

November 2017

Trust in water

# Company monitoring framework

2017 assessment

Individual company report – Southern Water

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## Company monitoring framework assessment

This document outlines the results of our 2017 company monitoring framework (CMF) assessment of Southern 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

We have seen some areas of significant improvement from Southern Water this year as compared to last year and it has made significant progress.

But considering the issues in the round, we have placed Southern 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 a pattern of behaviour that we considered leads to a reduction in trust and confidence.

Based on all of the relevant evidence, **we have decided to retain Southern Water's assurance status as "prescribed"**.

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

## Results of each assessment exercise

We amended text on page 3 on 6 December 2017. These amendments did not alter our assessment of the company.

### 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. While the impact of the errors was not material, they indicated that Southern Water had not followed our reporting guidance and consequently we consider that they led to a reduction in the trust and confidence that can be placed in the company.

- the company had omitted to report dividends on one of the tables.
- the company has not applied the correct notional capital structure when calculating RORE.
- the signage was incorrect when they reported dividend cover.

Our assessment: **minor 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 make our assessment by looking at the following:

- Board assurance statements;
- compliance with aspects of the charging rules which fall within the scope of the overall CMF assessment;
- significant movements in charges and how they are assessed and explained; and
- handling strategies to address significant movements in charges.

### What we found

Southern Water's Board Assurance Statement is very clear and informative. The company considered each individual charging rule and provided a compliance statement for each of them.

The company's relevant charges documents can all 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 had effective and timely consultation with the Consumer Council for Water (CCWater). It provided a very useful summary log of its consultation with CcWater. The company stated that none of its household bills were forecast to increase by more than 5%. It supported this statement by providing a table showing the level of bill increases for a representative set of household and non-household customers.

The company provided a statement to explain changes in some wholesale charges including the reason for the changes, and a table which showed an analysis of the movements in those charges. It provided evidence to show that it had publicly consulted to seek the views of all potential retailers and interested parties, and had used these views to inform its changes.

Our assessment: **exceeds 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, Southern Water has provided accurate, reliable information in tables 3A (outcome performance), 3B (sub-measures), 3C (abstraction incentive mechanism) and 3D (service incentive mechanism), and its annual reporting commentary. We did find instances where information was inaccurate or inconsistent, but we considered that these particular instances did not reduce stakeholders' trust and confidence.

#### Transparent and accessible information

There is clear evidence that the company's reporting is transparent and accessible to customers and other stakeholders. Southern Water has published performance information on the [Annual Report & Financial Statements 2016-17](#) page of its website. This is accessed using the Annual Report 2016-17 link on the homepage;

the full Annual Performance Report is available using the 'Downloads' link. The company's website and annual report contain well-presented, clear and easy to understand performance information.

### **Data assurance**

Southern Water's Data Assurance Summary, published alongside the Annual Performance Report, clearly describes some of the actions that the company has put in place during the reporting year. The company has also been proactively working with us in relation to the areas that we highlighted in our 2016 company monitoring framework (CMF) assessment.

Assessment of Southern Water's performance has been reviewed by an independent technical assurer who has challenged the company's data, methodologies, processes and supporting evidence. The company's Data Assurance Summary contains an Independent Limited Assurance Report by the technical assurer, PwC. In the report, PwC says that it was unable to obtain the necessary evidence to support the accuracy of the numbers of:

- WW1 (wastewater asset health – wastewater treatment works population equivalent compliance)
- WW1a (category 3 pollution incidents)
- WW6 (wastewater treatment works numeric compliance)

The company's Annual Report & Financial Statements 2016-17 says that the number of category 3 pollution incidents and wastewater treatment works compliance remain subject to further assurance. The three performance commitments all have financial, underperformance penalty-only, incentives. We have concerns that the company was not able to provide its technical assurer with complete and timely information and that this leads to a reduction in the trust and confidence that stakeholders can place in it.

### **Wider assurance**

There is clear evidence that the company has provided the wider assurance to demonstrate it is listening to customers. The company's independent [Customer Advisory Panel](#) (CAP) provides independent advice and challenges the company on the delivery of its business plan commitments, acting on behalf of customers where performance is less than promised. The Customer Advisory Panel Report 2016-17 includes a section on monitoring the delivery of the promises in the 2015-20 business plan; this provides customers and other stakeholders with an independent opinion on the company's progress in delivering its performance commitments.

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

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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.

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

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 reflects this.

As part of its 2017 annual performance reporting Southern Water restated the 2015-16 performance level for its sewer collapses sub-measure. This is part of the wastewater asset health performance commitment. The Data Assurance Summary 2016-17 document says that the company's own internal assurance work identified that a sub-contractor had not used the correct definition to capture sewer collapse data. The result was that the previous year's data was incorrect and has had to be restated. As the previous year's restated value does not fall into the penalty area, there is no financial impact.

We found that the company had provided sufficient explanation for the restated 2015-16 performance level. While the impact is visible to customers, we consider that the size and impact of the restatement was 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 concerns if we felt that the error appeared systemic, but this does not appear to be the case.

Our assessment: **minor 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 meeting our board leadership transparency and governance principles.

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.<sup>1</sup>

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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.



## 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.

### What we found

The company has increased the content in its assurance plan compared to last year and retained the helpful appendix setting out the company's approach to data governance and assurance.

The plan clearly sets out the context and purpose. It demonstrates good stakeholder engagement, highlighting where the company has amended its draft plan as a result of stakeholder feedback. The plan includes a detailed table setting out actions under the three lines of defence model. The company has added more detail around planned assurance activities and results, which has improved transparency. The scope and coverage of the plan recognises the requirements for a prescribed company.

Our assessment: **meets 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 overhauled the format and increased the content from the brief summary it published last year. 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 table clearly setting out all the assurance activities performed for each targeted area and detail on the findings. The scope of the summary is much wider than the annual performance report and covers other assurance activities such as charges related to the forthcoming price review. The assurance summary refers to a qualified opinion on information reported to the Environment Agency and we note the company has identified necessary actions to improve its data control in this area.

The data assurance summary is written as a self-standing document that is easy to read and is 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 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 Southern Water in the assessment period - three new connection determinations and an arbitration case - and we currently have two open cases - a sewer requisition case and a trade effluent appeal. There were concerns with the information provided to us for two of these cases (the sewer requisition case and a new connection determination we closed in July 2017). In both cases we had to go back to Southern Water to seek additional clarifications. Additionally, in the new connection case Southern Water did not fully respond to a request for information and provided incorrect information.

Our assessment: **minor concerns**

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