

Centre City Tower, 7 Hill Street, Birmingham B5 4UA
11 Westferry Circus, Canary Wharf, London E14 4HD

By email: [REDACTED]

Oliver Martin
Asset and Regulation Director
South East Water Ltd

21 December 2022

Dear Oliver

Monitoring Financial Resilience – Feedback

We are writing to you to provide feedback following our review of the financial data and information that was submitted in your Annual Performance Report (APR) for the year ended 31 March 2022. This letter includes general observations applicable to the wider sector and, in the appendix, feedback on matters specific to your APR submission.

We expect you to consider and address all the points set out in this letter as you prepare and plan for the 2022-23 APR and future submissions. In respect to dividends, where we have raised a specific point(s) of feedback, we require you to provide a response in writing to set out how you plan to address our concerns and the steps you are or will be taking to ensure you fully meet our expectations in future. We expect to receive this response no later than 31 January 2023.

The feedback in this letter is in addition to any feedback and requests for action you might have received in relation to APR data and information submitted relevant to the [Water Company Performance Report](#) (2021-22) and regarding [performance related executive pay](#).

APR Feedback

All water companies are required to publish information relevant to their financial performance and financial position in their APR. This APR data is a key source of information which we review and monitor over time and use to help form our view on the long term financial resilience of each regulated company. Some of the financial data submitted in companies' APRs for the year ended 31 March 2022 was recently published in our [Monitoring Financial Resilience Report](#) alongside our key messages and observations on financial resilience across the sector.

Each company is responsible for the integrity and assurance of the data and information that is reported in its APR. We expect all companies to review their reported metrics and outputs for accuracy and completeness in accordance with the latest Regulatory Accounting Guidelines (the RAGs).

This year we have completed a general review of the financial reporting tables and a specific review of dividend policies and decisions, the long term viability statement (LTVS) and ring-fencing certificate (RFC) submissions, together with financial flows data (Table 1F).

We have not carried out a detailed systematic assessment or audit of the reported financial data or information submitted.

Where material errors or omissions were identified we used a query process to clarify and, where necessary, companies corrected their reported information. Where changes and revisions have been made, we expect companies to republish their revised APR on their website accordingly.

Dividend policies and decisions

As monopoly providers of essential public services, water companies must be able to demonstrate to stakeholders that their approach to dividends engenders trust and accountability. In explaining dividend decisions and payments, all companies are expected to address all relevant factors, including clearly setting out how they have taken into account overall service delivery for customers and the environment, alongside their other commitments and the need for investment to support growth, long-term financial resilience and where necessary a turnaround of any poor performance.

Whilst our PR19 final determinations proposed a base dividend yield of up to 4% as a reasonable level, this was in the context of a company with little real RCV growth to support and that is performing in line with our determination in 2020-25. Consequently, we expect companies to be fully explaining dividends paid in their entirety, whether that is at the base yield or not and especially where it is above.

In 2021 we wrote to all companies about their dividend policies and provided feedback where reported dividend policies and the application of those policies did not meet the expectations that we had set out.

For 2022 we reviewed dividends on the same basis. Overall, while we consider there to have been some progress, we identified several companies that had again failed to meet our expectations to clearly set out and explain the link between their dividend decisions and payments with performance delivery for customers. Considering the substantial concerns we, and other stakeholders, have expressed on this issue for some time, this is very

disappointing. For those companies that did not meet our expectations we have provided feedback in the appendix.

As noted above, if feedback has been provided regarding dividends, we expect you to deliver a written response outlining the steps you are or will be taking to address our concerns.

We highlight that as regulatory requirements and stakeholder expectations evolve over time, we expect all companies to be reviewing and updating their policies on an ongoing basis.

Long term viability statements

All companies are required to provide a statement on their long term viability (the LTVS) either in their APRs or Annual Reports. It is important that the LTVS submitted is clear and specific to each company so that a reader can understand the basis on which the Board of Directors (the Board) has reached its conclusion i.e., on whether they believe the company will be able to continue in operation and meet its liabilities as they fall due over the period of the assessment period.

Our information notice [IN 19/07 – Expectations for companies in issuing long term viability statements](#) provides guidance for companies in preparing their LTVS and sets out our expectations, including that companies should test their forward looking financial and operational plans against severe but plausible scenarios reflecting the principal risks they have identified. Further to feedback provided in December 2021, we reminded companies in May 2022 of these expectations and the need for transparency.

Our review of the statements submitted for 2021-22 found the level of detail in certain areas remains inconsistent across companies, particularly in relation to the stress testing that has been carried out. For 2022-23 we expect all companies to clearly set out the sensitivities that they have applied to their base case to test the potential impact of the principal risks identified, the outcome of that testing across the assessment period and the mitigation that is reasonably available to remove or limit that impact.

Where we consider improvement in transparency is needed specifically, we have set this out in the appendix and expect you to address this in next year's LTVS.

Ring-fencing certificates

The ring-fencing certificate (the RFC) is a certificate stating that in the opinion of the Board, the company has sufficient resources to enable it to carry out its Regulated Activities, for at least the twelve month period following the date on which the certificate is submitted to Ofwat. The RFC is a licence requirement (Condition P31 for most companies).

For 2021-22 all companies provided a RFC, however several companies did not fully meet our expectations as set out in our guidance [IN 20/01 Requirements and expectations for ring-fencing certificates](#). Where we identified errors or omissions in carrying out our review, these were raised with the company for correction.

In the appendix, where applicable, we have set out the key issues that we raised with you together with general points of feedback regarding your RFC. We expect all feedback to be addressed in next year's RFC submission.

Restatement of prior year accounts

This year we noted that several companies had restated their financial statements in respect of prior years for presentational reasons and/or due to errors identified.

In this situation we expect companies to provide us with details of any figures which have been restated and the reasons for those restatements. We also expect companies to provide us with an update of any APR tables where changes are necessary as a result of the restatements of their statutory accounts. This is important to ensure comparability of the information that is available to stakeholders.

Should you have any queries or wish to discuss any of the matters raised in this feedback (general or specific) please do not hesitate to contact either me or [REDACTED] [REDACTED] in the first instance.

Yours sincerely

[REDACTED]

John Russell
Senior Director, Strategy, Finance and Infrastructure

Enc (or Encs)

Appendix - Company specific feedback

Dividends

Our assessment concluded that the company's dividend policy, application of the policy and the dividend narrative published in the APR was generally in line with our current expectations. As a reminder, future dividend payments and disclosures must be made in line with requirements and expectations in place at the time, including any that may arise from our proposal to strengthen the dividend policy licence condition and any changes to dividend reporting requirements in the RAGs.

Long Term Viability Statement (LTVS)

No material issues to feedback. The LTVS this year met expectations in most respects.

Ring-fencing Certificate (RFC)

The RFC this year met our requirements and expectations in most respects, with a minor point of feedback to address in next year's RFC:

- The RFC did not state where the auditor assurance statement from PwC could be found. It should have referred readers to the overall auditor assurance statement included in the APR on pages 22-25. The RFC should also have set out that an auditor assurance statement specific to the RFC had been separately submitted to Ofwat.

Financial Information

- A breakdown of net interest paid reported in Table 1C was not provided in the APR as required. This information is needed to support calculation of interest cover ratios.
- The non-household (business) retail market opened to competition in April 2017, following which all companies except for Hafren and Dŵr Cymru exited the non-household retail market. The company however continues to incorrectly report a business retail margin. Whilst not material, the company does not operate or have a separate business retail price control, and therefore all relevant revenue and cost should be captured in the household retail margin.

Financial Flows

- No material matters identified to feedback.