

January 2019

Trust in water

Company monitoring framework: 2018 assessment

Individual company report – Affinity Water

Company monitoring framework assessment

This document outlines the results of our 2018 company monitoring framework assessment of Affinity Water's assurance. It includes a summary of our assessment, and explains how we assess the company's assurance, and our findings.

In the company monitoring framework (CMF), we are looking for evidence that companies are meeting the high standards of assurance that stakeholders expect. We consider whether companies are providing clear, transparent and accurate data, and we assess the way companies present information to customers and other stakeholders. We also look at how transparent companies are in explaining, company structures, decision-making processes or any performance issues. For 2018 we also considered under the company monitoring framework data quality and consistency in company business plans submitted as part of the price review.

Further information on this year's assessment is available in our '[Company monitoring framework 2018 assessment](#)' publication. The framework is available in our '[Company monitoring framework final position paper](#)', which we updated in June 2018.

Summary of our assessment

Considering the issues in the round, we consider that Affinity Water has not instilled sufficient confidence in the information it publishes and provides to stakeholders. Therefore **we have decided to change Affinity Water's assurance status to 'prescribed'**.

We have looked at how well the company has performed against the expectations we have set for each of our assessments, including whether they have:

- met or exceeded our expectations by a clear margin,
- demonstrated leading edge behaviour, and
- displayed behaviours that could lead to a reduction in trust and confidence.

We have also considered any other issues or information relevant to the confidence that can be placed in the company's information in making our overall assessment.

The company met our expectations in some areas. However, we had minor concerns in four areas (charges engagement, cost assessment, water resources management plan and market information and business plan data consistency) and a serious

concern in one area, business plan data quality, where we identified material issues in the data provided on risk and return, financial modelling and cost assessment. We consider that the behaviour these concerns relate to has led to a reduction in the confidence that stakeholders can place in the information the company publishes. This means that the company has met the criteria to be demoted to the prescribed assurance category.

In this document we have set out a brief summary of the assessments that we undertook as part of the company monitoring framework in 2018.

Results of our assessment

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

Overall the company has met our expectations regarding the transparency and consistency of the information published in relation to financial monitoring. Affinity Water has followed our guidance, and the quality of data and the transparency of the published information met our expectations in many areas. We noted that their post-tax return on regulated equity reported in their Annual Performance Report (APR) was not consistent with the calculation in the Regulatory Accounting Guidelines (RAG's). However the error was not material and was not considered to have had an impact on the overall confidence in the information presented. In addition we had to

follow up with the company to provide more complete information on the sale of their business retail business. This was rectified in a second query response. There were also a number of minor immaterial issues which were not considered to have an impact on stakeholder confidence.

Our assessment: **meets expectations**

1.2 Charges engagement

What we were looking for

We have to date issued three sets of charging rules: Charges Scheme Rules; Wholesale Charging Rules; and Charging Rules for New Connection Services (English Undertakers). Each of these ‘charging rules’ require companies to publish a document in which they set out their charges relating to these rules. Their publications are charges schemes, charges schedules and charging arrangements respectively.

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 primarily on the documents that the charging rules require companies to publish or submit to us, as per [IN17/09](#), including but not limited to:

- the published charging documents;
- Board assurance statements;
- assurance of companies’ engagement on and publication of charges information, where appropriate under the charging rules;
- the information companies provide in their Statement of Significant Changes (if applicable); and
- the handling strategies companies devise and put in place to address significant changes to charges.

Where we considered it appropriate, we supplemented the information by submitting queries to some companies, looking more widely at material published on company websites, and cross-checking against customers’ and stakeholders’ comments or complaints on charging.

This year our assessment has included new connection services charging rules for companies wholly or mainly in England, which came into force in April 2018, for the first time.

What we found

Affinity Water met our expectations in most areas, and its disaggregate presentation of changes to some new connections charges was particularly helpful.

The company's assurance statement helpfully listed all charging rules and an explanation of Affinity Water's compliance with each rule.

Affinity Water has assessed that it had historically been under-recovering the overhead costs of works from developers. It was good that Affinity Water identified and corrected for this issue, though it did suggest that the company had not checked cost-reflectivity over a number of years previously.

However, we had concerns arising from a complaint we have received and are still considering regarding the costs Affinity Water uses to calculate the asset payment due to self-lay providers. We have been able to establish from our work to date that Affinity Water did not clearly consult on or explain the detail of how it would implement in practice what is outlined in its charging arrangements.

Our assessment: **minor concerns**

1.3 Outcomes

What we were looking for

We want to ensure that stakeholders understand company performance to deliver the outcomes that at that the company committed to deliver at PR14. This year our assessment focused on the availability and accessibility of published performance data and how that information is communicated to stakeholders. We expect companies to be transparent, provide accessible information for customers and other stakeholders and show that they have listened and responded to their customers and other stakeholders.

This is an important assessment, to ensure that stakeholders can understand what companies are doing to deliver the outcomes that customers expect.

This year our assessment did not include the quality of companies' assurance over published data, to avoid duplication with the data consistency and data quality assessments in the initial assessment of company business plans (see sections 1.11 and 1.12).

