

November 2017

Trust in water

# Company monitoring framework

2017 assessment

Individual company report – Severn Trent Water Ltd

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## Company monitoring framework assessment

This document outlines the results of our 2017 company monitoring framework (CMF) assessment of Severn Trent Water's assurance. It includes a summary of our assessment, and further information on the exercises we undertook to assess Severn Trent Water's assurance, and our findings.

In the context of the CMF, we are looking for evidence that companies are meeting the high standards of assurance that stakeholders expect. As well as checking that companies are providing clear, transparent and accurate data, we also look at the way companies present their information which should be accessible to customers and other stakeholders. We also look at how transparent companies are in how they explain any performance issues, company structures, and decision-making processes. We consider that all these elements contribute to the trust and confidence that customers and other stakeholders place in them.

Further information on this year's assessment is available in our [Company monitoring framework 2017 assessment](#) publication. The framework itself is available in our '[Company monitoring framework final position](#)', which we updated July 2017.

### Summary of our assessment

Considering the issues in the round, we have placed Severn Trent Water in the targeted category.

We have looked across how well the company has met or exceeded our expectations in all of our assessments, including whether they have demonstrated that they have met expectations by a clear margin, demonstrated leading edge behaviour, and whether there were any behaviours that we considered led to a reduction in trust and confidence. Taking all of this into account, while there are examples of good practice, we found evidence of behaviour that we considered leads to a reduction in trust and confidence.

Based on all the relevant evidence, **we have decided to change Severn Trent Water's assurance status to 'targeted'**.

In this document we set out a brief summary of our assessments within the CMF in 2017

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## 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

No issues were identified during our review of the information used for financial monitoring purposes and no queries had to be raised.

Our assessment: **meets expectations**

### 1.2 Charges engagement

#### What we were looking for

We have to date issued three charging rules: Charges scheme charging rules; wholesale charging rules; and new connection services charging rules (English undertakers). The rules require companies to publish the charges they set under these rules in Charges Schemes, Charges Schedule and Charging Arrangements respectively. They must publish these documents in February each year, which is at least two clear months before they take effect.

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For this assessment, we focused on how well companies have engaged with their stakeholders about their charges and charging policies through their publications and actual interactions. We based our assessment on the following:

- Board assurance statements;
- Assurance of the engagement on and publication of charges information, where appropriate under the charging rules;
- the information companies provide in their Statement of Significant Changes; and
- the handling strategies companies devise and put in place to address significant movements in charges.

## What we found

Severn Trent Water's directors added value to the company's assurance statement by explaining their reasons for signing the Board Assurance Statement. The company issued a joint Board Assurance Statement to cover its charges scheme and wholesale charges. But this is visible only in the wholesale charges section of its website. In the future, if it issues a joint Board Assurance Statement again, it should aim to provide links to the document in both sections of its website.

The company explained very well the likely bill impact of the changes in its charges. Beyond this, it could have enhanced this by providing, for example, a table showing the level of bill increases for a representative set of household and non-household customers.

The company stated that it did not expect bill increases of over 5% for its dual service customers who constitute the majority of its customers, but it did for a minority of customers. For the latter group, the company did not provide any evidence of having engaged with them or of having devised any strategy for managing incidence effects for them.

Our assessment: **meets expectations**

## 1.3 Outcomes

### What we were looking for

In this assessment we looked for:

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- 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

### Reliable, timely and appropriate information

Overall, Severn Trent Water has provided accurate, reliable information in tables 3A (outcome performance), 3B (sub-measures), and 3D (service incentive mechanism), and its annual reporting commentary. The company has provided a clear summary of performance against all of its PCs and outcomes.

We have a concern over the information provided in table 3C (abstraction incentive mechanism). Although the company has told us that it is not proposing any AIM sites, we consider that Severn Trent Water is one of the companies where the AIM could be most beneficial, as set out in the table in Appendix 1 to our [Guidelines on the abstraction incentive mechanism](#). The company's Annual Performance Report 2017 does not include an explanation of why it has no AIM sites.

### Transparent and accessible information

There is sufficient evidence that the company's reporting is transparent and accessible to customers and other stakeholders. Severn Trent Water has published its 'Annual Performance Report 2016/17' and a shorter customer focused document on the [Regulatory performance](#) page of its website. This is accessed using the 'About us' link on the homepage, then clicking 'Responsibility', then 'Our responsibilities to you' and then 'Regulatory performance'. To improve future accessibility, it would be helpful if historic and the most recent Annual Performance Reports were available in the same place, and more directly from the home page.

### Data assurance

There is sufficient evidence that the company has been transparent with customers and stakeholders about the data assurance that has been put in place. Within the 'Assurance summary for 2016/17' it has included a summary of the outcome of the

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assurance undertaken by Severn Trent Water's independent technical assurer, Jacobs. This provides customers and other stakeholders with additional assurance that the assessment of the company's performance has been reviewed, and the data, methodologies, processes and supporting evidence has been challenged.

Jacobs reported that it had found evidence of improvements in documentation of processes, controls and governance. The company states that Jacobs' assurance, and its own internal first and second line assurance checks, highlighted potential issues in its reporting for three performance commitments. These are:

- Customer experience (SIM) – written complaints
- Asset stewardship – number of internal and external sewer flooding incidents
- Size of carbon footprint – wastewater

In the 'Assurance summary for 2016/17' the company explains how it has dealt with each of these reporting issues.

