

January 2019

Trust in water

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

Company monitoring framework assessment

This document outlines the results of our 2018 company monitoring framework assessment of Thames 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, we also 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 the company monitoring framework is also considering 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 decided to promote Thames Water to 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.

Thames Water has demonstrated that it has acted on feedback that we provided, and has made significant improvements from the previous year. The company has exceeded our expectations in two areas (financial flows and charges engagement) and met our expectations in all of the other assessment areas except for the risk and

compliance statement and the water resources management plan and market information, where we have minor concerns.

The company has met the requirements for being promoted to the targeted assurance category. It has shown no evidence of behaviour that leads to a reduction in the trust and confidence stakeholders can place in it, has had no significant problems with its assurance plan and has been in the prescribed category for at least 12 months, therefore it meets the criteria to be promoted to the targeted assurance category. Companies in the prescribed assurance category in the previous year can only move up to the targeted category in one year.

In this document we have set out a brief summary of the assessments that we undertook as part of the CMF 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 the company has met our expectations in relation to financial monitoring. Thames Water has followed our guidance, and the quality of data and the transparency of the published information met our expectations in many areas. We identified an error in the company's presentation of Return on Regulatory Equity

(RORE) for 2015-16 relating to a simple typo. We also raised several clarification queries regarding dividends and how non household retail exit had been reflected in the RORE calculation. These clarification queries were not considered 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 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

Thames Water's charging documents were clear, easy to follow and pitched at a general audience. They showed good information relating to their stakeholder engagement.

Thames Water's assurance statements were clear and informative.

The new connections charging arrangements was particularly well laid out and accessible. They included clear explanations of what work was needed at each stage, and the charges that applied. Clear, helpful diagrams were also included. A number of worked examples were provided, which were clear and helpful and supported the main document. The income offset approach was complicated, but the company's website included an excel spreadsheet that calculated estimated income offsets.

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: **exceeds 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

Thames Water has met our expectations for this assessment. There is sufficient evidence that the company's reporting for the current and previous reporting years is transparent and accessible to customers and other stakeholders. Thames Water has published its 'Annual report and annual performance report 2017/18' (AR and APR) on the 'Our performance' page of its website; this is accessed using the 'About us', then 'Our business' links from the homepage. The AR and APR is well laid out with easy to understand tables that highlight the accrued and forecast underperformance and outperformance payments, and whether each performance commitment has been met or not. The performance dashboard on pages 28 to 37 gives a clear summary of performance against its key performance commitments. Performance Reports for previous years are available from a 'Previous reports' link on the 'Our performance' web page.

Last year we had concerns with the company's commentary relating to some of the performance commitments that had not been met. In particular, its leakage and Security of Supply Index (SOSI) performance commitments.

In this year's AR & APR the company's leakage performance, and its recovery plans to bring its performance back to its target performance level of 606 MI/d in 2020, are covered in the Board statement, Chairman's statement and Chief Executive's statement. In the 'Improving performance' section of the AR & APR, the company explains what it is doing to tackle leakage and minimise supply interruptions. In addition, the company is now publishing monthly leakage reports on its website; these can be accessed using the 'Help and advice', then 'Leaks' links from the homepage.

The AR & APR includes clear and helpful commentary for performance commitments such as greenhouse gas emissions. Going forward, the company should include a similar level of information for more of its performance commitments - for example, those relating to compliance with environmental regulations, reducing the amount of phosphorus entering rivers, the abstraction incentive mechanism, and educating customers. This would ensure that transparent and accessible information is provided for all performance commitments, and it would allow customers and other

stakeholders to more fully understand the progress that the company is making towards its targets.

Our assessment: **meets expectations**

1.4 Water resources management plan and market information

What we were looking for

Companies are required to produce a water resources management plan every five years setting out their approach to maintaining the long-term supply and demand balance in a way that delivers best value for customers and the environment for the next 25 years. We review and provide comments on draft water resource management plans to Defra and the Welsh government, in our capacity as a statutory consultee.

Our assessment in the company monitoring framework considered the quality of the information in companies' draft water resources management plans for the period 2020 to 2025. The assessment considered the quality of data and internal consistency in the plans, the extent to which stakeholders had been involved in the development of the plans, how clearly plans had been communicated to stakeholders and evidence of assurance of the plans. The assessment also considered the quality of the water resources market information published by the company. In that respect, the assessment considered the quality and completeness of the data, the clarity of its presentation and its consistency with the company's draft water resources management plan.

This is the first time that water resources management plans and market information have been included within the company monitoring framework.

