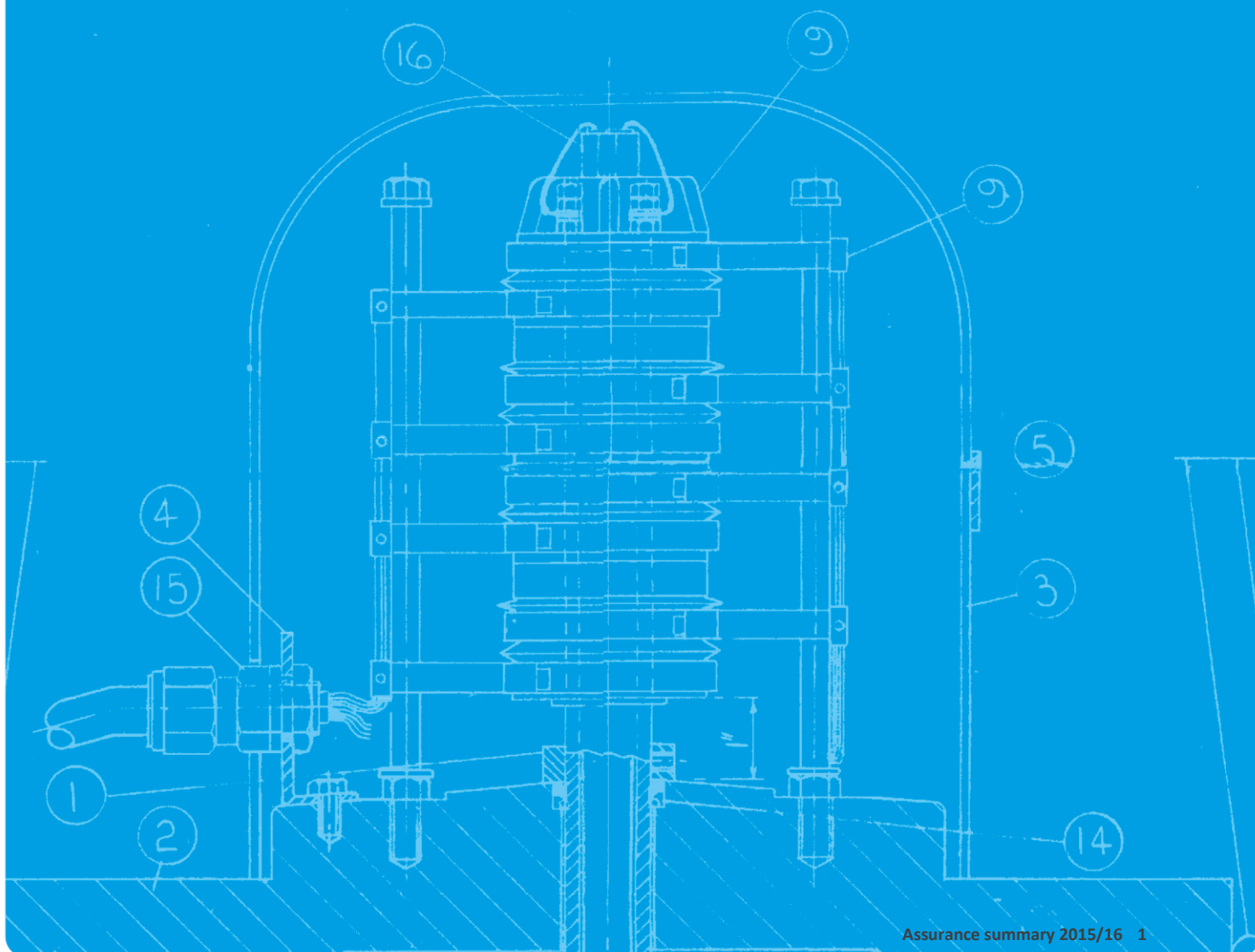


# Assurance summary 2015/16

July 2016



## About this document

*Severn Trent Water is one of the largest of the ten regulated water and sewerage companies in England and Wales. We strive to provide high-quality services to more than 4.3 million households and businesses in the Midlands and mid-Wales. Our customers pay the lowest average bills in the UK.*

By 2020, we want to be the most trusted water company: delivering an outstanding customer experience, the best value service and environmental leadership.

Every year we publish a wide range of information about our services and our performance. This information is used in a variety of ways; not least it may shape the choices our customers and stakeholders make. We therefore want to make sure that it can be relied on.

This document summarises the outcome of our assurance plans for this year.

