

November 2016

Trust in water

# Company monitoring framework

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2016 assessment

Individual company report – Thames Water Utilities Ltd

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## Company monitoring framework assessment

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

Thames Water has made some encouraging steps towards improving its assurance practices, particularly where engaging with stakeholders. We picked up good, proactive wider assurance activity in our assessment of Thames Water's assurance plan and strengths, risks and weaknesses exercise, as well as its proactive approach to engaging with us on open cases.

However, our assessment picked up several minor concerns. We found inconsistencies and minor concerns in Thames Water's financial information and blind year submission, and our targeted review on tax. We also found shortcomings in Thames Water's wider assurance which was not sufficiently transparent about its board and group structure.

Our minor concerns across five of eleven assessments are evidence of behaviour that could lead to a reduction in the trust and confidence that stakeholders place in the company. We have not therefore concluded that Thames Water should be promoted to the 'self-assurance' category. As our concerns were relatively minor,

and in some similar areas Thames Water exceeded expectations, we have decided that they are unlikely to lead in a sufficiently serious reduction in trust and confidence for us to move to the 'prescribed' assurance category. We have also noted Thames Water's proactive approach to engaging with stakeholders, particularly in terms of our casework and its risks, strengths and weaknesses exercise.

**We have decided to retain Thames 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>
Meets expectations	Financial monitoring framework
Meets expectations	Charges schemes assurance
Minor concerns	Financial information
Minor concerns	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
Exceeds expectations	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

Our review identified a small number of immaterial errors relating to the company's disclosure of net debt and financial derivatives and the calculation of dividend metrics, however these were not assessed to have had an impact on the overall trust and confidence in the information presented.

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 the company demonstrated that it followed our guidance, and the quality of data and the transparency of the published information met our expectations. The company provided a clear assurance statement and a good description of the underlying processes.

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 three relatively minor inconsistencies between the published annual performance report and the tables submitted to us. Although this did not cause us to have serious concerns, we would expect the annual performance report and the tables submitted to us to be consistent.

Our assessment: **minor concerns**

## 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

The company met most of our expectations for the final 2010-15 reconciliation submission in respect of all the elements that are relevant to the company, though we had some minor concerns with the RCM information provided in the initial submission.

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 serviceability and 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 that the board approved the submission.

Our assessment: **minor concerns**

## 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

Overall, Thames Water provided accurate, reliable information in table 3A (outcome performance) and its annual reporting commentary, however we did find an isolated instance where information was inconsistent. We considered that this particular instance did not reduce stakeholders' trust and confidence.

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 clear evidence that the company has provided the wider assurance to demonstrate it is listening to customers and delivering the services they want and can afford. To accompany the annual reports and accounts and annual performance report, the company has published a report from its Customer Challenge Group (CCG). This is an independent group, whose role is to review the company's progress against the commitments given to customers at PR14. The CCG's report provides customers and other stakeholders with an independent opinion on the company's progress in delivering its performance commitments.

There is clear evidence that the company's reporting is transparent and accessible to customers and other stakeholders. When the company became aware that it was not going to meet its performance commitment for internal flooding incidents it was proactive in seeking to engage with its customers, CCG and other stakeholders at an early stage. In 'Here for you. Annual performance report 2015-16' the company provides a clear explanation of the issue, and how it will be rectified.

An area where there remains room for further improvement is Thames Water's reporting of its performance commitments relating to the Thames Tideway project. We expect the company to be transparent with customers and other stakeholders about these performance commitments. We recognise Thames Water's positive engagement with the CCG, and the CCG's involvement in shaping the measure for its Thames Tideway customer engagement. In future this will provide customers and other stakeholders with an independent opinion on the company's progress.

There is clear 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 it has not provided a sufficient explanation of how the role of the holding company in approving certain strategic decisions allows the regulated company to have ownership of its strategy. This lack of transparency could undermine the confidence of stakeholders in how the regulated company operates as a separate company from the holding company.

The company has not provided a group structure diagram. It is important to provide transparency for all stakeholders that structure of the group within which the company sits is set out clearly and unambiguously.

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 appropriately signed to demonstrate endorsement by 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

The assurance plan clearly sets out the purpose of assurance and the company's approach to assurance. It includes a very detailed summary of risks, strengths & weaknesses exercise and resulting targeted areas. There is a helpful description of the existing assurance activities which is suitable for a non-technical audience. There is clear evidence of early engagement before the company published its draft plan. The final plan is unchanged from the draft (although a very minor point was that it was not clear if the company received any further feedback from stakeholders on the draft plan).

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; and
- 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 tax reconciliation note published in the annual performance report details that no tax was allowed in the PR14 final determination but an actual current tax charge was reported. We would expect the company to provide a narrative to explain why/how this tax charge has arisen when not forecast to do so, quantifying each difference.

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

While the company provided a short recap of the risk, strengths and weaknesses process, the data assurance summary could provide more context, background and explanation of the company's assurance process. However, the table covering the data assurance audits carried out and the results are clear and mostly focused on the external assurance of the annual performance report.

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. This is not the case for all stakeholders, so a more user-friendly style would be helpful. Being bound in the annual performance report, it is not prominent on the company's website though the annual performance report is returned in the 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 have opened two cases concerning Thames Water since April 2015. These were determinations under section 99 of the Water Industry Act 1991 (the Act) and they are both now closed. In both these cases Thames Water responded to all our questions and provided additional information where appropriate which helped limit the amount of follow-up information required. Thames Water also provided swift responses and kept us up to date over the investigations. We also opened two cases concerning Thames Water prior to April 2015. One of these cases was a determination under section 42 of the Act and Thames Water provided the information in a timely manner, in a helpful format and answering all the questions. The other case was a trade effluent appeal where the information provided was thorough and timely. Taking the above into account, we consider Thames Water should score "exceeds expectations" to reflect the positive and proactive approach it has taken to cases since April 2015.

Our assessment: **exceeds expectations**