

November 2016

Trust in water

# Company monitoring framework

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2016 assessment

Individual company report – Northumbrian Water Ltd

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## Company monitoring framework assessment

This document outlines the results of our 2016 company monitoring framework (CMF) assessment of Northumbrian Water's assurance. It includes a summary of our assessment, and further information on the exercises we undertook to assess Northumbrian Water's assurance, and our findings.

In the context of our CMF, in order to be in the self-assurance category, we were looking for leading edge companies to meet the high standards of assurance that stakeholders expect. As well as providing clear, transparent and accurate data, we expect companies to present their information in a way that stakeholders can engage with. We were looking for companies who can demonstrate a successful and positive approach to stakeholder engagement, including in their approach to developing their assurance plans where appropriate. Transparency about company structures, procedures and decision-making processes is another important area of focus that helps companies to earn their stakeholders' trust and confidence.

Further information on this year's assessment is available in our '[Company monitoring framework 2016 assessment](#)' publication. The framework itself is available in our '[Company monitoring framework final position](#)', published in June 2015.

### Summary of our assessment

In general, Northumbrian Water has met our expectations for its assurance practices, and in some cases exceeded our expectations. We were impressed by how it responded to our new financial monitoring framework, in particular in relation to getting the RORE calculation right first time. Apart from a few minor issues, we were happy with Northumbrian Water's assurance of charges schemes, blind year submission and other published financial information.

However, we also uncovered several issues relating to its assurance practice. We felt that Northumbrian Water's minority NED representation on the board and remuneration committee, and their lack of explanation of why this was appropriate, impacted stakeholder trust and confidence. We also raised concerns with the tax reconciliation in the tax targeted review, and the poor quality data assurance summary which was brief, poorly written and hard to find. We also found room for improvement in other aspects of Northumbrian Water's wider assurance.

Although we found some areas of exceeding expectations and many satisfactory aspects of Northumbrian Water's assurance, we consider that the concerns we found would result in a reduction of trust and confidence that stakeholders can place in the company. For this reason we have ruled out an improved assurance categorisation for Northumbrian Water as it has not consistently met the high standards that customers and other stakeholders would expect.

### **We have decided to retain Northumbrian Water's 'targeted' assurance status.**

In this document we have set out a brief summary of the individual assessments that we undertook as part of our Company Monitoring Framework (CMF) assessment in 2016. The remainder of this document provides brief feedback on the company's performance against each of our eleven assessment areas for this year:

<b>Our view</b>	<b>Assessment</b>
Exceeds expectations	Financial monitoring framework
Meets expectations	Charges schemes assurance
Meets expectations	Financial information
Meets expectations	Final 2010-15 reconciliation data submission
Meets expectations	Outcomes
Minor concerns	Compliance with principles of board leadership, transparency and governance
Meets expectations	Risk & compliance statement
Exceeds expectations	Assurance plan
Minor concerns	Targeted reviews
Minor concerns	Data assurance summary
Not applicable	Evidence from casework activities

## **Results of each assessment exercise**

### **1.1 Financial monitoring framework**

#### **What we were looking for**

In this assessment we looked at how the companies had followed our financial monitoring framework guidance. Our assessment focused on the quality of financial information published in the annual performance report, the transparency of disclosures and consistency of financial metric data published.

This is an area where companies' data assurance is particularly important, and companies need to ensure that the information that they publish is in line with the guidance provided by Ofwat. This enables Ofwat, and other stakeholders, to be

confident that the information that each company publishes has been prepared on a consistent basis and allows meaningful comparisons to be made between companies.

## What we found

Northumbrian Water provided all of the information we expected. We were pleased that the information was accurate, and clearly set out. Northumbrian Water was the only company that we did not have to approach to query errors during our review.

Our assessment: **exceeds expectations**

## 1.2 Charges schemes assurance

### What we were looking for

Companies must publish their forward charges schemes in February each year. We checked that companies:

- published and assured their charges schemes;
- complied with our charging rules;
- assessed and explained significant movements in charges; and
- devised and put into effect effective handling strategies to address significant movement in charges.

This is an important assessment, because our charging rules are designed to protect customers through stable, transparent and predictable charging, in the absence of competition.

### What we found

Northumbrian Water met all the requirements for this assessment, and has demonstrated that it has put handling strategies in place. It would have been helpful if the company had provided more information about the bill impacts arising from the transition of RV based charges to assessed charges.