### Background

As we developed our [business plan for 2015-20](#), we recognised that the introduction of performance commitments with associated Outcome Delivery Incentives (ODIs) would create a new area of focus for our assurance plans.

There are 45 performance commitments in our plan. Of these performance commitments, 33 have financial rewards and penalties attached to them as ODIs – which may impact our customers' bills. These performance commitments and financial ODIs were agreed with Ofwat in its [2014 Final Determination](#). We are one of just three companies able to apply some of these ODIs during the 2015-20 period (i.e. before our plan is completed).

In recognition of this, we set out detailed proposals for assurance in our business plan with the aim of ensuring that our customers and stakeholders can trust the data and information that we provide on our performance.

### Ofwat's company monitoring framework

Ofwat's company monitoring framework (published in June 2015) set out its expectations for how it will oversee the information that water companies provide to our customers. There are 18 water companies serving household and business customers in England and Wales – 10 provide water and wastewater services. The remaining eight provide water only. Under its company monitoring framework, Ofwat assessed Severn Trent and 14 other companies out of the total of 18 as requiring targeted assurance. This means we need to work with our customers and stakeholders to target issues, and consult on our draft assurance plans to make sure they are sufficient to address them.

We are supportive of this approach – we cannot expect to build and maintain the trust of our customers and stakeholders if we do not first understand if they have any concerns, and then seek to address them.

## Using customer and stakeholder engagement

This document marks the end of a 10-month long programme of work.

- In September 2015 we carried out customer and stakeholder research to better understand how they use the information we produce and the extent to which they trust it. This built on our established channels of 'business as usual' engagement with our regulators, investors, customers and other stakeholders. We used this information, and our own assessment, to produce a **statement of risks, strengths and weaknesses**. Section 1 of this document summarises that statement.
- In November 2015 we published a written consultation on our risk statement and a **draft assurance plan for 2015/16**. Our assurance plan set out how we proposed to respond to our risk statement. We asked for views about whether it was sufficient to mitigate the risks identified.
- In March 2016, we published our **final assurance plan for 2015/16** which takes into account comments from our stakeholders.
- This document summarises the outcome of the assurance we have undertaken. Its main focus is the data assurance undertaken for our **Annual Performance Report**. It should also be read in conjunction with our Board's **Annual Compliance Statement**.

# 1. Our assurance plans for 2015/16

*In this section we summarise our statement of risks strengths and weaknesses. We also provide an overview of our approach to assurance during 2015/16.*

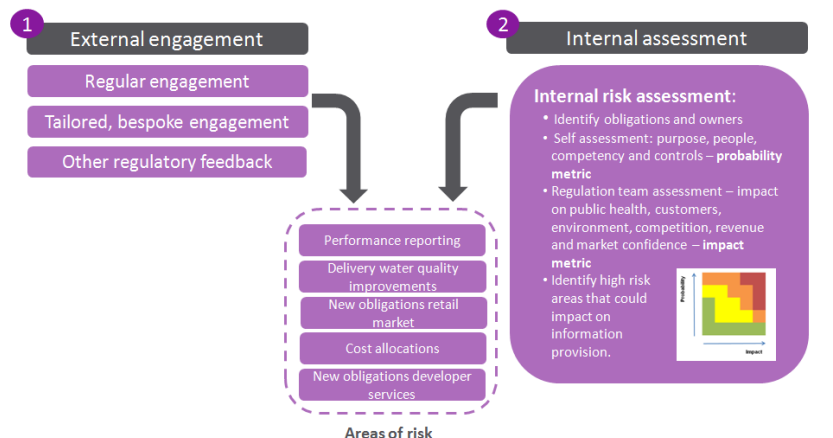
## 1.1 Statement of risks, strengths and weaknesses

Figure 1 below illustrates how we developed our statement of risks, strengths and weaknesses using two inputs:

1. External engagement. We built upon our existing channels of engagement by asking our regulators, customers and other stakeholders about how they use information we produce and whether they have any concerns about the integrity or quality of that information.
2. Internal assessment. We used a framework to identify potential risks to complying with our statutory and regulatory obligations (relating to our regulated water business). This assessment considered the probability of not complying, and the impact.

This was a separate exercise to the assessment of risks inherent in our business activities and mitigation measures, which we include in our [Annual Report and Accounts](#).

**Figure 1: Approach to developing this risk assessment**



The risks we included in our statement principally reflect:

- new reporting requirements and statutory obligations; and
- other changes in our external environment or our customers' and stakeholders' expectations.

