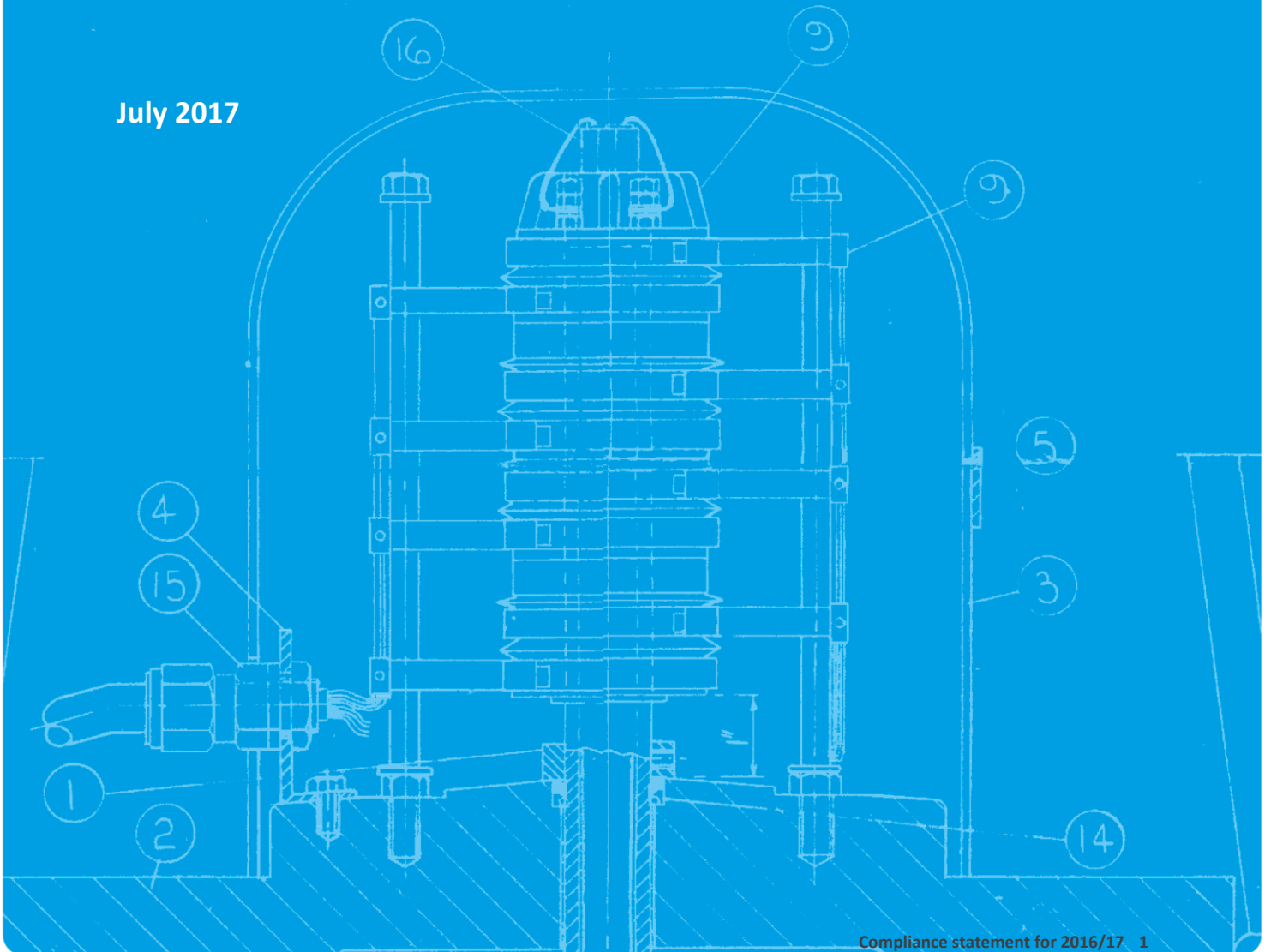


Risk and compliance statement 2017

July 2017



1. Statutory and regulatory obligations

The statutory and regulatory obligations pertinent to our functions as a Water and Sewerage Undertaker are primarily set down in the Water Industry Act 1991 and our Instrument of Appointment - the "Licence". The Licence also requires us to perform duties imposed under any other statutory and regulatory obligations as necessary to fully discharge our duties as a Water and Sewerage Undertaker.

Our approach to achieving compliance with our statutory and regulatory obligations is based on establishing sound governance and systems of internal controls. We set ourselves high standards, though it is important to understand that such systems cannot provide absolute guarantees.¹

Our Director of Strategy and Regulation – Dr Tony Ballance - is accountable for the compliance framework relating to our Licence and other statutory and regulatory obligations. Tony is supported by the Regulatory Compliance team which reports to him. We introduced a new compliance framework last year to provide a robust process to set high levels of compliance backed up by rigorous assurance. Responsibility for compliance with specific Licence conditions and obligations are assigned to individual strategic leaders within Severn Trent Water relevant to their areas of responsibility. This includes the development, implementation and testing of controls to ensure compliance in areas such as policy and standards, procedures, supervision, training, and management information. An annual process of self-certification takes place to inform this compliance statement.

