

January 2019

Trust in water

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

Company monitoring framework assessment

This document outlines the results of our 2018 company monitoring framework assessment of South West 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 South West 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 eight assessment areas and exceeded our expectations in two areas (assurance plan and water resources management plan and market information). However, we had minor concerns in one area (cost assessment) and serious concerns in one area, outcomes, where the company

applied an exclusion to mitigate the impact of severe weather on its ‘Duration of interruptions in supply’ performance commitment and made an adjustment to reduce its underperformance penalty, despite there being no provision to make such an exclusion within its performance commitment. The company did not refer to this in the main section of its Annual Performance Report, including only a brief reference in the technical audit summary report which did not transparently set out what they had done.

We consider that, looking at the company’s performance in the round, these concerns are not 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. South West Water has followed our guidance, and the quality of data and the transparency of the published information met our expectations in many areas. There were a number of minor clarification queries raised. These clarification queries did not 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 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 West Water's assurance statements were short, but met the minimum requirements.

Stakeholder engagement was referenced in the assurance statements, but limited detail was given on how this took place, the topics discussed, and the outcome of any engagement.

The company's new connections charging arrangements also met the minimum requirements. A helpful glossary was included in the document, with plain English supporting text in the main document. Charges were set out in tabular form, by section, meaning it should be reasonably straightforward to calculate an estimate. The document set out the three steps to calculate the infrastructure charge, although it did not seem straightforward. The income offset was mentioned in various places, and amounts quoted, but no explanation was given as to how it had been calculated.

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 serious concerns over the company's exclusion of the impact of severe weather on its 'Duration of interruptions in supply' performance commitment, despite no provision for such an exclusion in its performance commitment. The company made an adjustment to its underperformance penalty for this exclusion meaning that it would pay less than it should do.

The company was not transparent with its stakeholders about this exclusion or adjustment. The company had requested our advice on the potential exclusion before submitting its Annual Performance Report (APR) and we had advised the company to submit a formal query through the PR19 query process. We understand that the company decided not to submit a query as they believed that it did not fit in with the timescales for submission of the Annual Performance Report. The company instead made the exclusion and adjustment without informing us that it had done so; we only became aware that the company had made the exclusion from a reference in the third party technical assurer's report appended to the Annual Performance Report.

We also have concerns with the transparency of the commentary relating to another performance commitment. The company did not explain in its Annual Performance Report and Regulatory Reporting 2018 that it had made adjustments to the reported performance levels to mitigate the impact of severe weather on one sub-measure of its 'Asset reliability - pipes' performance commitment. We would have expected the company to provide accessible information about how and why it had applied this adjustment.

For the company's other performance commitments, there is sufficient evidence that the company's reporting is transparent and accessible to customers and other stakeholders. The '2018 South West Annual Performance Report and Regulatory Reporting' document covers South West Water and Bournemouth Water and has been published on both websites. On the South West Water website it can be accessed from the home page using the 'About us' and 'How are we performing' links. On the Bournemouth Water website it can be accessed from the home page using the 'Company information' and 'Company reports and assurance' links. The document provides clear and easy to understand performance commitment commentary with graphs for each performance commitment showing the last four years performance.

In addition to the main Annual Performance Report and Regulatory Reporting document, the company has produced short, customer/area focused summary performance reports for South West Water and Bournemouth Water. The summary

documents include clear performance tables and commentary explaining where the company has performed well, and where improvement is needed.

The South West Water annual performance reports and regulatory reporting for previous years can be accessed from the home page using the 'About us' and 'How are we performing' links. The Bournemouth Water performance and regulatory accounts for previous years can be accessed from the home page using the 'Company information' and 'Company reports and assurance' links.

Our assessment: **serious 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 exceeds our expectations in this area, as it has demonstrated good practice in terms of the scale and breadth of its customer participation activities, with clear evidence of assurance and regular monthly board involvement. The documentation is clearly written, well structured, and easily accessible with very few data inconsistencies between the draft water resources management plan and data tables identified, and none of these material to the outcome.

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.

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 South West Water has met our expectations for the long-term viability statement included in the Annual Performance Report. The directors have provided a statement that they have reasonable expectations that the company is financially

resilient and can continue in operation and meet liabilities as they fall due for a period of five years to 31 March 2023.

The company presented a risk assessment that contained a high level of detail with graphics explaining where the risk lies as well as providing appropriate mitigating actions for each individual risk. The consideration of past delivery and expected performance was well evidenced with a breakdown of the change in risk direction for 2017 and 2018 included. The Board had clearly been engaged throughout the long-term viability statement and provided internal assurance through their "three lines of defence" approach. There is evidence that the statement has been reviewed by third party assurance with signposting to the report.

The company could have provided further detail on the level of stress and scenario testing. The statement does not set out that the company scenarios tested represent severe, plausible and reasonable levels of stress. Further detail could also have been provided on the impact of the testing on the ability of the company to service its debt. There is no indication within the statement of 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.

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 met our expectations in this area. The company produced a separate financial flows document with supporting narrative which had been externally assured. However, the document was not part of the company's Annual Performance Report so it was unclear whether it had been published. There was only one data variance, relating to dividends paid, which we consider did not have an impact on stakeholder confidence.

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

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.

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 exceeded our expectations. The company continues to demonstrate good stakeholder engagement. The plan sets out in detail the methodology and provides a thorough summary of assurance initiatives to handle the potential risks identified. The integrated assurance framework and the role of Board is discussed in detail and the plan clearly sets how it has been applied to the risks identified. For each identified risk a specific assurance plan has been developed that details both the use of internal and external processes to provide comfort that the various risks have been addressed.

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

We had minor concerns in this area. All cost assessment tables were complete with no missing data, but we had to raise several queries to seek explanation for data variances where additional commentary would have been helpful to provide greater confidence in the data. The accounting separation methodology was available but had limited detail regarding the methods of allocation and why they were considered the most appropriate. There were also no details of the internal assurance process or external assurance relating specifically to accounting separation.

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 one case concerning South West Water in the assessment period. This was a trade effluent determination under section 122 of the Water Industry Act 1991.

We consider that the company met our expectations with regards to the above case as the information provided was 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 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 no material issues within our assessment of the data tables and only a minor issue in the area of risk and return.

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.

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