They were:

1. Performance reporting – performance commitments and ODIs.
2. Cost allocations (and segmental reporting).
3. Delivery of drinking water quality improvements.
4. New obligations for the retail market.
5. Voluntary reporting on developer services.

In section 2 of this document, we explain the outcome of our assurance to mitigate risks 1 and 2 above. They are both important components of our new Annual Performance Report. In section 3 we provide an update on assurance of the other three risks, and our annual assurance activities more broadly.

## 1.2 Our approach to assurance

We have an established assurance and performance reporting framework. Our assurance plan for this financial year, 2015/16, continued the processes we have developed for reporting of company KPIs in our annual report and accounts and for regulatory submissions in previous years.

Our framework is underpinned by four key principles:

- *Robust assurance* – we operate a three-lines of defence model, targeted at areas of greatest risk.
- *Ownership and accountability* – we have clear lines of ownership for both the delivery of performance, and the accuracy of the data provided.
- *Effective governance* – provided by our Board, Audit Committee, Disclosure Committee and with additional challenge provided by the Water Forum.
- *Transparency and public accountability* – we publicly report on our performance, and hold ourselves to account where we do not meet our commitments.

In this section we provide an overview of each principle.

### Robust assurance

We have an established approach to internal controls and related assurance. We operate a ‘three lines of defence model’ which distinguishes between first line processes and controls, second line oversight and third line independent assurance.

**Table 1: Three lines of defence model**

Line	Functions	Purpose	Typical activities
1a	<i>Business operations:</i> Wholesale operations, Customer teams.	Responsible for the delivery of service and performance.	<ul style="list-style-type: none"><li>• Provision of source information.</li></ul>
1b	<i>Embedded first line:</i> Wholesale finance and performance, Retail planning and performance.	Responsible for the reporting of performance.	<ul style="list-style-type: none"><li>• Reporting of performance information.</li><li>• Defining and documenting methodologies and processes.</li><li>• Quality checks and reviews.</li></ul>
2	<i>Oversight functions:</i> Chief Engineers Office, Finance, Regulation, General Counsel.	Define policy and provide assurance.	<ul style="list-style-type: none"><li>• Development of assurance framework.</li><li>• Quality checks and reviews of systems and controls.</li></ul>
3	<i>Independent assurance:</i> Internal Audit, external assurance providers.	Provide independent challenge of levels of assurance provided by first and second line.	<ul style="list-style-type: none"><li>• Review methodologies and processes.</li><li>• Review application of methodologies and processes and ultimate integrity of the data.</li><li>• Review completeness and appropriateness of assurance framework (Internal Audit).</li></ul>

Assurance is a year round activity for us. First and second line activities are on-going, continuous processes that are undertaken throughout the year. For areas identified as higher risk, or where we have specific reporting obligations (eg financial accounts), we employ external third line assurance at relevant points during the year, much of which is brought together and culminates in our year-end financial and performance reporting.

Section 2 sets out where we employed third line assurance this year (2015/16) in order to produce our Annual Performance Report.

## Ownership and accountability

Strong personal and collective ownership is critical for ensuring the accuracy of information we produce, driving improvements and holding ourselves to account. Regular internal performance reporting to our Executive Committee (weekly and monthly) and Board (at every meeting), and half-yearly performance reporting to the Water Forum reinforces this culture of ownership and accountability. Every year we refresh our compliance framework to ensure that individual accountabilities are assigned to our regulatory and statutory obligations. And we operate a rigorous process of sign-off for our performance data – sign-off by the data owner, the responsible senior manager and finally the accountable director in addition to our Board governance arrangements (see below).

Our three lines of defence assurance model ensures that there is clear separation of accountabilities between those responsible for delivery of a performance commitment or a regulatory/statutory obligation and those responsible for ensuring the integrity of that data. This division is mirrored in our governance arrangements.

## Effective governance

As a publicly listed company we have committed to comply with reporting requirements under the UK Corporate Governance Code, the Transparency Directive and UKLA Listings Rules. Ofwat's June 2014 'Commentary on company governance codes' assessed our governance code as fully meeting its principles.

Our assurance plans provide for governance of our performance commitments and other external reporting with a clear delineation of accountabilities.