As the evolution of regulation continues so does the evolution of our compliance framework. Over the last year our Licence conditions have been updated to reflect industry changes such as the opening of the Non-household Retail market and introduction of new Market Codes. Our compliance framework has been updated to reflect these changes and those of the organisation, most notably to include the overview of Water Plus, our joint venture with United Utilities, who have held the responsibility for discharging our non-household retail statutory and regulatory obligations since 1 June 2016. In relation to these obligations, the Board has received assurances from the Water Plus Select Ltd Board, commensurate with the statements set out in section 5 below.

The Severn Trent Plc Board holds ultimate responsibility for our system of internal control which they and the Audit Committee review annually in May. Our Internal Audit team support the Audit Committee in evaluating the design and effectiveness of internal controls and risk mitigation strategies. As part of this, Internal Audit complete an annual cycle of formal reviews agreed by the Audit Committee which cover the material business risks and key processes of the company. A number of these formal reviews address aspects of the overall framework for compliance with our statutory and regulatory obligations. The audit findings from these formal reviews are shared both with management and with the Audit Committee.

Internal Audit also maintain an Assurance Map for our significant risks, as identified through the Enterprise Risk Management (ERM) process. The Assurance Map assesses the effectiveness of assurance across the three lines of defence for our significant risks with a six monthly report produced for Audit Committee to highlight areas for improvement.

During the year, the Board has considered the company's performance against the commitments and obligations set out in the 2014 Final Determination. The company's performance, including where commitments have not been met, is set out in its Annual Performance Report.

¹As set out by the Financial Reporting Council, Corporate Governance, Guidance for Directors on Risk Management, Internal Control and Related Financial and Business Reporting, September 2014 <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Risk-Management,-Internal-Control-and.pdf>

The Board has also considered any potential departures from the statutory and regulatory obligations explained above. Departures are set out in Annex 1.

2. Customer expectations

In last year's compliance statement we recognised the importance of our commitment to delivering outcomes that reflect our customers' views and environmental needs - through the customer Outcome Delivery Incentives (ODIs) we developed for our 2015 – 2020 (AMP6) business plan.

The customer ODIs provide a transparent mechanism by which we can demonstrate to our customers whether the performance they have received from us is subject to a reward or penalty. We believe the customer ODIs provide strong incentives for us to innovate and become more efficient, protecting our customers against instances of under-delivery and where merited, rewarding us for outperformance in areas where customers are willing to pay more to receive more of what they want.

Throughout the year we have continued to work with our customer challenge group, the Water Forum, to demonstrate how we are delivering on our ODIs. We have discussed our year-end performance and customer ODI results with the Water Forum - including the amount of reward/penalty we propose to recover through our customers charges for the year 2018/19.

3. Managing risk

Our vision is to be 'the most trusted water company in the UK by 2020'; this desire aligns closely to Ofwat's shared vision 'where customers, investors and wider society have trust and confidence in vital public water and wastewater services'. Consistent with the Company Monitoring Framework (CMF) we have considered the risk to customer 'trust and confidence' in the context of provision of accurate data and our ability to demonstrate we are listening to their needs and delivering the services they want and can afford.

We are pleased that in November 2016, under the CMF, Ofwat re-assessed companies and moved Severn Trent from 'targeted' into the 'self-assured' category. Whilst we are no longer required to consult on our assurance plans, our aim is to remain self-assured by proactively engaging with our customers and stakeholders to hear their views about our data.

Last year, we conducted a wide ranging survey with customers and stakeholders to establish the levels of trust they have in the information that we produce and their priorities for our future assurance plans. This year we wanted to expand on this question further by understanding how our customers prefer our information to be presented to them. In particular we wanted to examine how well they understood the link between our customer ODI performance and the impact on bills to ensure our reward/penalty mechanism is transparent to our customers. In October and November we undertook a series of customer focus groups and used this information, along with our own assessment, to produce a statement of risks, strengths and weaknesses.

We continue to use our Enterprise Risk Management (ERM) process to manage our significant risks. The ERM process identifies possible risks, their causes and potential impacts. This allows us to focus on having the right controls in place to manage those risks by considering how to minimise the likelihood of these risks occurring and how to maximise our resilience against them.

