

January 2019

Trust in water

Company monitoring framework: 2018 assessment Individual company report – Hafren Dyfrdwy Water

Company monitoring framework assessment

This document outlines the results of our 2018 company monitoring framework assessment of Hafren Dyfrdwy'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 have decided to retain Hafren Dyfrdwy in the 'prescribed' assurance category.**

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 only three areas (outcomes, risk and compliance statement, and assurance plan). In all of the other assessment areas it fell short of the expectations we have set. Therefore we consider that the company

has not instilled sufficient confidence in the information it publishes and provides to stakeholders.

In this document we have set out a brief summary of the specific 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 we had minor concerns regarding the transparency and consistency of the information published by the company in relation to financial monitoring. We identified a number of differences between the published Annual Performance Report (APR) and the excel tables submitted to Ofwat as changes made during the audit process had not been fully reflected. This required corrections to a number of the metrics submitted in the company's excel file because they were significantly different to the numbers published in the Annual Performance Report. We also identified errors in the calculation of the weighted average years to maturity of debt instruments. The combination of these factors has had an impact on overall confidence in the information presented to Ofwat.

Our assessment: **minor concerns**

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

Overall we had minor concerns. The company sent a link to their joint assurance statement but this link was no longer valid by the time we carried out the assessment. The company explained that this was a result of a change in the

website domain but this impacted the accessibility of important assurance information for stakeholders.

The assurance statement says that the Board considered the outcome of discussions with The Consumer Council for Water when this statement was being written. While the company confirms that ‘stakeholders (including The Consumer Council for Water) were consulted in a timely and effective manner’, it would be useful to have more information regarding the level or outcome of engagement.

As the company is wholly or mainly based in Wales, it was not required to publish new connection 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 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, in order 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

The company met our expectations for this assessment. There is sufficient evidence that the company’s reporting is transparent and accessible to customers and other stakeholders. The company has published its ‘Annual Performance Report 2017-18’

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'. Performance reports for previous years can be accessed from the 'Regulatory performance' page by using the link to the library of current and historic documents.

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 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 resource 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 had 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 have been included within the company monitoring framework.

What we found

While the company provided evidence of assurance and Board involvement, we had minor concerns as the draft water resources planning tables did not contain all relevant information required to understand the company's plans. For example, cost information and links to drought plans were omitted from the planning tables. These

points were raised in the Ofwat draft water resources management plan representation to Defra and the Welsh government ([Dee Valley Water draft WRMP19 consultation response](#)).

Our assessment: **minor concerns**

1.5 Long-term Viability Statement

What we were looking for

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

This assessment is important in providing Ofwat and other stakeholders with assurance that companies have the long-term financial resilience to meet the needs of consumers in the long-term.

The assessment 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. The assessment considers how their long-term financial viability statement linked to their wider risk assessment including mitigating actions, the extent to which companies stress tested their projections, whether they clearly explained their approach and the evidence of assurance over the process.

This is the first time that information on the 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

We had some minor concerns in relation to the long-term viability statement provided by the company.

While the directors set out their approach to risk management and identified the principal risks, little detail was provided on the current status of each risk and the movement in the net risk position relative to the previous period. The list of principal risks was limited, with risks that had been identified by other companies clearly

absent. For example, the company did not include financial or economic risks in their list of principle risks (although this was included in the scenarios).

The company presented the scenarios that it had stress tested to assure its long-term viability statement, including a link to the principal risks identified. However, there is little detail in the statement regarding the potential impact of these scenarios on the company's debt covenants and its resulting ability to maintain financial ratios in line with an investment grade credit rating. In identifying mitigating actions, the company has identified Severn Trent Group as the company's principal source of funding and has, therefore, referenced the outcome of the Severn Trent Group's assessment of viability. However, there is no indication within the company's statement that the Severn Trent Group has committed to support Hafren Dyfrdwy.

Assurance of the long-term viability statement was adequate and was achieved by reference to the internal audit report signposted by the Audit Committee. The company stated that a third party assurer was used to assess the long-term viability statement as part of their normal audit duties and this was supported via signposting to the external audit report.

Our assessment: **minor concerns**

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

We had minor concerns with the company's financial flows submission. There were a number of data variances and the data had been neither published nor internally or externally assured.

Our assessment: **minor concerns**

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.

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.

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.

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. The plan has been significantly improved and updated since last year. The company has responded to much of our feedback. The risks, strengths and weaknesses exercise identified many new risks from last year as expected, such as the company's boundary realignment, data migration and brand change, along with price review risks, which have all been well explained.

There is also evidence of much improved engagement with and response to stakeholder feedback. The company provides a summary of its assurance framework with the typical activities undertaken in its 'three lines of defence' model.

The plan uses a table to list out the risk areas, the reason for inclusion and the assurance activities planned to address the risk areas identified. However some of the targeted areas such as the charging information and annual performance report are very broad and high level. The annual performance report consists of four sections of information which will be subjected to different levels and types of assurance, but the structure of the plan does not enable this to be explained.

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

The company's cost assessment tables were complete with no missing data. We had minor concerns as we had to raise a number of queries to seek explanation for data variances where commentary was lacking or the company did not provide sufficient explanation, with some of these queries leading to 2017-18 and historical data corrections.

The company's accounting separation methodology was available however we had concerns around the company's cost allocation methodologies and external assurance of this. In the company's variance analysis it states that variances are due to refining the cost allocation methodologies in some areas, typically around water resources and raw water distribution, but no further detail was provided on the refinements or on the process undertaken to ensure they are appropriate. The company did not include information on external assurance of the cost allocation methodologies or who provided it. The only statement it made in this respect was that "third stage review is performed by external assurance providers to confirm the cost allocation principles comply with the regulatory requirements."

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 engage with them to 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

No assessment was made because we did not have any live cases involving the company during the assessment period.

Our assessment: **not applicable**

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 assessment. The relevant parts of the initial

assessment tests are: confidence and assurance test 5 which covers data consistency (considered here), and test 6 which covers data quality (covered below). 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 a number of inconsistencies and omissions between the data submitted in the company’s Annual Performance Report and in its business plan tables in the areas of cost assessment and outcomes.

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 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 a number of issues within the company's data tables in the areas of outcomes, cost assessment, risk and return and financial modelling. For example in risk and return, we identified inconsistencies in key information and in financial modelling, we identified differences between the data contained in the business plan tables and that submitted in the accompanying financial model.

Our assessment: **minor 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 by companies 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

This year, for the first time, all companies were required (as set out in [IN18/07: Expectations for monopoly company annual performance reporting 2017-18](#)) to provide a performance statement, setting out how the company is delivering for the stakeholders that rely on its services and how its aspirations have been shaped. In our assessment we considered whether or not the company had provided this statement, and whether it was compliant with the requirements of IN18/07.

The company did not provide this statement. While relevant information has been provided across its annual reporting, this is not in the form of a short statement as requested in IN18/07.

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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