- The Board's role is to meet its obligations to the company's stakeholders. It reviews performance in the light of the company's strategic objectives and business plan commitments – ensuring that any necessary corrective action is taken.
- The Board's Audit Committee assists the Board in discharging its responsibilities for the integrity of the company's financial statements, the assessment and effectiveness of internal controls and the effectiveness of internal and external auditors.
- The Board's Disclosure Committee oversees the company's reporting obligations under the Companies Act 2006, the UK Corporate Governance Code and the UKLA Listings, Disclosure and Transparency Rules.
- The Water Forum provides independent external challenge of both our performance against our commitments and the information we provide on it.

## Transparency and public accountability

Since 2008 we have had a Continuous Disclosure and Communications policy. This sets out our commitment to earn the trust of our customers and stakeholders by being open in our communications and performance reporting.

Our communications are based on transparency, integrity, accessibility and timeliness. Each year we publish annual reports and accounts for Severn Trent Plc and Severn Trent Water Ltd and have historically published an annual performance report against our regulatory KPIs for the latter.

This year we continue to hold ourselves publically to account with the publication of our Annual Performance Report. We are also publishing a report specifically tailored to our customers.

## 2. Assurance of our Annual Performance Report

*In this section we explain how the data included in our Annual Performance Report has been assured, and the outcome of that assurance.*

This is the first year of delivery of our new business plan for 2015-20 (under the controls set out in Ofwat's 2014 Final Determination). Our new Annual Performance Report, which incorporates the reporting requirements of Ofwat's Regulatory Accounting Guideline 3.08, sets out both our financial and non-financial performance during this first year.

The Annual Performance Report comprises four sections:

- regulatory financial reporting
- price review and segmental reporting
- performance summary, and
- additional regulatory information.

We summarise below the assurance undertaken for each section, and the outcome of that assurance.

### 2.1 Regulatory financial reporting

This section of the Annual Performance Report provides a baseline level of historical cost financial information which is aligned to our price controls (and associated regulatory performance commitments and incentives) set out in Ofwat's 2014 Final Determination.

Data for this section is produced consistent with the definitions set out in Ofwat's Regulatory Accounting Guidelines, Accounting Standards and our own published accounting policies.

Deloitte LLP ('Deloitte'), Severn Trent Water Limited's statutory auditor, audit this section and Section 2, which together form the Regulatory Accounting Statements. Deloitte have provided an audit opinion on the Regulatory Account Statements, which is set out in full in the Annual Performance Report.

### 2.2 Price review and segmental reporting

This section of the Annual Performance Report provides a more detailed disaggregation of revenue and costs.

Data for this section is audited by Deloitte as explained above.

Deloitte's audit opinion does not extend to the appropriateness of the methodology used to allocate costs. Furthermore, as we completed our statement of risks, strengths and weaknesses, we assessed cost allocations as an area of risk. Our assessment recognised that Ofwat's decision to assign Severn Trent to 'targeted' assurance was in part based on a query regarding cost allocations raised in our business plan - and although Ofwat were satisfied with the additional information provided in response, and subsequent regulatory accounts submissions – we recognise that the pending introduction of non-household competition would heighten the impact of any material error in the future.

In the light of the above, we asked Jacobs Consulting (Jacobs), our independent technical assurers, to review our cost allocation processes in more detail.

### Outcome of Jacobs' assurance

Jacobs' findings identified that there was scope to include a higher degree of precision in some areas. We recognise the importance of ensuring a high degree of accuracy and this remains an area of focus for us over the coming financial year.

Jacobs have also undertaken additional assurance in relation to specific cost allocations and compliance with RAG 5.06 which were identified as higher areas of risk. Further information is included in section 3 of this document.

## **2.3 Performance summary**

This section of the Annual Performance Report explains how we have progressed against our 45 performance commitments in the first year of delivery of our business plan.

Independent technical assurance on our performance commitments is provided by Jacobs. It is our duty to openly and fully disclose all information to allow Jacobs to effectively challenge us. Our Audit Committee seek assurance from Jacobs directly that this has been the case.

Jacobs undertake assurance using a staged approach; this process is completed in full before any internal sign-off of data (using the governance described in section 1) occurs.

Stage one focuses on process. During stage one, Jacobs review the process description templates (PDTs) which are followed in order to report against performance commitments. Stage one includes both desktop reviews and face-to-face interviews. These reviews ensure that:

- Processes are in place to produce data that are consistent with the performance commitment definition.
- Improvements and changes in processes from previous assurance rounds are clearly stated.
- Accountability and responsibility of each stage of the process is clear with dependencies, risks and mitigations identified.
- There is appropriate quality assurance with checks and controls identified.