There was one isolated incidence where the company was unable to identify a customer, who had followed the company's advice and contacted the company, as

one of those expected to face significant increase in bills. The customer's bill was initially high, but once the company became aware of the error it worked with the customer to resolve this issue. Although this has not affected our overall assessment due to its isolated nature, we would expect the company to ensure that its processes are robust enough to prevent such occurrences.

Our assessment: **meets expectations**

## 1.3 Financial information

### What we were looking for

In this assessment we looked for an absence of omissions or errors, where the companies reported their actual performance and to compare aspects of this performance to the assumptions made at the PR14 final determination. We did not look at all areas but chose four key risk areas to look at this year which were:

- wholesale total expenditure reporting;
- revenue and profit statements, disaggregated by price control;
- methodology statement on how costs are allocated across the price controls; and
- disclosures required for transactions with non-regulated associate companies.

We developed a log of the issues, errors and inconsistencies we uncovered as part of our analysis. We assessed the nature and number of issues identified to form a view on the quality of assurance in each company's published financial information.

This is an area where companies' data assurance is important, because a range of stakeholders will use this information and rely on its accuracy. It also informs important preparatory work for PR19.

### What we found

We identified no issues during our review of the four areas we chose to look at this year.

Our assessment: **meets expectations**

## 1.4 Final 2010-15 reconciliation data submission

### What we were looking for

In this assessment we assessed companies' adherence to our guidance (IN15/17, December 2015) covering assurance, data and commentary requirements. Our guidance covered a range of requirements including data table completion, explanatory requirements, supporting evidence and board signoff.

This is an important area for companies' data assurance, because the submission is used to update the final reconciliation of the PR09 incentive arrangements for the 2010-15 period which directly impact the companies' revenue allowances they can recover from customers.

### What we found

Overall we have no concerns with the assurance of the final 2010-15 reconciliation submission. The company met our expectations for the submission in respect of all the elements that are relevant to the company.

We noted minor data ambiguities in and across tables which when queried were easily corrected and we considered them to be in part a consequence of interpreting our guidance in a not unreasonable way. However there was insufficient level of detail provided in the initial commentary to allow us to assess the change protocol. Consequently we raised a number of queries seeking to clarify our understanding of the information provided in the submission which the company resolved proactively to our satisfaction.

While the company omitted an explicit board sign-off statement, there is sufficient explanation of its assurance procedures and evidence the board approved the submission.

Our assessment: **meets expectations**

## 1.5 Outcomes

### What we were looking for

In this assessment we looked for:

- reliable, timely and appropriate information for customers and other stakeholders;
- transparent and accessible information for customers and other stakeholders;
- appropriate data assurance;
- evidence that the company has listened and responded to its customers and other stakeholders; and
- compliance with the outcome delivery and reporting proposals as set out in the PR14 final determination company-specific appendix

This is an important assessment, to ensure that stakeholders can understand what companies' are doing to deliver the outcomes that customers expect.

### What we found

Northumbrian Water provided accurate, reliable information in table 3A (outcome performance) and its annual reporting commentary.

There is sufficient evidence that the company's reporting is transparent and accessible to customers and other stakeholders.

There is sufficient evidence that the company has been transparent with customers and stakeholders about the data assurance that has been put in place.

There is sufficient evidence that the company has provided the wider assurance to demonstrate that it is listening to customers and delivering the services they want and can afford. We recognise that there has been a comprehensive review of the role of the Water Forum and that this revised role will include constructive challenge of the company's performance. This will provide customers and other stakeholders with an independent opinion on the company's progress in delivering its performance commitments. The Corporate Responsibility Action Group Report on Northumbrian Water Group's (NWG) Corporate Responsibility and Sustainability Activities 2015, and the NWG Partnership Report 2015 provide customers and other stakeholders with an independent opinion on the company's progress in delivering its environmental performance commitments.

There is sufficient evidence that the company is implementing its proposals for outcome delivery and reporting as set out in the PR14 final determination company-specific appendix.

Our assessment: **meets expectations**

## **1.6 Compliance with principles of board leadership, transparency and governance**

### **What we were looking for**

In this assessment we looked for how the information which the company provided demonstrated that it has met our board leadership transparency and governance principles. This included the provision of:

- transparent governance information, including group structure and on director remuneration;
- evidence that the board of the regulated company has full control over the company, including its long-term strategy, and is fully focused on its obligations; and
- clear information on the composition of the board and its sub-committees.
- This is an important assessment, designed to give stakeholders trust and confidence that the company is structured appropriately and transparently, and complies with its legal obligations.