What we found

Overall, we have minor concerns in this area due to the internal inconsistencies of the presentation of leakage reduction within the draft water resources management plan (WRMP). This a key WRMP metric, which was also subject to a late change in policy raising concerns about the quality of Board assurance and involvement. We did not identify any other data issues relating to WRMPs or market information. The company provided evidence of its assurance process.

Our assessment: **minor concerns**

1.5 Long-term Viability Statement

What we were looking for

This assessment focused on the transparency and assurance of companies' long-term financial resilience as set out in their long-term viability statements.

This assessment is important in providing Ofwat and other stakeholders with assurance that companies have the long-term financial resilience to meet the needs of consumers in the long-term.

The assessment considered the extent to which companies have followed our guidance for issuing long term viability statements as set out in [IN18/04](#) and in particular the approach they have taken to assessing their long-term financial viability. The assessment considers how their long-term financial viability statement linked to their wider risk assessment including mitigating actions, the extent to which companies stress tested their projections, whether they clearly explained their approach and the evidence of assurance over the process.

This is the first time that information on the long-term viability statement has been included as a separate category in the company monitoring framework (last year it was included within the “financial monitoring framework”).

What we found

Overall Thames water has met 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 ten years to 31 March 2028.

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 with consideration of the principal risks versus the strategic priorities, as well as clear mitigation and management actions to taken.

The company has clearly set out the scenarios tested and the links to the principal risks with evidence of the key assumptions underpinning the scenarios although there is little detail of the mitigating actions that would be taken based on the impact of the specific scenarios.

The assurance undertaken on the assessment of long-term viability has been set out by the company 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 exceeded our expectations in this area because, in addition to its data being in line with our expectations, it had published all of its Financial Flows data and detailed supporting narrative, for all three reporting periods, in its Annual Report and Annual Performance Report (AR and APR).

Our assessment: **exceeds 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 risk and compliance statement confirming that it has an understanding of, and is meeting its material obligations. However we have minor concerns because while the risk and compliance statement mentions the failure to meet leakage targets, it does not specifically acknowledge that Thames was found to have breached a statutory obligation and a licence condition. The company mentions elsewhere in the report the steps it is taking to improve planning and monitoring following the breach. However the omission from the statement itself affects the confidence that can be placed in it.

The Board has confirmed that the company 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: **minor concerns**

¹ Our findings here, and throughout our company monitoring framework assessment, are without prejudice to any issues that we may investigate under our enforcement powers and subsequently find wanting. It would be inappropriate to pre-empt the outcome of any investigations that might consider whether the assurance provided is indeed appropriate or accurate. Any adverse findings in this respect may be taken into account in future assessments.

1.8 Assurance plan

What we were looking for

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

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

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

What we found

The company's assurance plan meets our expectations. It illustrates the assurance process and how key stakeholders have a say in the process. The customer feedback refers to eighty-three responses but does not include the comments received and if any changes were made as a result. There is a detailed description of the three line defence which outlines all possible measures on managing reported risk. The assessment considers twelve types of potential risk reported from last year ranging from leakage to cost assessment. Each of these risks are presented in tabular form with the core assurance activities planned, these range from internal control to external review and customer and stakeholder involvement. Some of the descriptions of the assurance activities to reduce reporting risks are brief. The analysis concludes with an outline to improve information accessibility to stakeholders and consumers.

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 has met our expectations in this area. All cost assessment tables were complete with no missing data. The company's submission could have included more table commentary; the absence of commentary resulted in a significant number of queries being raised. The company's accounting separation methodology is available and is an example of best practice for its robust and detailed commentary, the reasoning provided in relation to variances as to why the changed allocation is most appropriate and the details of other allocation methods used and how this ties back to our regulatory accounting guidelines.

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

We closed seven cases concerning Thames Water during the assessment period. These all concerned the appointment of an arbitrator but we did not request any information from the company during the assessment period. As such, they do not form part of this assessment.

We had three live cases (subsequently closed) concerning Thames Water during the assessment period. These were an enforcement case, an eligibility determination and a new connection determination. We had minor concerns in regards to the new connection determination where not all the information Thames Water provided was clear. We consider, however, that Thames Water met our expectations in regards to the enforcement case and the eligibility determination as the information provided was complete, accurate, provided on time and of a quality that enabled us to rely on it to progress the cases. Overall, we consider the company met our expectations.

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 issues within the data tables in risk and return (tax forecasts, although this has no impact on customers), financial modelling and outcomes, but 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

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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