Stage two focuses on data produced and associated commentaries which explain our performance in more detail. Audits are carried out in person with the responsible data owners. These audits ensure that:

- Data produced are consistent with the PDT and any deviations from this are identified and evidenced.
- Any rewards/penalties or further data points are calculated in line with Final Determination requirements.
- Commentaries accurately reflect the data and performance within the year.
- All individuals within the approval process have signed-off the data and commentary.

As we undertook our risk assessment last year (to inform our statement of risks, strengths and weaknesses), we identified performance commitment reporting as a key area of risk. This assessment considered the likelihood of an issue occurring. For example, many performance commitments require new reporting procedures to be developed. It also considered the potential impact. For example, outperformance on ODIs can directly impact customers' bills.

The assurance undertaken this year reflects that level of risk. Stage one and stage two reviews of all 45 performance commitments have been carried out at both the half and full year.



### Outcome of Jacobs' assurance

Stage one and stage two reviews of all performance commitments were undertaken halfway through this financial year (October 2015). The outcome of this assurance allowed us to identify three areas of risk where more targeted assurance was required before financial year end:

- **Categorisation of drinking water quality complaints.** Jacob's half year review highlighted concerns about the quality of input data (particularly the categorisation of complaints) for this performance commitment. We completed data checks of over 16,000 records which indicated an error rate of less than 1%. We amended our reporting processes to ensure there is greater quality assurance embedded prior to financial year end.
- **Mains bursts.** Jacobs' review identified that our method of measuring mains bursts had the potential to report a single incident as multiple bursts. Subsequent investigation found that the duplication averaged c.11% in any given year. This duplication was embedded into our final performance commitments.

We have now rectified our reporting processes. As a result it will appear that we have improved against our performance commitment by 11%, without any actual change in performance. To compensate for this, we have introduced a 'shadow' performance commitment that has been adjusted by 11% each year; the point at which a penalty is incurred has been similarly rebased. For transparency we have reported both figures in our Annual Performance Report.

We have discussed our proposed amendment with the Water Forum who supported it as being in the interests of customers. We also explained this change to Ofwat.

- **Sewer flooding.** Jacobs' assurance highlighted a potential weakness with the way that sewer flooding incidents were being allocated to private assets (those not owned by Severn Trent) and excluded from our performance reporting.

A further internal review found that overall our processes are robust. However, in a small number of cases (less than 5%), incidents that have been recorded as something other than flooding are being retrospectively reviewed and changed to a flooding incident on the basis of evidence collected. The full dataset of cases for 2015/16 have been reviewed and reporting processes are being revised for 2016/17. GSS payments are being made to customers where re-categorisation has taken place.

As part of its year end assurance, Jacobs reported material weaknesses in our reporting for two performance commitments:

- **Successful catchment management schemes.** The 2014 Final Determination does not define in detail what constitutes a 'successful' catchment management scheme. We recognise the need to demonstrate that success has been determined objectively, and as such we propose using a suite of KPIs. These KPIs have been discussed with the Water Forum and we will continue working with members regarding their application. The KPIs undergo independent audit by an expert third party. In its year end assessment, Jacobs reported that the coverage of this third party audit should be extended.

Our committed level of performance is to deliver 12 schemes by 2018/19, with no interim targets. This year we are reporting zero schemes delivered. We therefore believe weaknesses in our reporting this year represent a low risk to customers and stakeholders. The issues will be addressed in time for 2017/18 reporting.

- **Biodiversity improvements.** There is an inconsistency between the definition of this performance commitment used in the 2014 Final Determination and that used to assess our baseline performance – namely that the former excludes the condition of land that is not owned by us, but may be impacted by our operations.

Our intent when setting the performance commitment was to make a contribution to biodiversity in our region, regardless of whether we were in direct ownership of the land. We are therefore proposing to include land both in our ownership and impacted by our operations in our assessment. We recognise, as identified by Jacobs, that this interpretation represents a risk to our reporting if it is not accepted by stakeholders, including Ofwat and Natural England. We are also working with Natural England to agree a methodology that provides confidence to stakeholders that it is our activities that have delivered the required improvement.

Our committed level of performance is to deliver improvements to 75 hectares of land by 2019/20 with no interim targets. This year we are reporting a deterioration of c.5 hectares based on a re-assessment of condition undertaken by Natural England. We therefore believe weaknesses in our reporting this year represent a low risk to customers and stakeholders. We expect to reach agreement with Natural England and resolve the issues noted above ready for 2017/18.

