

January 2019

Trust in water

# **Company monitoring framework: 2018 assessment**

## **Individual company report – Severn Trent Water**

**Ofwat**

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## Company monitoring framework assessment

This document outlines the results of our 2018 company monitoring framework assessment of Severn Trent 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 Severn Trent 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.

Whilst the company has met our expectations in all but two of the specific assessment areas (outcomes and cost assessment), it has not exceeded our expectations or demonstrated leading edge behaviour in any areas. Therefore it has

not met the criteria for promotion to the self-assurance category and 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. Severn Trent Water has followed our guidance, and the quality of data and the transparency of the published information met our expectations in many areas. Our clarification query on the effect on Return on Regulatory Equity (RORE) due to business retail exit required no further adjustments and was not considered to have had an impact on the overall trust and 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

Severn Trent Water’s assurance statements were brief, but met our requirements. More detail on how each of the charging rules had been complied with would have been helpful. Similarly, while assurance was given that stakeholder engagement had

taken place, there was no detail on when or how this occurred, and what the outcome of this engagement was.

The company's new connection charging arrangements were set out in a clear and accessible manner. A helpful glossary was included as well as providing good, clear examples. The document gave clear, well explained descriptions of what each charge is for and how the charges work and used plain English for the most part.

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

We have a minor concern that the company did not explain the adjustment to the water supply interruptions underperformance payment in its 'Annual Performance Report 2017-18' and 'Annual Performance Report 2017-18 - a summary for our customers' published in July 2018. The reports contained two values, -£16.753m and -£24.519m, and it was not clear which of these applied. This performance commitment is of particularly high importance to customers and the adjustment was

of a significant value. We consider that not explaining the adjustment could reduce stakeholders' confidence.

For the other performance commitments there is clear evidence that the company's reporting is transparent and accessible to customers and other stakeholders. Severn Trent Water 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: **minor concerns**

## **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

Overall the company met our expectations in this area and minor issues identified were not considered material to the plan or its presentation. Planning tables for the draft water resources management plan and market information were completed adequately, with some very minor transparency concerns with drought plan links. Clear evidence of customer involvement with draft plan development was lacking as was much explanation for large changes in data since the previous plan. However, assurance of both the draft plan and supporting data has been referenced.

Our assessment: **meets 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.

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 Severn Trent Water has met expectations for the long-term viability statement included in the Annual Performance Report, via a clearly sign-posted

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 period of seven years to 31 March 2025, setting out the approach to the assessment and the basis for the period reviewed.

The company has set out its approach to long-term planning and has provided a clear description of the risk management process and principal risks facing the company, describing each risk (with a link to which part of the business, strategy and company values it relates to) with the principal impacts on the company and its obligations, the movement in the current risk exposure, as well as mitigation and management actions taken. The company has clearly set out the scenarios tested and the links to the principal risks, although further detail could have been provided on how the combined scenario was developed and the actions to be taken to mitigate the impact of the scenarios. The company has set out the assurance undertaken on the assessment of long-term viability within the statement and through the link to the Audit Committee Report and external audit report.

Our assessment: **meets expectations**

## 1.6 Financial Flows

### What we were looking for

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

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

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

## What we found

The company has met our expectations in this area as it has provided consistent and accurate data within acceptable tolerance levels. However the company did not publish its data or provide and evidence of internal or external assurance.

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>

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.

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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: **meets expectations**

## 1.8 Assurance plan

### What we were looking for

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

- explanation of the assurance framework and their approach to it;
- evidence of stakeholder engagement undertaken to develop the plan;
- clear scope, and rationale for targeting specific areas; and
- appropriate language and accessibility for all stakeholders.

This is a key test of whether companies are listening to their stakeholders and using their views to improve their practices.

### What we found

The company's assurance plan met our expectations. It clearly sets out the context of the company monitoring framework and the work done to date demonstrating good stakeholder engagement, highlighting where the company has amended its draft plan as a result of stakeholder feedback. Severn Trent Water has outlined what the customer priorities for PR19 are, stating that customers do not prioritise access to published information but referring to customer issues in accessing their publications. The plan explains the company's approach and explains where risks lie and where the resulting assurance should be targeted. The risk assessment undertaken was sufficient, though one risk that they have not included is the variation of their area (border realignment) with Dee Valley Water and all of the potential data issues this raises. The assurance plan details how the framework has been applied, with a good summary of approach covering internal and external assurance. 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

We had minor concerns in this area. Whilst the company's cost assessment tables were largely complete with only one data item incomplete in table 4L, we had to raise a significant number of queries due to a lack of explanatory commentary for most data tables. Some of these led to changes to 2017-18 and historic data tables. The company's accounting separation methodology was available and has 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 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**

We closed two cases concerning Severn Trent Water in the assessment period. These were both trade effluent appeals submitted under section 122 and 126 of the Water Industry Act 1991. No assessment has been provided as the information was gathered largely through an independent expert.

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**

Overall the performance and financial data reported in the company's business plan tables 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 within our assessments of the data tables in the policy areas of outcomes, risk and return, financial modelling and cross cutting themes (water resources). However, these issues 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 - 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 has not provided a short statement setting out how it is delivering for everybody who depends on its services and how it has set its aspirations. While relevant information has been provided across its annual reporting, this is not in the form of a short statement as requested in IN 18/07.

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.

Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA

Phone: 0121 644 7500  
Fax: 0121 644 7533  
Website: [www.ofwat.gov.uk](http://www.ofwat.gov.uk)  
Email: [mailbox@ofwat.gsi.gov.uk](mailto:mailbox@ofwat.gsi.gov.uk)

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