

January 2019

Trust in water

# **Company monitoring framework: 2018 assessment Individual company report – Yorkshire Water**

## Company monitoring framework assessment

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

In making our overall assessment, we have also considered any other issues or information relevant to the confidence that can be placed in the company's information.

The company has met our expectations in six assessment areas and exceeded our expectations in three areas (outcomes, risk and compliance and assurance plan). However, we had minor concerns in one area (financial monitoring framework) and

serious concerns in one area, charges engagement, where the new connections charging arrangements were re-published with amended charges over a month after the deadline without this change having been pro-actively communicated with stakeholders or Ofwat.

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 we had minor concerns regarding the transparency and consistency of the information published by the company in relation to financial monitoring. We identified one significant issue relating to the dividend yield and dividend cover calculations where the company had incorrectly deducted "Dividends used to pay head office costs and Kelda Finance interest" from their gross dividend. This error could have had an impact on the reader's view of the performance. The company has acknowledged the issue and has demonstrated its commitment to report in line with expectation for 2018-19.

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

Yorkshire Water's documentation was reasonably well presented, but a combination of issues together give us serious concerns about the company's communication of its charges with its customers for this year. We have discussed these issues with the company and are content that it intends to address them.

The new connection charging arrangements were re-published with amended charges over a month after the deadline for publishing these charging arrangements. We were not able to find information from the company's website or the revised charges document to state that that this change had occurred and, despite sending a query to the company on this point, we have not seen evidence of this change being pro-actively communicated with stakeholders or Ofwat at the time the change was made. We only became aware of this change due to customer feedback. This raises concerns around both quality assurance and transparency.

The company is required to explain how it has maintained a broad balance of charges that existed prior to the implementation of the rules (or why it has not maintained the balance). The company was no longer offering income offset or asset payments, but did not explain how it managed to maintain the balance in these circumstances.

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.

In order to comply with the new connection charging rules, charging arrangements should largely take the form of fixed upfront charges. While charges were presented in tables, in the text they were repeatedly referred to as estimates. This is confusing, undermining the purpose of the documents to enable a customer to confidently work out how much they are likely to have to pay. The arrangements did not include worked examples, which may have served to mitigate the confusion. The Board Assurance Statement stated that most charges were fixed, but this was not clear from the charging arrangements themselves.

Our assessment: **serious 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

Yorkshire Water has exceeded our expectations for this assessment because the performance information in the Annual Performance Report 2017-18 and accompanying Performance Summary 2017-18 is clear, easy to understand, well sign-posted and includes useful hyperlinks to other relevant documents and websites. For example, section 3 ('Review of our performance') includes clear, customer-focussed information and helpful hyperlinks. This includes:

- explaining how Outcome Delivery Incentives (ODIs) work and how they are calculated;
- an ODI summary of underperformance and outperformance payments accrued in 2017-18, accrued so far from 2015-16, and AMP6 (2015-20) forecast totals;
- performance summary for each performance commitment; and
- comparing Yorkshire Water's performance with other water companies for performance commitments such as drinking water quality, water use, supply interruptions, leakage and customer service.

The company has also worked with the Plain English Campaign and has received a Crystal Mark for its Performance Summary. This ensures that performance is

transparent to customers and other stakeholders. Overall there is clear evidence that the company's reporting is transparent and accessible to customers and other stakeholders. Yorkshire Water has published performance information on the 'Our Performance – How we're doing page' of its website; this is accessed using the 'About us' and 'See how we are performing' links from the homepage. An archive of reports from earlier years is on the 'Our reports' web page, from the home page this can be accessed using the 'About us' and 'View our company reports' links.

Our assessment: **exceeds 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 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 has met our expectations in this area. We do not consider that any minor concerns identified materially impacted the plan outcomes or confidence in the data submitted. However, as recognised in the Ofwat representation on the draft water resources management plan ([Yorkshire Water draft WRMP19 consultation response](#)) there is need for further clarity on the Board's role in the decision making process, including the late adjustment to the ambition around leakage reduction in the published draft plan.

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 Yorkshire 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 seven years to 31 March 2025.

The company presented a clear and well-structured risk management approach with appropriate mitigating actions for the principal risks considered by the Board. The sensitivities tested were clearly articulated however an area of improvement would be provide more detail on the actions considered in relation to the results of the sensitivity testing.

The company has set out the internal assurance undertaken on the principal risks, however further information could have been included for the internal assurance of the long-term viability. There is clear signposting to the third party assurance provided by the external auditors.

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. The company's data was mostly correct, with some data being published and assured. The company used the wrong template for its original submission but we do not consider that this had 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.<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 sign off of the statement demonstrates clear endorsement from the entire Board.

The company has exceeded our expectations because the Board's statement is supported by a letter from the company's independent technical adviser which summarises the review it carried out of how the company assesses compliance with

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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.

its obligations. This is valuable in increasing the confidence of stakeholders in the statements being provided by the Board.

Our assessment: **exceeds 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 assurance plan is a substantial document, split into three main areas, (the approach to assurance, assurance activities - the targeted areas - and feedback from stakeholders and consumers). For 2018, there are twenty-four targeted areas identified with the majority being high risk. For these targeted areas, there are up to thirteen different assurance mechanisms and significant detail exists for the planned assurance to be undertaken for all targeted areas.

There is evidence of good engagement with stakeholders and evidence that comments have been addressed. The plan clearly sets out in detail the assurance activities done to date and the work that is still to be completed. Although quite long, because the assurance plan is structured in layers (providing increasing levels of detail) it allows readers to choose how much of the plan they wish to read. At all levels the plan is comprehensive.

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

The company has met our expectations in this area. All cost assessment tables were complete with no missing data. The company's reporting was generally robust with some helpful commentary, but we raised several minor queries resulting in some data changes. The company's accounting separation methodology was available and is an example of best practice. The company has provided a good breakdown of cost drivers and justifications for why they have been used. Its accounting separation methodology has been subject to internal and external audit.

Our assessment: **meets expectations**

## 1.10 Casework

### What we were looking for

This assessment relates to the information that companies provide to us when we engage with them to carry out our investigation and enforcement functions. We looked at companies' responses to cases from 1 April 2017 onwards. We considered companies' responses to our requests for information. We checked that companies had provided complete, accurate information within our timescales, and engaged effectively with us.

This assessment focused on our confidence in companies' information provision, and complemented the other assessments that focused on information published by companies.

## What we found

We closed one case concerning Yorkshire Water in the assessment period. This was a trade effluent appeal under section 126 of the Water Industry Act 1991. No assessment has been provided for this case as we did not require Yorkshire Water to provide any information in 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**

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 minor issues 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

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.

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