What we found

Affinity Water has met our expectations for this assessment. There is sufficient evidence that the company's reporting is transparent and accessible to customers and other stakeholders. Affinity Water has published performance information in its 'Annual Report and Financial Statements for 31 March 2018' published on the 'Investor Library' page of its website; this is accessed using the 'Investors' link on the homepage. The document contains clear and easy to understand performance information. From mid-August 2018 this report was also available on the 'Our Performance' page, accessed using the 'About us' link on the homepage. The company's area is broken down into eight water resource zones, which it calls communities. Publication of the community performance report 'Our Year in Review 2017/18' provides customers with an easy to understand summary of the company's performance. Reporting performance at community level provides greater transparency for customers in each geographical area. From mid-August 2018 this report was available on the 'Our Performance' page of the website. The Annual Report and Financial Statements for 31 March 2013 to 31 March 2018 are available on the 'Investor Library' page.

Our assessment: **meets expectations**

1.4 Water resources management plan and market information

What we were looking for

Companies are required to produce a water resources management plan (WRMP) every five years setting out their approach to maintaining the long-term supply and demand balance in a way that delivers best value for customers and the environment for the next 25 years. We review and provide comments on draft water resources management plans to Defra and the Welsh government, in our capacity as a statutory consultee.

Our assessment in the company monitoring framework considered the quality of the information in companies' draft water resources management plans for the period 2020 to 2025. The assessment considered the quality of data and internal consistency in the plans, the extent to which stakeholders had been involved in the development of the plans, how clearly plans have been communicated to stakeholders and evidence of assurance of the plans. The assessment also considered the quality of the water resources market information published by the company. In that respect, the assessment considered the quality and completeness of the data, the clarity of its presentation and its consistency with the company's draft water resources management plan.

This is the first time that water resources management plans and market information has been included within the company monitoring framework.

What we found

We had minor concerns in this area due to the unclear presentation of some data elements in the company's draft water resources management plan and market information. Board assurance was described but we had concerns regarding its effectiveness following an initial regulator submission that did not meet requirements prior to public consultation.

Our assessment: **minor concerns**

1.5 Long-term Viability Statement

What we were looking for

This assessment focused on the transparency and assurance over companies' long-term financial resilience as set out in their long-term viability statements.

We considered the extent to which companies have followed our guidance for issuing long term viability statements as set out in [IN18/04](#) and in particular the approach they have taken to assessing their long-term financial viability. We considered how this linked to their wider risk assessment including mitigating actions, the extent to which companies have stress tested their projections, whether they have clearly explained their approach and the evidence of assurance over the process.

This is the first time that long-term viability statement has been included as a separate category in the company monitoring framework (last year it was included within the “financial monitoring framework”).

What we found

Overall Affinity Water has met our expectations for the long term viability statement included in the Annual Performance Report. The directors have provided a statement that they have a reasonable expectation that the company will continue to operate and meet its liabilities, as they fall due, for a period of five years to 31 March 2023, and have set out the approach to the assessment and the basis for the period reviewed.

The company has clearly set out the risk management process and principal risks facing the company, describing each risk and the potential impacts on the company and its obligations, the link to the company’s strategy, the movement in the current risk exposure, as well as mitigation and management actions taken.

The company has also clearly set out the scenarios tested and the basis for these scenarios, however further information could have been provided as to how the company developed the combined scenario and further detail about the outcome of the stress testing on financial ratios, debt covenants and credit ratings and the mitigating actions available.

The sensitivities applied were approved by the Audit Committee and the directors have considered the level of sensitivities to be sufficient to cover the risks identified. However, there could have been further detail regarding the internal assurance process or the extent, if any, to which the company have used third party assurance to ensure the quality and robustness of their long term viability statements.

Our assessment: **meets expectations**

1.6 Financial Flows

What we were looking for

The requirement for companies to submit financial flows covering the periods 2015-16, 2016-17 and 2017-18 is one of the key ways in which we are improving the transparency of financial flows to investors.

In our assessment, we focused on companies' compliance with the requirements of [IN18/08](#) in terms of data quality and assurance as well as how meaningful the data and supporting commentary is to stakeholders.

This is the first time that information on financial flows has been included within the company monitoring framework.

What we found

The company has met our expectations in this area. All data tables were complete and the company published its data for 2017-18 with high level narrative. The data was also assured by the company's external auditors. However, we identified some data errors in the company's submission; we were satisfied with the company's response to the issues we identified.

Our assessment: **meets expectations**

1.7 Risk & compliance statement

What we were looking for

This assessment is designed to test our confidence in companies' approach to compliance and risk management. The risk and compliance statement is intended to facilitate a company-led approach to compliance.¹

Our assessment looks 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.

¹ Our findings here, and throughout our company monitoring framework 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.

This year we have also taken into account relevant information provided in companies' annual reporting to ensure that they are consistent.