### **What we found**

The information provided in the company's annual reporting has demonstrated that it has met most of our board leadership transparency and governance principles.

However the company has not provided a sufficient explanation for all stakeholders as to why independent non-executive directors are not the largest group on the board. It has also not explained sufficiently why the remuneration committee is not independently chaired nor has a majority of independent members. Our principles require companies to explain why they consider the approach they have taken is appropriate where they have chosen not to comply with particular principles.



This lack of transparency could undermine the confidence of customers and other stakeholders if it is not clear how the company ensures that there is a strong, independent voice on its board and sub-committees.

Our assessment: **minor concerns**

## 1.7 Risk & compliance statement

### What we were looking for

In this assessment we looked for a statement, explicitly endorsed by the company's board, which confirms 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.

This assessment is designed to give stakeholders trust and confidence in companies' approach to compliance and risk management. The statement is intended to facilitate a company-led approach to compliance.

### What we found

The company has provided a clear statement that it 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. However, the statement is only signed by the company secretary (by order of the board) and therefore it may not be sufficiently clear to all stakeholders that it has the endorsement of the whole board. Additional sign off by an independent member of the board could help add legitimacy for stakeholders.

Our assessment: **meets expectations**

## 1.8 Assurance plan

### What we were looking for

In this assessment we looked for the following in companies' assurance plans

- Explanation of the framework and their approach to it;
- Evidence of stakeholder engagement undertaken to develop the plan;
- Clear scope, and rationale for targeting specific areas; and
- Appropriate language and accessibility for all stakeholders.

This is a key test of whether companies are listening to their stakeholders and using their views to improve their practices.

## What we found

The assurance plan sets out context and provides a good summary of the company's assurance framework. There is evidence of good engagement with stakeholders. The draft assurance plan focused only on the performance commitments. Following our feedback this was updated for the final assurance plan. The final assurance plan clearly sets out which specific areas are to be targeted and why. It also sets out the assurance activities that will be performed.

Our assessment: **exceeds expectations**

## 1.9 Targeted reviews

### What we were looking for

In this assessment we looked at:

- Companies' tax reconciliation notes published in the annual performance report to see if they acted on our tax targeted review recommendations.
- Improvements companies have made to 2015-16 reporting in response to our sludge and water resources targeted review.

These are two areas we have recently highlighted for companies to focus on, and we want to see evidence that they are taking steps to improve their assurance.

### What we found

The company did not publish a note reconciling reported tax charge to PR14 final determination allowance – rather it provided just a very brief narrative to explain a significant variation. We also noted that the company did not provide a current tax

reconciliation to the standard effective rate as required by the regulatory accounting guidelines, but just prepared a total tax reconciliation including deferred tax which is less meaningful.

The published cost allocation methodology statement clearly set out the changes made for 2015-16 reporting as a result of the CEPA recommendations made following our targeted review into sludge and water resources.

Our assessment: **minor concerns**

## 1.10 Data assurance summary

### What we were looking for

We checked that companies have:

- Published a data assurance summary for 2015-16 activities;
- Covered the targeted areas from the company's assurance plan; and
- Provided an overview of the company's assurance methods and processes, the audit exercises carried out and their findings.

This assessment is designed to ensure that companies provide accessible assurance to stakeholders, to build trust and confidence in their data publications.

### What we found

The company published an extremely brief data assurance summary as a section in the annual performance report. The data assurance summary is lacking context, background and content. There is no summary of the company's assurance process and the data assurance summary is purely focused on the external assurance of annual performance report and does not cover all areas raised in assurance plan.

The data assurance summary is written in a technical style that assumes the reader is knowledgeable and well informed about assurance practices and the water sector context. Being bound in the annual performance report, it is not prominent on the company's website and there are no search results for "data assurance".

Our assessment: **minor concerns**

## 1.11 Casework

### What we were looking for

In this assessment we looked at companies' responses to cases from 1 April 2015 onwards. We considered the company's response to our requests for information. We checked that companies had provided complete, accurate information within our timescales, and engaged effectively with us.

This assessment focused on our trust and confidence in companies' information provision, and complemented the other assessments that focused on information published by companies.

### What we found

We did not have any live cases against the company in the 2015-16 regulatory year.

Our assessment: **Not applicable**