

Consultation on how companies should demonstrate long-term financial resilience

Response from Northumbrian Water Limited

Q1 Do you agree that the proposed approach to companies demonstrating their financial resilience will provide an appropriate level of assurance about each company's financial resilience?

We support the proposal that a long-term viability statement, produced in accordance with the UK Corporate Governance Code (the Code) and associated Guidance on Risk Management, Internal Control and Related Financial and Business Reporting (the Guidance), would provide stakeholders with assurance that the company is financially resilient over the longer term. This is consistent with our response to an Ofwat letter in respect of assurance on adequacy of financial capital in July 2015.

However, we disagree with any requirement to go beyond the requirements of the Code. The Code applies to premium listed companies, which are expected to meet the UK's highest standards of regulation and corporate governance. The consultation states that Ofwat expects regulated companies to comply with the Code and follow the same reporting procedures. However, the proposal then places additional requirements on companies which go beyond those set out in the Code and Guidance, specifically in respect of requiring additional explicit statements to be made and an expectation of third party assurance.

The requirements of the Code and Guidance set out a framework within which companies can carry out a robust assessment of principal risks and an assessment of the longer term prospects of the company, appropriate to the individual circumstances of the company. The Code also requires directors to explain how they have assessed these prospects and any assumptions made. Compliance with these clear requirements should therefore be sufficient in its own right to demonstrate financial resilience without Ofwat specifying additional explicit statements.

In respect of assurance, the viability statement in the statutory accounts falls within the scope of the statutory auditor's report. We believe that it should be for a company's Board to determine what additional assurance it requires to enable it to make the statement. We do not believe that this assurance should be specified by Ofwat to a level beyond that required for premium listed companies.

Q2 Is there anything else that we should be recommending that companies explicitly include in their statement on long term financial viability?

Compliance with the requirements set out in the Code and Guidance are, in our view, sufficient. We do not agree that Ofwat should specify, or even recommend, what companies should include in their statement.

Q3 Are there alternative approaches to companies demonstrating their long term financial resilience that Ofwat should be considering?

As stated above, we support the proposal that a long-term viability statement would provide stakeholders with assurance that the company is financially resilient over the longer term. We do not suggest an alternative approach.

Additional matters in the consultation

Inclusion in both statutory and regulatory statements

The consultation proposes that a viability statement should be made in both the statutory and regulatory accounts. It is our intention to produce our statutory accounts and regulatory annual performance report (APR) as a single document with cross-referencing from the APR to relevant commentary provided within the statutory accounts, as allowed by paragraph 2.2.3 of RAG 3.08.

We do not see any benefit in duplicating the viability statement in two separate places within the same document, as we would expect both the process to produce the statements and the content of the statements to be effectively the same. We would propose making a statement in the APR referencing the viability statement in the statutory accounts and confirming that it is also applicable to the regulated business on a standalone basis.

Looking outside the regulatory ring fence

We would like to reiterate the comment we made in our response to the Ofwat consultation on the financial monitoring framework, that Ofwat should not be looking outside of the regulatory ring fence. Interactions with associated companies are regulated through the requirements of Condition K of the Instrument of Appointment and RAG 5.06. These are sufficient to ensure the financial independence of the regulated company.

Northumbrian Water

25 February 2016