

January 2019

Trust in water

Company monitoring framework: 2018 assessment Individual company report – South East Water

Company monitoring framework assessment

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

The company met our expectations in many areas and exceeded our expectations in two areas, the assurance plan and water resources management plan (WRMP) and

market information. However, we had minor concerns in four areas; the financial monitoring framework, charges engagement, PR19 business plan data consistency and PR19 business plan data quality. Given the number of concerns we consider that overall the company has not consistently met the high standards expected in order to be assessed as self-assurance.

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 we had minor concerns regarding the transparency and consistency of the information published by South East Water in relation to financial monitoring. We identified a number of errors, which indicated that South East Water had not followed our reporting guidance and raised minor concerns regarding the quality of the assurance processes in place. We raised queries to obtain clarification on some of the financial metrics disclosed in its Annual Performance Report, some of which resulted in adjustments and corrections. However some discrepancies were a result of simple typos and not providing data to two decimal places.

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

South East Water's assurance statement provided useful detail on the assurance processes in place and was clear and easy to understand. It explained Board oversight procedure, internal and external assurance and included an external assurance statement on the calculation of the tariff models.

However, overall we had minor concerns in relation to the quality of the charging documents. The company used inconsistent terminology and did not mention the income offset at all in its charging rules. In addition, we expected more detail on how charges for developer services are derived. No worked examples were provided to help with understanding. It was not clear whether charges are fixed or estimates in the company's 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

South East 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. South East Water has published performance information that can be accessed using the 'About us' and 'News & Info' pages within the 'Corporate' part of the company website. The 'Performance, People and Planet 2017/2018' report is clear and easy to understand. The reports for previous years can be accessed from the home page by selecting 'Corporate', 'News & info', 'Publications', and then 'Performance reports'.

To improve accessibility to customers and other stakeholders, South East Water could consider linking to the Annual Performance Report on the Performance, People and Planet report page, and vice versa.

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 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

South East Water exceeded our expectations in this area. The company's draft WRMP provided examples of good practice, for example the independent non-executive director 'deep-dive' review sessions. We do not consider any issues identified (i.e. points for clarification in relation to lower materiality metrics and one minor inconsistency with supply-demand balance between plan and table, with all other key metrics correctly presented) to be significant or to impact customer understanding of the plan.

Our assessment: **exceeds expectations**

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.

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 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 South East Water has met our expectations with respect to the long term viability statement included in the Annual Performance Report, via a clearly signposted reference to the Annual Report and Accounts. The Directors have

provided a statement that they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the five year period ending 31 March 2023, clearly setting out the approach to the assessment and the basis for the period reviewed.

South East Water has set out the risk management process and principal risks but could have provided further information on the current status of each risk and the movement in the net exposure from the previous period. The company has set out the scenarios stress tested, along with the combination of scenarios tested, but could have provided further detail to link the scenarios tested to the principal risks identified. In addition, further detail could have been provided on the consideration given to and the impact (if any) on the financial viability of the regulated business as a result of the overall group structure, intra-group transactions and any other group activities outside the regulatory ring-fence.

The company has set out the assurance undertaken on the assessment of long term viability within the statement by signposting the internal audit report completed by the Audit Committee. They have signposted to the external audit report where there is specific reference to testing the assurance of the long-term viability statement.

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

South East Water has met our expectations in this area. The company published a separate document with accompanying narrative, and published its financial flows for 2017-18 in its Annual Performance Report which has been externally assured. There were some queries over the accuracy of the submission but these were not considered to be significant or to impact customer understanding of the company's financial flows.

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.

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.

What we found

South East Water has met our expectations in this area. The company's 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

South East Water was placed in the self-assurance category in 2016-17. Self-assurance companies have discretion over their approach and the structure of the 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.

South East Water chose to update and publish an assurance plan. The company's assurance plan exceeded our expectations. The plan was clear, well written and accessible to a non-technical audience. It set out the context for and purpose of the assurance plan and the work done to date. There was a clear summary of the company's approach to assurance. We were encouraged by the level of stakeholder engagement and the explanation of how the company took account of stakeholders' comments. The risk, strengths and weaknesses assessment undertaken appeared thorough and the scope of information considered was sufficient. The plan set out the mitigating actions and activities for each risk area the company identified. The plan covered the recent freeze/thaw incident and the development of a business plan assurance framework.

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

South East Water met our expectations in this area. The cost assessment tables were complete with no missing data, the accounting separation methodology was available and data was generally consistent with historic trends, but with some commentary lacking. A number of queries had to be raised however this only resulted in a minor data changes to one data table. There was evidence of external assurance over the allocation of fixed assets but no evidence of external assurance over the accounting separation methodology specifically as a whole although there

did appear to be a robust internal assurance process. These concerns were not significant enough to impact on our overall assessment of this area.

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 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 South East 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 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. We identified inconsistencies between the company's business plan and Annual Performance Report in the areas of cost assessment, outcomes (affordability and vulnerability) and risk and return.

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 several issues within the data tables in relation to outcomes, cost assessment, risk and return and financial modelling. For example, in outcomes, for the affordability and vulnerability table, the number of people on the Priority Services Register was missing and the table included a misleading total with no explanation.

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

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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