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**

1.8 Assurance plan

What we were looking for

In this assessment we looked for the following in companies' assurance plans:

- explanation of the assurance framework and their approach to it;
- evidence of stakeholder engagement undertaken to develop the plan;
- clear scope, and rationale for targeting specific areas; and
- 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's assurance plan met our expectations. It has been updated from last year to include their Customer Challenge Group (CCG) and Risk Management in addition to the Role of the Board and internal systems and processes. It sets out the report categories, the main risks associated and the subsequent controls and assurance procedures in place. There is strong evidence of engagement with stakeholders with a sound description of the feedback process. As we raised in our feedback last year, the report categories are broad, for example the Annual Performance Report (APR) is not broken down into sections. Different sections of the APR will be subjected to different levels and types of assurance, but the structure of

the plan does not make this clear. Other stakeholder information is high level with the only example given of the Customer Performance Report. Additional information on this category as to other initiatives could have provided more confidence to stakeholders in the company's assurance framework.

Our assessment: **meets expectations**

1.9 Cost assessment

What we were looking for

Our assessment focused on the assurance of cost assessment data submitted in the annual performance report. The assessment of efficient costs is a key element of setting price controls. We need good quality, consistently reported cost assessment data to do this effectively. This year's assessment considered the completeness and accuracy of the cost assessment data, allocation of costs and assurance over data. It also considered how meaningful the data and supporting commentary is to stakeholders.

This is the first time that cost assessment has been included as a separate category in the company monitoring framework (last year it was included within "wider assurance and information").

What we found

We had minor concerns in this area. All cost assessment tables were complete with no missing data. However, we had to raise several queries to seek explanation for data variances where there was no supporting commentary. Some of these led to 17-18 and historical data corrections.

The company's accounting separation methodology was available, however we were concerned that many of its cost allocations are still based on management estimate and that the chosen cost allocation methods have not been properly justified. There was also no mention of the assurance that had been undertaken on the accounting separation methodology other than a statement that the accounting separation data can be traced back to the audited accounts through the company's accounting systems.

Our assessment: **minor concerns**

1.10 Casework

What we were looking for

This assessment relates to the information that companies provide to us when we carry out our investigation and enforcement functions. We looked at companies' responses to cases from 1 April 2017 onwards. We considered companies' responses 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 confidence in companies' information provision, and complemented the other assessments that focused on information published by companies.

What we found

We opened one case concerning Affinity Water in the assessment period. This was an eligibility determination. We consider the company met our expectations in this case as the information provided was complete, accurate, provided on time and of a quality that enabled us to rely on it to progress the case.

Our assessment: **meets expectations**

1.11 PR19 Initial assessment of business plans – data consistency

What we were looking for

In September 2018, companies provided us with their business plans for the 2020-25 period. Our initial assessment of business plans tests how companies have met our expectations and requirements for meeting the needs of customers. The initial assessment incentivises companies to submit high quality, ambitious and innovative business plans. The quality of companies' information, and their track record on assurance are important parts of a high quality business plan

As set out in our '[Company monitoring framework final position paper](#)', updated in June 2018, we take account of how companies' business plans have performed

against our initial assessment tests on data quality and assurance as part of our 2018 company monitoring framework assurance categorisation. The relevant parts of the initial assessment tests are confidence and assurance tests 5 which covers data consistency (considered here), and test 6 which covers data quality (covered later). The full scope of test 5 is:

“To what extent does the company have a good track record of producing high quality data taking into account the company’s data submission, assurance process and statement of high quality, and our 2018 assessment of the company under the company monitoring framework?”

In our company monitoring framework assessment we have focused on the elements related to data consistency and not included the initial assessment of business plan element related to the company monitoring framework to avoid double counting.

What we found

We found minor issues overall with the consistency of performance and financial data reported in the company’s business plan tables with previous data submissions. This was due to material inconsistencies between the company’s business plan tables and Annual Performance Report in the area of cost assessment.

Our assessment: **minor concerns**

1.12 PR19 Initial assessment of business plans – data quality

What we were looking for

This section considers confidence and assurance test 6 which looks at:

“How consistent, accurate and assured are the company’s PR19 business plan tables, including the allocation of costs between business units, information on corporation tax, and the assurance and commentary provided?”

What we found

Overall the business plan falls significantly short of providing sufficient and convincing evidence that the company’s PR19 business plan tables including the

allocation of costs between business units, information on corporation tax, and the assurance and commentary provided are consistent, accurate and assured.

We identified material issues within our assessments of the data tables in the policy areas of cost assessment, risk and return, financial modelling and cross cutting themes (water resources). For example:

- In cost assessment, there were material variances in one table which had not been prepared in accordance with our guidance and definitions;
- In risk and return, the financial ratios included in one of the business plan tables were materially different and in some cases higher, and we were unable to verify how they had been calculated;
- In financial modelling, the company's submitted financial model includes a material adjustment for 'Allowed revenue' which is not included in the data tables; and
- In cross cutting themes (water resources), the company did not follow the definition of bilateral entry capacity and confuses it with bilateral trades.

Our assessment: **serious concerns**

1.13 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 could potentially impact on 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.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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