The Audit Committee reviews the processes for and outputs from ERM, the effectiveness of the risk management system on behalf of the Board, and keeps under review ways in which to enhance the control and assurance arrangements. Every six months the Chief Financial Officer reports our significant risks to the Audit

Committee and provides an assessment of the effectiveness of controls over each risk along with an action plan to improve controls where needed. This year we have enhanced ERM reporting through the introduction of a reporting dashboard. This provides the Audit Committee with clarity and insight leading to a more thorough review of the target risk positions, considering risk appetite and whether improvement actions to achieve these are on target with the correct prioritisation in place. It has ultimately meant that more information can be reported and reviewed, but in a clear and concise format.

In addition, individual risks or specific risk topics are also discussed by the Board during the year. Our risk management approach including the key regulatory risks and how these relate to our business model is outlined in more detail in our Severn Trent Plc Annual Report and Accounts.

4. Assurance of our performance reporting

In order to maintain trust and confidence with our customers and other stakeholders, it is essential that we provide accurate information as the basis for any conversations or publications relating to performance. This commitment extends beyond data alone to include the presentation and explanation of such data in a manner which is both relevant and fair, balanced and understandable. Having information that is easy to understand and navigate provides transparency and helps build trust and confidence.

We have a well-established, rigorous assurance and performance reporting framework. Our assurance plan for this financial year, 2016/17, continues the high standard processes we implemented in last year's assurance plan, commensurate with a self-assured company, for reporting our performance commitments in our Annual Report and Accounts and Annual Performance Report.

In March we published our final assurance plan for 2016/17 setting out the activities planned to mitigate the risks identified in the risks, strengths and weaknesses statement. Details of the assurance carried out and the outcome of the assurance can be found in our Assurance Summary 2016/17.

Overall accountability for the preparation and production of the Annual Performance Report (which includes reporting of performance against performance commitments and associated ODIs) rests with the Director of Strategy and Regulation. The outcome of the assurance undertaken is reviewed by the Audit Committee on behalf of the Severn Trent Plc Board.

We have a well-established approach to internal controls and related assurance. We operate a 'three lines of defence' model within Severn Trent Water which distinguishes between first line processes and controls, second line oversight and third line independent assurance. We use this model for our regulatory returns so that we have a level of assurance that these submissions have been well prepared - consistent with our established internal processes. These processes are outlined below and the outcome of the assurance is set out in our Assurance Summary 2016/17.

First, our operational teams have well documented processes to ensure that they produce accurate and complete data. This is based on rigorous controls and ensures that there are:

- Clearly defined accountabilities and responsibilities.
- Documented methodologies for preparation of each of the individual performance commitments and related Ofwat data tables.
- Training and facilitation of information providers.
- High levels of automation in data handling to reduce the potential for error.
- Extensive internal and external assurance of methodologies, processes, data, controls and conclusions.
- Sign off of data by data owners, performance commitment owners and Directors.

These documents are updated regularly and where changes have been made to processes on key risk areas, we perform assurance checks at both the half and full year.

Secondly, our Compliance team was responsible for developing the assurance framework, to include oversight and challenge of the output from the operational teams.

Finally, we undertook independent assurance both from Internal Audit and from third party providers - Deloitte and Jacobs. Financial aspects of the Annual Performance Report were audited by Deloitte with Jacobs providing assurance over the performance commitments and associated customer ODIs.

While, in this transitional year, the cost assessment information is not included in Ofwat's reporting requirements for the Annual Performance Report itself, we have included this as part of our year end assurance processes for that document. A risk based approach has been taken to assure historic data and careful consideration has been given to the appropriateness of confidence grades applied and transparency about the assumptions made.

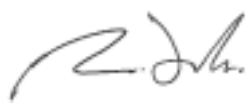
In addition, Internal Audit have conducted a number of formal reviews throughout the year in line with their annual cycle agreed by the Audit Committee, and have reviewed the completeness and sufficiency of assurance of this year's submissions.

5. Board statement

Having taken into consideration the above:

- We have a full understanding of and we comply with our statutory, licence and regulatory obligations in all material respects. Departures are set out in Annex 1.
- We have taken appropriate steps to understand and meet customer expectations.
- We have sufficient processes and internal systems of control to fully meet our obligations.
- We have appropriate systems and processes in place to identify, manage and review our risks.

Signed by and on behalf of the Board:



Andrew Duff
Chairman
Severn Trent Water Ltd



Liv Garfield
Chief Executive
Severn Trent Water Ltd



John Coghlan
Chairman – Audit Committee
Severn Trent Plc

Annex 1 – Obligations – Departures from the statement

Description of duty / obligation	Purpose of duty / obligations	Disclosure
Water Industry Act 1991 section 86A	Procedure for dealing with complaints	<p>During this financial year, we identified that one of our third party contractors had not been passing on complaints to Severn Trent Water that have been sent directly to a specific email inbox that was created in 2015.</p> <p>As a result, we have reviewed all customer emails to the inbox retrospectively and have updated our reported performance. We are now ensuring that customer contacts made through this third party contractor are reported through our established managed processes.</p>

