement on financial resilience should remain with the Board and that no further assurance was appropriate.</p>	<p>We do not intend to specify the level of third party assurance that is required.</p> <p>Statements about the long term viability of the companies are the responsibility of each company's Board and they should also be responsible for determining the extent of any third party assurance that they consider is necessary.</p>
<p>Placement of the statement on long term financial viability</p>	<p>The consultation set out that companies should include a statement on long term financial viability in both their statutory accounts (as required by the UK Corporate Governance Code) and in their regulatory accounts.</p> <p>A number of respondents questioned whether there was a need to include the statement in both sets of accounts and whether a single statement could be made with an appropriate cross reference to each set of accounts.</p>	<p>We confirm that where companies publish both their regulatory and statutory accounts at the same time, and company Boards consider that the same statement is appropriate for both statutory and the regulatory accounts then it is acceptable for that statement to be included in one place with appropriate cross references to the other set of accounts.</p>

<p>Length of future period that companies should be considering when they are assessing their financial viability.</p>	<p>We did not specify in the consultation how far forward companies should be looking when assessing their long term financial viability, however we set out that companies may need to look both within and beyond the current price control period.</p> <p>A number of respondents suggested forward looking periods of between 3 and 5 years were appropriate while one respondent requested confirmation that they would not need to look beyond the end of the current price control period in all circumstances.</p>	<p>In our view company Boards should determine the appropriate period over which they are making their assessment of long term viability and should be stating why they consider the period they have selected to be appropriate.</p> <p>We do not intend to specify the period that companies should be considering at this point in time. If having reviewed the statements made by companies for the 2015/16 financial year we do not think that companies have selected appropriate periods then we may issue more prescriptive guidance for future years.</p> <p>We also want to clarify that companies should be providing justification for the period they are considering and it may be appropriate for companies to look at a period which goes beyond the end of the current price control period. We would not expect this to be a constraint.</p> <p>For example, in 2017/18 it would not necessarily be appropriate for companies to look forward only 2 years to the end of the current price control period, just because the end of it was approaching when previously they had considered a forward looking period of, say, 4 years to be appropriate. Companies should keep the period over which they are assessing their financial viability under review but must provide clear justification for any changes to their approach.</p>
<p>Looking outside the regulatory ring fence</p>	<p>In the January 2016 consultation we confirmed that we were not intending to look outside the regulatory ring fence as a matter of course, but would only do so if we had concerns about the financial position of the group to which the appointee belonged and the potential impact on the regulated company.</p> <p>A number of respondents expressed the view that Ofwat should not be looking outside the regulatory ring</p>	<p>Our position has not changed. At this point in time we do not intend to look outside the regulatory ring fence as a matter of course.</p> <p>We will in line with our primary statutory duty in respect of resilience consider looking outside the regulatory ring fence if we have concerns over the financial stability of other members of the appointee company's group which could have an impact on the financing of the appointed company.</p>

	fence under any circumstance while others welcomed the clarification of our position.	We also continue to encourage companies to be transparent about the tax and other arrangements that they have in place with other group companies.
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