
November 2017

Trust in water

Company monitoring framework

2017 assessment

Individual company report – Thames Water

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Company monitoring framework assessment

This document outlines the results of our 2017 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 the company'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 Thames Water in the prescribed 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 of the relevant evidence, **we have decided to change Thames Water's assurance status to "prescribed"**.

In this document we have set out a brief summary of the assessments that we undertook as part of the CMF in 2017.

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, summarised below, which indicated that Thames Water had not followed our reporting guidance and raised concerns regarding the quality of the assurance processes that they have in place. Our assessment reflects the number of errors made and the importance to stakeholders of one of the affected metrics.

- The company initially added cash to borrowings rather than deducting it when calculating net debt, this required them to correct their net debt disclosures and some other connected metrics.
- When the company resubmitted the data relating to the error above the signage was incorrect in the table they provided.
- We identified errors in the calculation of dividend yield and dividend cover.
- There was an error in the spreadsheet used to calculate adjusted interest cover.
- There was an error in the spreadsheet used to calculate return on RCV and the company had used an incorrect RCV figure.

Our assessment: **serious concerns**

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.

For this assessment, we focus 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

Thames Water's Board Assurance Statement is very clear and informative. The company provided the background information which informed the Board's decision to confirm compliance and, consequently, issue the statement.

All the company's relevant charges documents can be accessed from a single landing page on its website; this makes it very easy for stakeholders to access the documents in which they are interested.

The company provided evidence of its engagement with the Consumer Council for Water (CCWater). It developed customer information in consultation with CCWater with a view to ensuring that customer leaflets explain bill changes clearly and appropriately.

The company stated that it did not expect any of its bills to increase by more than 5%. As a further improvement, the company could have supported this statement with, for example, a table showing the level of bill increases for a representative set of household and non-household customers.

Our assessment: **meets expectations**

1.3 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

Reliable, timely and appropriate information

Overall, Thames Water has provided accurate, reliable information in tables 3A (outcome performance), 3B (sub-measures), 3C (abstraction incentive mechanism) and 3D (service incentive mechanism).

Transparent and accessible information

Most of the company's reporting is transparent and accessible to customers and other stakeholders. Thames Water has published performance information on the [How we are delivering on our promises](#) page of its website; this is accessed using the 'About us', then 'Our business' and then 'Our performance' links from the homepage. The Annual Performance Report (APR) is well laid out with easy to understand tables that highlight the accrued outperformance payments and underperformance penalties, and performance commitments (PCs) that have not

been met. It also includes brief descriptions for each PC with a clear summary table that includes relevant performance details.

We have serious concerns with the commentary relating to some of the performance commitments that have not been met. In particular, Thames Water has accrued the maximum underperformance penalty for its leakage performance in the 2016-17 reporting year and therefore will be returning the maximum amount of money to customers for this performance commitment. Performance is below the underperformance penalty collar and given the nature of the underperformance we would have expected the company to provide a fuller, more informative, explanation of the performance issue, as well as its planned activities and future focus to improve leakage performance in the best interests of customers. This performance commitment is of particularly high importance to customers, and by explaining the issues that have arisen, customers and wider stakeholders would see that the company is proactively engaging with them. The company also provided limited information on how its performance failure against the Security of Supply Index (SOSI), which is linked to leakage, will be managed.

Data assurance

In its Final Assurance Plans 2016-17, Thames Water says that KPMG undertook independent assurance of the data. However, a summary of the results of this assurance does not appear to be publically available. This would provide 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.

Wider assurance

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. The [Customer Challenge Group's](#) (CCG) 'Commentary on Thames Water's Performance Commitments' has been published on the [How we are delivering on our promises](#) page of the Thames Water website. In its commentary the CCG notes Thames Water's willingness to brief it in considerable detail about operational issues and to discuss their plans in an open and transparent way. The CCG notes some key issues which it feels will need to be addressed in order to enable progress and meet the aspirations of customers – these cover customer service improvements, cross industry comparisons, social media and complaints, greenhouse gas emissions, asset health, underestimated demand, and innovation.

The CCG raised concerns about the timing of the publication of the company's annual reports. For transparency, the CCG believes that it is imperative that the Annual Performance Report and Annual Report and Financial Statement are

published simultaneously. This would allow proper scrutiny of how the company is delivering on its performance commitments to customers, against their financial rewards to Thames Water's shareholders, executives and staff. The CCG notes that this year the Annual Report was again published prior to the performance report - which does not serve these objectives. We agree with the company's CCG. In future years we expect Thames Water to publish its performance report simultaneously with its annual report and financial statements.

PR14 final determination company-specific appendix

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

Our assessment: **serious concerns**

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;
- 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 is generally meeting our board leadership transparency and governance principles.

There was one area where the company could further improve its reporting. The company states that 'certain strategic decisions' are reserved to its holding company board. However it would help improve the confidence that stakeholders have in the governance of the company if it explained how this does not prevent the regulated company operating as a separate company from the holding company.

Our assessment: **meets expectations**

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.

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.¹

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

¹ 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.

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.

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, helpful, summary of the risks, strengths and weaknesses exercise and the resulting targeted areas. There is a helpful description of the existing assurance activities which is suitable for a non-technical audience. The plan has been updated in response to stakeholder feedback, and highlights new targeted areas. It also reports back on the results of assurance activity carried out last year to explain whether it is still required.

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.

What we found

The company has continued with the format and content used for the summary last year. While the company provided a link to the risk, strengths and weaknesses process, the data assurance summary could provide more context, background and explanation of the company's assurance process. The table covering the data assurance audits carried out and the results is 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 accessible but not prominent on the company's website.

Our assessment: **meets expectations**

1.8 Casework

What we were looking for

In this assessment we looked at companies' responses to non-strategic 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 two cases concerning Thames Water during the assessment period and both of these cases were included in last year's assessment. As no further information was sought from the company during the assessment period on these cases, these have not been taken into account for this year. We also closed five cases in August 2017 concerning the appointment of an arbitrator but we did not request any information from the company during the assessment period. As such, no assessment was made.

Our assessment: **not applicable**

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

We noted some issues with the information Thames Water submitted in September 2017 in relation to the valuation of their bioresources assets. These included internally inconsistent data, that the Board statement was only signed by Executive Directors and lack of adequate cross-checks to provide confidence in the allocation of the RCV proposed.