### **Wider assurance**

There is sufficient evidence that the company has provided the wider assurance to demonstrate it is listening to customers. An area where there remains room for further improvement is the publication of stakeholder feedback as a result of the company's wider assurance and engagement. For example, the 'Annual Performance Report 2016/17' says that its independent customer representative group, the Water Forum has provided challenge. Publishing an easily accessible summary of the Water Forum's comments would provide customers and other stakeholders with additional transparency around the wider assurance that the company has put in place.

### **PR14 final determination company-specific appendix**

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

### **Restated 2015-16 performance commitment levels**

Earlier this year, Severn Trent Water made its Customer Challenge Group and us aware that it had identified some areas where it would need to restate its performance. Following this, as part of its 2016-17 annual performance reporting the company restated performance levels for the following performance commitments:

- S-A1 internal sewer flooding incidents
  - S-A2 external sewer flooding incidents
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- S-D1 carbon emissions (wastewater)

This directly affects the outperformance payments that were included in our final determination of Severn Trent Water's in-period outcome delivery incentives for 2015-16.

Accurate reporting of performance is important for trust and confidence. Company assurance processes are key to this and we want to incentivise high quality assurance. But we recognise that some information is, by its nature, uncertain and may need to be revised. Our assessment looks at assurance in the round; if serious errors were in place and undetected then our assessment would reflect this.

We also believe that a company should be proactive and show that it can be trusted to identify and deal with issues without intervention by us. We aim for a proportionate and risk-based approach; it is in customers' interests that the assurance process is proportionate to the risks around data.

Overall, we found that the company had explained the issues that it had found and how it had dealt with them. While the impact is visible to customers, we consider that the size and impact of the restatements were not significant enough to affect trust and confidence in the overall view of performance, nor individual commitments, or our previous view of company assurance. We would have serious concerns if we believed that errors appeared systemic, but this does not appear to be the case.

In our determination of Severn Trent Water's in-period outcome delivery incentives for 2016-17 we have included adjustments for the restated performance levels.

Our assessment: **meets expectations**

## **1.4 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;
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- 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 as part of the company's annual reporting has demonstrated how it has met most our board leadership transparency and governance principles.

However we could not identify a description of its group structure either as part of its annual reporting or on its website. It is important that companies set out the structure of the group clearly and unambiguously for all stakeholders to provide transparency.

Our assessment: **minor concerns**

## **1.5 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.

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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.<sup>1</sup>

## What we found

The board has provided a clear statement confirming that the company has an understanding of, and is meeting, its obligations. It has also confirmed that the company has sufficient processes and internal systems of control to meet those obligations and has systems and processes in place to identify, manage and review its risks.

The statement has been appropriately signed off on behalf of the board.

Our assessment: **meets expectations**

## 1.6 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.

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<sup>1</sup> Our findings here, and throughout our CMF assessment, are without prejudice to any issues that we may investigate under our enforcement powers and subsequently find wanting. It would be inappropriate to pre-empt the outcome of any investigations that might consider whether the assurance provided is indeed appropriate or accurate. Any adverse findings in this respect may be taken into account in future assessments.

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## What we found

Self assurance companies have discretion over the exact approach and structure of assurance they undertake. Although they are not required to update and publish assurance plans, where these are published we review them and provide feedback and an assessment on the quality of those plans in the same way as for companies in the targeted or prescribed categories. Any information about any company's approach to engaging with stakeholders and explaining their approach may feed into our CMF assessment, whether this is detailed in an assurance plan or not.

Severn Trent Water chose to update and publish an assurance plan. The assurance plan clearly sets out context and work done to date which demonstrates good stakeholder engagement, highlighting where the company has amended its draft plan as a result of stakeholder feedback. The plan clearly explains the company's approach and explains where risks lie and where the resulting assurance should be targeted. The risk assessment undertaken was thorough and the scope of information considered was sufficiently wide. The assurance plan transparently details how the framework has been applied, with a good summary of approach covering internal and external assurance. The plan also highlights new targeted areas identified.

Our assessment: **exceeds expectations**

## 1.7 Data assurance summary

### What we were looking for

We checked that companies have:

- published a data assurance summary for 2016-17 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.

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## What we found

The company published a succinct and comprehensive summary of the data assurance carried out throughout the year. The data assurance summary takes the reader through the company's assurance process and links to previous documents published. There is good coverage of all areas targeted in the assurance plan with a short summary of work performed and issues found in each area. It also covers other assurance activities in 2016-17 beyond the annual performance report such as the cost allocation information and preparation for market opening. The data assurance summary is written as a self-standing document that is easy to read and to find on the company's website.

Our assessment: **exceeds expectations**

## 1.8 Casework

### What we were looking for

In this assessment we looked at companies' responses to cases from 1 April 2016 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 closed four cases concerning Severn Trent Water during the assessment period and currently have one open case. Two of the closed cases were included in the previous year's assessment and no additional information was requested from the company during this assessment period. No assessment was made for this company because for the further two closed cases and the open case no information was requested from the company during the assessment period.

Our assessment: **not applicable**

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## **1.9 Wider assurance and information**

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

This assessment considers any information - across a range of publications, regulatory submissions and bilateral engagement - that impacted on trust and confidence in the information produced and that we therefore considered relevant to our overall decision for each company. In carrying out this assessment, we consider the context in which any relevant information was published or shared.

### **What we found**

Severn Trent Water made a statement regarding our guidance on the Return on Regulatory Equity (RoRE), which we considered to be inaccurate. We issued a correction in response to be clear that the issue was inconsistencies in the approaches used by companies in calculating their RORE numbers.

We found no other issues that we considered relevant to our assessment of the company in relation to wider assurance and information this year.

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