

January 2019

Trust in water

Company monitoring framework: 2018 assessment Individual company report – Northumbrian Water

Company monitoring framework assessment

This document outlines the results of our 2018 company monitoring framework assessment of Northumbrian 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 Northumbrian Water has not consistently demonstrated the high standards required to remain in the self-assurance category. Therefore **we have decided to change Northumbrian Water's assurance status to 'targeted'**.

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.

While the company met our expectations in most areas, it only exceeded expectations in one area (assurance plan), and we had concerns in two areas, cost

assessment, and the water resources management plan (WRMP) and market information assessment. In cost assessment, we had to raise a significant number of queries where commentary was lacking and / or the company did not provide sufficient information, some of which led to 2017-18 and historic data corrections. There was also no evidence of external assurance over the company's accounting separation methodology. In relation to the company's draft WRMP, we had concerns around the lack of consistent representation of the industrial water resource zone in both the WRMP and the water resources market information which resulted in the company's supply-demand balance position and the potential for trading or third party involvement being uncertain. There was limited evidence of the assurance process undertaken and of Board involvement and sign off of the draft WRMP.

In the round the impact of these concerns – in particular given the limited evidence of external assurance processes in some parts of these two assessment areas and the potentially material impact of the lack of consistent data for the industrial water resource zone on the overall supply-demand balance position of the company – mean that the company has not consistently met the standards that we expect of a self-assurance company. We consider the fact that the company exceeds expectations in one area, the assurance plan, is insufficient to maintain its status as self-assured.

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 Northumbrian Water has met our expectations in relation to financial monitoring. The company has followed our guidance, and the quality of data and the transparency of the published information met our expectations in many areas. We identified a small error in relation to the calculation of the company's effective tax rate which did not take account of prior year adjustments for consortium relief payments. However, we did not consider that this had an impact on the overall confidence in the information presented.

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

The company's assurance documents and other supporting documents satisfied the requirements of our charging rules and were brief and functional. They would benefit from additional succinct supporting information, for example on quality assurance processes or how stakeholders were engaged and influenced the charges.

The company's new connections charging arrangements were well laid out and accessible, and included clear explanations of the charges. The worked examples provided were clear and helpful and could readily be cross referenced to the charging tables in the main part of the document. The company reissued this document prior to the start of the year making what appeared to be minor changes that are systematically recorded in the document.

In contrast to the majority of other companies, a good explanation was provided as to how the infrastructure charges were derived.

Our assessment: **meets expectations**

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

Northumbrian Water has met our expectations for this assessment. There is clear evidence that the company's reporting is transparent and accessible to customers and other stakeholders. Annual Performance Reports and Annual Performance Report summaries have been published on the Northumbrian Water and Essex and Suffolk Water websites. These can be accessed using the 'About us' and 'Annual performance review' links from the companies' website home pages.

To accompany the more detailed Annual Performance Report 2018, the company has produced a helpful Annual Performance Report Summary for customers.

The performance information in the Annual Performance Report 2018 and accompanying Annual Performance Report Summary is clear, easy to understand and customer-focussed, with helpful links to relevant documents and web pages. Annual Performance Reports for previous years are available on the 'Annual Performance Review' pages on the Northumbrian Water and Essex & Suffolk Water websites.

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

We had minor concerns in this area due to the lack of consistent representation of the industrial water resource zone in both the draft WRMP and the water resources market information. The lack of transparency in this area of the draft WRMP resulted in the company's supply-demand balance position and the potential for trading or third party involvement being uncertain. These issues were compounded by the limited evidence provided of the assurance process undertaken or Board involvement and sign off of the draft WRMP and no evidence of external assurance on the company's draft WRMP. This was improved at the revised draft plan stage but only after stakeholder comments had been incorporated. It should have been clear in the draft plan.

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

Overall Northumbrian Water has met our expectations with respect to the long-term viability statement included in the Annual Performance Report, via signposting to the Company's Financial Statements. The directors have provided a statement that the business can continue to operate effectively over the long term and, specifically, meet its financial liabilities over the seven years to 31 March 2025, setting out the factors taken into account and the basis for the period reviewed.

Northumbrian Water has clearly set out its risk management process and the principal risks facing the company, describing each risk, the movement in the current risk exposure, as well as mitigation and management actions taken. However, the company could have provided more detail about the potential impact on the company's operations, for example through possible regulatory fines and performance penalties, for all risks identified. The company has set out the scenarios tested including the principal risks identified, however, more detail could have been provided in relation to the outcome of the testing and the impact on the ability of the

company to service its debt and on its credit rating, and the mitigating actions that would be taken in all cases as set out in the Information Notice IN18/04.

Northumbrian Water has clearly set out the third party assurance undertaken with respect to the calculations and impact of the stress testing scenarios on the medium term plan.

The company could also have provided more detail on the internal processes and governance that has been followed in providing assurance over the assessment.

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

Northumbrian Water met our expectations in this area. The company completed the required data tables for all three years in accordance with our guidance. The company published the 2017-18 data with supporting narrative, assured by their external auditors, in its Annual Performance Report.

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.

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 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.

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

Northumbrian Water was placed in the self-assurance category in 2016-17. Self-assurance companies have discretion over their approach and the 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 company monitoring framework assessment, whether or not this is detailed in an assurance plan.

Northumbrian Water chose to update and publish an assurance plan. The assurance plan is of a high standard. It is clearly structured and well written in non-technical language making it accessible for all stakeholders. It sets out the context of the exercise and provides a good summary of the company's assurance framework. There is evidence of proactive engagement particularly with customers. The plan outlines the assurance activities that will be undertaken. There is a thorough and detailed list of risks, and for each of those risks, the plan details what assurance activity has been applied during 2017-18 and what measures are being planned for 2018-19. Each risk is given a rating as to its importance for monitoring for future activity.

Our assessment: **exceeds 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

Northumbrian Water's cost assessment tables were complete with no missing data. We had some concerns because we had to raise a significant number of queries to seek explanation for data variances where commentary was lacking or 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, but there was no evidence of it having been externally assured.

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 Northumbrian Water in the assessment period – a work in private land determination. We assessed the information that the company provided with respect to this case as 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 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

Overall the performance and financial data reported in the company's business plan table was consistent with previous data submissions, and any issues identified were relatively minor, isolated or resolved through queries.

Our assessment: **meets expectations**

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 provides sufficient and convincing evidence that its 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 some issues with the data tables in the areas of outcomes, risk and return and financial modelling, but we do not consider that these had an impact on the overall confidence in the company's business plan data quality.

Our assessment: **meets expectations**

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

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.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gsi.gov.uk

January 2019

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