Our assurance identified eight further performance commitments where the definitions agreed with Ofwat in its 2014 Final Determination when applied could be open to interpretation. We discussed this ambiguity with the Water Forum. In section 3 of our Annual Performance Report, we explain where this ambiguity exists, and for transparency, set out the interpretation we have used for reporting.

Finally, during the course of the year, we identified **leakage** as an area where we wanted to place greater assurance focus. Leakage is a priority area for our customers. It is also one of the most complicated performance commitments to calculate, relying on a number of datasets and methodological assumptions. We therefore asked Jacobs to ‘deep dive’ into our approach.

As part of our own review and confirmed by Jacobs’ deep dive, a minor calculation error was found in our leakage figure for 2014/15. We are consequently restating our performance in 2014/15 as 444MI/d (from 441MI/d). This performance remains within our regulatory target for that year.

Jacobs have also tested where we have proposed changes to the methodological assumptions in our leakage measurement this year. These changes are explained in more detail in Section 3 of our Annual Performance Report.

## 2.4 Additional regulatory information

This section of the Annual Performance Report contains additional financial and non-financial information, including accounting policies, financeability statement, current cost reporting, totex analysis.

Table 4a includes non-financial information on the number of properties and volumes served. Jacobs assure this table using the two stage process set out in section 2.3 above. Jacobs’ full year review did not find any material weaknesses in our reporting processes or final data provided.

Tables 4b to 4g include additional financial information. Assurance for these tables is provided by Deloitte, who have performed a series of agreed upon procedures to confirm the accuracy of the calculation of the data and extraction from source records.

### 3. Additional assurance activities in 2015/16

*In this section we summarise additional assurance activities undertaken in 2015/16 as part of our company wide assurance plans.*

In our assurance plan for 2015/16, we set out a number of other areas where we would be undertaking assurance (in addition to the Annual Performance Report).

This plan did not detail every assurance activity that we carried out this year, particularly using first and second lines of defence, but rather focused on the key areas of risk identified in our statement of risks, strengths and weaknesses, as well as where we have established third-line assurance processes (for example, audit of statutory accounts) that we have continued.

An update on these assurance activities is set out below.

- **Charges scheme.** Our charges scheme for 2016/17 was approved by a Board Committee in January 2016. Assurance was undertaken by Deloitte and Jacobs, and was reported to the Board's Audit Committee prior to approval. No material issues were outstanding.
- **Severn Trent Water Ltd's statutory accounts.** Severn Trent Water's statutory accounts are audited by Deloitte. Deloitte's audit opinion is included with the statutory accounts.
- **Access prices.** We have an established process to calculate indicative access prices. Input data is updated each year. Jacobs' review this year found no material issues.
- **Preparations for non-household competition (Water Act 2014).** Incumbent licensees are required to provide letters of assurance to Ofwat and Defra regarding progress with their preparations. External assurance of the Severn Trent Plc's market readiness programme (including relevant licensees within the group) was undertaken by PwC. The Severn Trent Plc Board submitted its first letter of assurance in February 2016.

Severn Trent subsequently announced our intention to form a Joint Venture with United Utilities to operate in the non-household retail market. This materially altered the retail plans which our initial letter of assurance was based on. Assurance of the revised plan was undertaken by PwC and a revised letter submitted in April 2016.

- **Cost allocations.** In addition to the activity set out in section 2.2, Jacobs have undertaken a review of cost allocations in three targeted areas of risk to ensure consistency with RAG 5: 'green power' contracts with our non-appointed business; transitional service agreements with the proposed JV; and non-household metering.
- **Voluntary reporting on developer services.** Internal Audit have reviewed the processes and methodologies for the voluntary reporting of developer services metrics to Water UK. The compiling and reporting of these metrics will be reassessed by Internal Audit during 2016/17.
- **Drinking water quality improvements.** Our 'Cleanest Water Plan' was created to provide stronger governance around a programme of improvements designed to target performance issues. Internal Audit has reviewed specific elements of the Cleanest Water Plan to confirm that the programme was delivering

the planned improvements. During 2016/17, Internal Audit will assess whether the benefits have been delivered, improvements sustained and assess progress against any new planned improvements.

- **Strategic casework.** We have been working with Ofwat as it investigates the provision of sewerage services to 23 properties in Derbyshire. Whilst Ofwat has indicated that it is not its current intention to pursue this investigation further under section 203 of the Water Industry Act 1991, we remain committed to finding a resolution and are providing regular reports to Ofwat under the case management of a senior leader.

