

January 2019

Trust in water

# **Company monitoring framework: 2018 assessment**

## **Individual company report – SES Water**

## Company monitoring framework assessment

This document outlines the results of our 2018 company monitoring framework assessment of SES 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 have retained SES Water in the 'targeted' 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 has met our expectations in all but two of the assessment areas (long-term viability statement and water resources management plan and market information). In the water resources management plan and market information, we had serious concerns as the draft plan had omissions and inconsistencies and there was no evidence of the assurance process over the plan. We did not feel that, given

the company's overall performance, this and our minor concerns in relation to the long-term viability statement, was sufficient to demote the company to prescribed status. Therefore we have retained the company in the targeted assurance category for 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 in relation to financial monitoring. SES Water has followed our guidance, and the quality of data and the transparency of the published information met our expectations in many areas. We raised two queries to obtain clarification regarding the financial metrics disclosed in the company's Annual Performance Report (APR) relating to the calculation of average years to maturity of debt instruments and reflecting retail exit in Return on Regulatory Equity (RORE). We reviewed the responses to these queries and have confirmed that the reasons for the differences are explained and no adjustments were subsequently required. These clarification queries were not assessed to have 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 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 the engagement on and publication of charges information, where appropriate under the charging rules;
- the information companies provide in their Statement of Significant Changes; and
- the handling strategies companies devise and put in place to address significant movements in charges.

In certain cases, 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 regarding 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

SES Water produced informative statements of significant changes, however the company’s assurance statements were quite short. The assurance statement included a timetable showing engagement with The Consumer Council for Water,

which included actions, content, feedback and the date on which it happened. The company also produced a thorough assessment of bill increases on different customer groups.

The new connections charging arrangements were clear and concise with diagrams to explain what connections were, why the new framework was introduced, and tables to explain the application cost and design fees. The company consulted in January 2018, which was quite late in the process.

In common with most companies, we expect the company's explanations of how charges are derived, consistent with the rules, to be improved next year.

Our assessment: **meets expectations**

## 1.3 Outcomes

### What we were looking for

We want to ensure that stakeholders understand what companies are doing to deliver the outcomes that customers expect and agreed 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 / responded to their customers and other stakeholders.

This is an important assessment, to ensure that stakeholders can understand whether 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

SES 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. SES Water has published its 'Annual Report 2018' on the 'Performance Reports' page of its website. This is accessed using the 'About us' and 'Publications' links from the home page. The performance information in the Annual Report 2018 is clear and customer-focused. Performance reports for previous years can also be accessed from the 'Performance Reports' 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 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**

Overall we had serious concerns in this area, principally as the draft water resources management plan does not provide any evidence of the assurance processes followed and this raises concern about the robustness of plan

development. This was raised in the Ofwat representation on the draft plan ([SES Water draft WRMP19 consultation response](#)).

We identified missing items of data in both the draft water resources management planning tables and the market information which reduces the transparency of the plan, for example cost data for demand-side options in the planning tables. A number of inconsistencies were also noted between the draft water resources management plan narrative and the planning tables including the proposed level of leakage reduction by 2025 and the representation of the level of service with respect to severe restrictions, such as standpipes.

Our assessment: **serious concerns**

## 1.5 Long-term Viability Statement

### What we were looking for

This assessment focused on the transparency and assurance on 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 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 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 have minor concerns with respect to the long-term viability statement set out by SES Water in the 2018 Annual Report. The directors have provided a statement that they have a reasonable expectation that the company will be able to fulfil its obligations including meeting its liabilities as they fall due for a period of seven years to 31 March 2025, setting out to some extent the approach to the assessment and the basis for the period reviewed.

The company has set out its principal risks and provided a score for each risk based on impact and likelihood of occurrence, along with the mitigations undertaken for each risk. The long-term viability statement states that the directors have taken account of the potential impact of the principal risks, but does not provide any detail on the approach adopted in doing so with regards to stress testing severe, plausible and reasonable scenarios for key variables, covering the principal risks facing the business in the short and longer term, as set out in our Information Notice. Whilst the statement says that it has tested the ability to withstand the scenarios suggested by Ofwat, and has provided detail of these scenarios, it does not set out, with reasons whether the Directors consider the particular scenarios to be appropriate, or set out any company specific scenarios considered. The directors have stated that they have assessed the impact of the scenarios, mitigating actions and responses in the event that mitigations proved ineffective in the Company's ability to comply with the financial covenants. However, there is little detail of the outcome of the scenario testing on those financial covenants, financial ratios or the company's ability to maintain its credit rating.

There is no indication within the statement of the impact (if any) on the financial viability of the regulated business as a result of the overall group structure, inter-group transactions or any other group activities outside the regulatory ring-fence. The statement says that "The Company's draft PR19 business plan has been approved by the whole Board and the results of the stress-testing undertaken for the purposes of issuing this statement have been reviewed by the Audit Committee." However, there is no detail of the assurance process undertaken, the involvement of the Board in the governance process and the extent to which the company has used any third party assurance.

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

The company has met our expectations in this area. All data tables were complete, the company has published its data within the Annual Performance Report and the data has been assured by its external auditors. However we raised a number of queries around the accuracy of the submission.

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.<sup>1</sup>

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<sup>1</sup> 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.

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**

## **1.8 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 introduction has a good description of how consumers, consumer groups and stakeholders shape the

assurance plan. The plan concentrates on two areas for assurance namely charging information and the annual performance report. The governance and assurance process is adequately described from the bottom upwards to Board approval. However as we commented on last year, the targeted areas in both the charging information and annual performance report are broad and high level and could be further disaggregated. In addition there is no discussion on the potential risks of each activity and potential steps to help mitigate the situation.

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 met our expectations in this area. All cost assessment tables were complete with no missing data. However, the company's submission was lacking in commentary to provide reassurance over its robustness, despite data appearing consistent with historical trends. The company's accounting separation methodology was available. A high proportion of the company's costs have been directly attributed and for the remainder the allocation methods used have been described. There is external assurance but no details of internal governance and assurance related specifically to accounting separation.

Our assessment: **meets expectations**

## 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 SES Water 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 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**

Overall the performance and financial data reported in the company’s business plan tables was consistent with previous data submissions, and any issues identified where 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 within our assessment of the data tables in the policy areas of financial modelling, outcomes and risk and

return, but these were not considered to have 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 produced by the company – across a range of publications, regulatory submissions and bilateral engagement – that could potentially impact on confidence and that we therefore considered relevant to our overall decision. 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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