

November 2016

Trust in water

Company monitoring framework

2016 assessment

Individual company report – Yorkshire Water Services Ltd

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Company monitoring framework assessment

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

Yorkshire Water has met our expectations in six of our eleven assurance assessments. We found some satisfactory evidence of data assurance, including its financial information and blind year data sets. We also found evidence of a positive approach to making its documentation transparent and stakeholder-friendly, particularly in the case of its Annual Report. This approach to wider assurance was supported by the role of its independent Customer Advisory Panel, which provided challenge to the company in delivering its performance commitments.

However, we have concerns with Yorkshire Water's assurance in five of our eleven assessments. We identified one concern relating to the data assurance summary which Yorkshire Water has failed to present. We had some concerns with Yorkshire Water's corporate governance, where the company has not sufficiently explained how the role of the holding company in approving business strategy allows the company to have ownership of the company's strategy. In its risk and compliance statement the company has not explained how its chairman's independence is not undermined by him also chairing a holding company. Given the nature of the group

structure within which Yorkshire Water operates the chairman's role does not raise any particular issues. However, a lack of transparency undermines the confidence stakeholders have in the company's board leadership and governance.

We also had some minor concerns with Yorkshire Water's data assurance. These included a number of errors we identified when checking compliance with our financial monitoring framework guidance. We also considered that the company's tax reconciliation note was not sufficiently clear and transparent, following our targeted review on this matter.

We identified a pattern of 'minor concerns' with Yorkshire Water's assurance. In our approach to assessment, we considered the outcomes from all of the individual assessments as a whole, bearing in mind the relative importance of each assessment, the number and materiality of the concerns we had. We also took account of the tests in the CMF final position paper. We concluded that the pattern of concerns we identified represented a reduction in the trust and confidence that stakeholders could place in the company. **We have therefore decided to change Yorkshire Water's assurance status to 'prescribed'.**

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
Minor concerns	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
Minor concerns	Risk & compliance statement
Meets 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 number of errors, which while not material, indicated that Yorkshire Water had not followed our reporting guidance.

- The figures for net debt and gearing were calculated based on the financing group and not the regulated business.
- We queried the financial derivatives disclosure as it was not transparent.
- An incorrect RCV figure had been used in the calculation of returns on regulatory equity.
- We also identified two mistakes in the tax notes in the annual performance report which were not consistent with the disclosures in the statutory accounts.

Our assessment: **minor concerns**

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

Yorkshire Water met all the assurance requirements for this assessment. However, it could have provided further explanation of its 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 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 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.

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

Overall, Yorkshire Water provided accurate, reliable information in table 3A (outcome performance) and its annual reporting commentary, however we did find instances where information was inaccurate or inconsistent. We considered that these particular instances 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. For example, a statement from Halcrow, the company's independent technical assurer, has been included in the annual performance report. This statement confirms that "overall, the information provided in the annual performance report 2016 provides a fair, balanced and understandable summary of the Company's 2015/16 circumstances and performance and of their future direction".

The company has referred to directly engaging with stakeholders (for example, the Customer Forum, Environment Agency, Drinking Water Inspectorate, and local flood authorities) on its performance, but has not provided evidence to support this. Going forward, the company should consider making the outcomes of this engagement and challenge publically available. This would provide customers and other stakeholders with an independent opinion on the company's progress in delivering its performance commitments, and provide evidence of wider assurance to demonstrate that the company is listening to customers.

There is sufficient evidence that the company's reporting is transparent to customers and other stakeholders. Going forward, the company should consider making the performance summary commentary within the annual performance report less regulator-focused and more accessible to stakeholders.

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 of how the role of the holding company in approving business strategy allows the company to have ownership of the company's strategy. This lack of transparency undermines the confidence of stakeholders in how the regulated company operates as a separate company from the holding company.

The company has also not provided an explanation as to how its chairman's independence is not undermined by him also chairing the holding company. Given the nature of the group structure within which Yorkshire Water operates the chairman's role does not raise any particular issues but a lack of transparency undermines the confidence stakeholders have in the board leadership and governance of the company.

While the company has provided a clear group structure diagram it would have helped improve transparency for all stakeholders if it had set out the role of all of the different companies within the group structure.

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 itself is not signed to demonstrate board endorsement, nor is there any overall sign off of the annual performance report (in which the statement is given). Sign off of the statement is important to give all stakeholders confidence that it has the endorsement of the whole board.

Our assessment: **minor concerns**

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 gives the background to its purpose and sets out work done to date. There is clear evidence of good engagement with stakeholders in the development of the plan. The plan includes a good summary of the existing approach to assurance and highlights new and existing challenges. It identifies targeted areas, and for each area it states the risk identified and assurance process (mitigation) that will address this risk.

We note the 2015-16 assurance plan is heavily focused on information published in the annual performance report. We expect the scope of the next plan to be wider encompassing all the information provided to stakeholders throughout the whole year.

Our assessment: **meets 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 company's published tax reconciliation note should have provided clearer explanations. The company should have taken the opportunity to explain their tax approach to group losses and capital allowance disclaimers in a more transparent way.

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: **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

We could not locate a complete data assurance summary in or accompanying the annual performance report. This makes it difficult to find out about the company's assurance framework, approach, methods and audit outcomes.

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 one case concerning Yorkshire Water since April 2015 and this was a determination under section 181 of the Water Industry Act 1991. In this case, Yorkshire Water went above and beyond to provide all of the information it had, including various telephone recordings which it had with the complainant as the nature of some of the allegations made by the complainant was serious. Yorkshire Water was also willing to follow an informal resolution route, though this was not taken up by the complainant.

Our assessment: **exceeds expectations**