

November 2016

Trust in water

Company monitoring framework

2016 assessment

Individual company report – South West Water Ltd

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Company monitoring framework assessment

This document outlines the results of our 2016 company monitoring framework (CMF) assessment of South West Water's assurance. It includes a summary of our assessment, and further information on the exercises we undertook to assess South West Water's assurance, and our findings. It also includes our assessment of the performance of Bournemouth Water Ltd which was acquired by Pennon PLC in April 2015.

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

The company has met our expectations in eight of our eleven assessments this year, and exceeded in one assessment.

We were pleased with the company's response to our targeted review on tax. It published an effective tax reconciliation note in the annual performance report. The published methodology statement clearly sets out the changes made for 2015-16 reporting as a result of the CEPA recommendations made. Its risk and compliance statement was also an area of relative strength.

However, we also identified some concerns in two of our assessments. On outcomes reporting, the company did not comply with our guidance and we consider that this is of significance to wider stakeholders. In the board leadership, transparency and governance assessment, we felt that South West Water should have been clearer

about its new board and group structure, and how it is set up to ensure independence and transparency of decision making.

Although we were satisfied with South West Water’s assurance in most areas, the areas of concerns we identified would reduce stakeholders’ trust and confidence. We said in our CMF final proposals that we would re-categorise companies from ‘self-assurance’ to ‘targeted’ if their behaviour leads to a reduction in the trust and confidence that stakeholders can place in it and where we found that the company had not consistently met the high standards expected for self-assurance. In view of our two concerns, we therefore consider that South West Water has not demonstrated adequate assurance to retain ‘self-assurance’ status as we are looking for leading edge companies here.

We have therefore decided to move South West Water to ‘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:

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

The quality of information submitted was generally good. We identified one issue in relation to the disclosure of financial derivatives which needed to be corrected, but overall the impact was not considered to be significant within the context of this assessment (or the overall assessment).

Our assessment: **meets 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

Overall South West Water demonstrated that it followed our guidance. The quality of data and the transparency of the published information met our expectations. We consider that it may be worth the company considering also the impact on business customers as part of the statement of significant changes.

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 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.

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

For most of their performance commitments, South West Water and Bournemouth Water provided accurate, reliable information in table 3A (outcome performance) and its annual reporting commentary. However we did find isolated instances where information was inaccurate or inconsistent.

We have concerns in relation to two of Bournemouth Water's performance commitments where the reporting of estimated accrued notional rewards could be misleading to customers. These estimates of an annualised performance were reported in table 3A and the company's 'How we're doing - our performance for the year to 31 March 2016' report. The company's leakage and large scale interruptions performance commitments both have an annual review of progress towards a March 2020 target; rewards and penalties may only apply in 2019-20. In these instances, the company did not comply with annual performance report guidance and we consider that this is of significance to wider stakeholders and so only relatively minor weaknesses in the context of this assessment (and the overall assessment).

With the exception of the reporting of rewards relating to Bournemouth Water's leakage and large scale interruptions performance commitments, there is sufficient evidence that the reporting by South West Water and Bournemouth Water is transparent and accessible to customers and other stakeholders. Where the company has not met its 2015-16 committed performance level it has provided an

explanation of the performance issue and, where appropriate, provided an explanation of how it will address the issue in the best interests of customers.

There is sufficient evidence that South West and Bournemouth have been transparent with customers and stakeholders about the data assurance that has been put in place. For example, South West Water's annual performance report and Regulatory Reporting document explains its assurance framework in a clear and transparent manner, including a helpful flow chart.

There is sufficient evidence that South West Water and Bournemouth Water have provided the wider assurance to demonstrate it is listening to customers and delivering the services they want and can afford. The independent WaterShare panel reviews and challenges the company's recommendations on how any rewards can be shared with customers - as either extra investment to improve customer service or as a bill reduction. The minutes of the WaterShare Panel meetings are available on the company's website.

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: **Minor concerns**

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

We have had discussions with the company in the year about implementing a revised corporate governance structure. In implementing this structure the company has utilised the ability to meet our board leadership, transparency and governance principles through explaining why it considers that its approach is an appropriate alternative to complying with the principles. However while we are content with the explanations provided to us, the information provided in the company's annual reporting is not sufficient to demonstrate to other stakeholders that it has met most of our board leadership, transparency and governance principles.

The company has not provided a sufficient explanation for all stakeholders as to how this new structure allows it to meet our principles in relation to the regulated company acting as separate company, board composition, the independence of the chair and the composition of board committees. Nor is the group structure set out clearly and unambiguously.

It is important that the company sets out a clear explanation for all stakeholders as to how it is meeting our principles, not just Ofwat. A lack of transparency could undermine the confidence which stakeholders have in the board leadership and governance of the company.

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. The statement has been signed by each member of the board which clearly and unequivocally demonstrates to stakeholders that it has the endorsement of the whole board.

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.
- 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

As a company in the self-assurance category, South West Water was not required to publish an assurance plan.

Our assessment: **Not applicable**

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 published a good tax reconciliation note in the annual performance report which contained some elements of best practice. The table format clearly quantified the variances and what they relate to, with some helpful narrative alongside.

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 of sludge and water resources.

Our assessment: **exceeds expectations**

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 a succinct summary of the data assurance carried out throughout the year. Whilst the data assurance summary opens with "As a 'self-assurance' company, South West Water continues to employ an effective and rigorous risk management and assurance process." there is no explanation of what 'self-assurance' means and in what context.

The data assurance summary is written in a style that is easy to read though, being bound in the annual performance report, is not prominent on the company's website.

Our assessment: **meets expectations**

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 South West Water or Bournemouth Water in the 2015-16 regulatory year.

Our assessment: **not applicable**