

Risk and compliance statement 2018

July 2018

WONDERFUL ON TAP



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 in 2015 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 senior 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-certification² takes place to inform this compliance statement.

As the development of regulation continues so does the evolution of our compliance framework. Over the recent years our Licence conditions have been updated to reflect industry changes such as the opening of the business retail market and introduction of new Market Codes. Our compliance framework has been updated to reflect these changes and those of the organisation, and this year we have included the changes made to the Reservoir Act 1975 and our licence conditions.

Our compliance framework accounts for the role 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 and, 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 it reviews annually in May. It is assisted in this regard by the Board’s Audit Committee, which assesses the design and effectiveness of internal controls and risk mitigation strategies, supported by our Internal Audit team. 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 and recommended actions arising from these formal reviews are shared both with management and with the Audit Committee, which reports its findings to the Board.

¹ As 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>

² More detail on our annual self-certification process can be found in our assurance summary located in our [regulatory library](#)

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 all three lines of our assurance framework for our significant risks, with a six monthly report produced for Audit Committee to highlight areas for improvement.

The Disclosure Committee oversees the Group's reporting obligations under the Companies Act 2006, the UK Corporate Governance Code, the UKLA Listing, Rules, Disclosure Guidance and Transparency Rules and the Company's annual and continuing regulatory reporting requirements, considering the materiality, accuracy, reliability and timeliness of information disclosed and assessment of assurance received.

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.

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

We recognise 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 2016/17 and 2017/18 we have carried out our most extensive customer engagement programme ever to co-create our PR19 plan, as well as continuing to track customer sentiment through our quarterly customer tracker. Our customer challenge group, the Water Forum, has continued to play a vital role in challenging our customer engagement.

In addition to our established 'business as usual' engagement with our regulators, investors, customers and other stakeholders, we have also undertaken the following:

- Targeted research with over 18,000 customers over the past two years, including willingness to pay research, deliberative research on strategic investment areas and developing a better understanding of how we help customers who are struggling to pay their bills.
- Launching our online community Tap Chat with over 8,000 customers. Tap Chat represents an opportunity to establish ongoing dialogue with our customers, as well as undertaking diverse research activities.
- Research with customers on the performance commitments they are most interested in hearing about, the ways in which they would like to see information presented and how bills should be broken down.

We have also explored, in a number of research projects, the role that comparative information plays when customers make choices.

Throughout the year we have continued to work with 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.

3 Managing risk and good governance

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 were disappointed to be moved to 'targeted' assurance this year after achieving 'self-assured' last year. The requirements for 'targeted' companies are the same as 'self-assured' – companies must put in place assurance processes that give stakeholders the confidence that the information they publish is accurate and reliable. In addition however, 'targeted' companies are required to:

- Carry out an exercise with stakeholders to identify areas of risks requiring additional assurance
- Publish a statement of risks, strengths and weaknesses on this in the autumn of each year in advance of submitting information.

We sought the views of our customers and stake holders on our draft assurance plan, published in November 2017 and used these to shape our final assurance plan, which was published in February this year. Our aim has been to address the issues highlighted by Ofwat in their CMF assessment and improve the trust and confidence of all our stakeholders, which will enable us to return to the 'self-assured' category.

The main area of concern noted by Ofwat was 'compliance with principles of board leadership, transparency and governance'. In particular, Ofwat commented that it *'could not identify a description of its group structure either as part of its annual reporting or on its website. It is important that companies set out the structure of the group clearly and unambiguously for all stakeholders to provide transparency.'* As a result, we updated our website with a clear and full company structure to complement our full subsidiary disclosures in our annual reporting at the financial year end.

In addition, this year we have asked Jacobs to review our approach and processes we follow to assess our compliance with our obligations and the systems and processes we have in place to run our business and identify and manage risks in a way that meets the relevant obligations. As part of their assurance activity Jacobs have noted that *'through our work assuring your APR, annual charges schemes and other submissions, we have seen evidence of appropriate systems and controls'* and that our Licence to Operate process *'is mature and comprehensive in its scope'*.

Severn Trent Water is part of the publicly listed company Severn Trent Plc. As such we are committed to comply with reporting requirements under the UK Corporate Governance Code³, and the UKLA's Disclosure Guidance, Transparency Rules and Listing Rules and we continue to adhere to the principles set out in Ofwat's 'updated assessment of monopoly water companies' governance arrangements'⁴ published in June 2015.

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, to further enhance the clarity of reporting and insight that can be gained from this ERM information, 'risk flightpaths' are now in place and reported to the Audit Committee. The flightpaths graphically demonstrate the level of risk the Group faces and the timeline for the key risk mitigation steps to manage the risk to the target position. This builds upon the established reporting dashboard for the Group's significant risks. The flightpaths and the reporting dashboard help to facilitate 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.

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 and Severn Trent Water Annual Report and Accounts.

We recognise the importance of longer term risk management and resilience. With this in mind we have reviewed our statements of long term viability and we have included our seven year viability statement in our 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 and robust assurance and performance reporting framework. Our assurance plan for this financial year, 2017/18, continues the high standard processes we developed and implemented in the previous years, for reporting our performance commitments in our Annual Report and Accounts and Annual Performance Report.

³ The version of the Corporate Governance Code applicable to the current reporting period is the April 2016 UK Corporate Governance Code

⁴ http://www.ofwat.gov.uk/wp-content/uploads/2015/11/pap_pos20150615boardleadership.pdf

In February this year we published our final assurance plan for 2017/18 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 annual assurance summary published with our Annual Performance Report.

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 risk-based 'three lines of assurance' 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, and our customers, 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 2017/18.

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 assured by Deloitte with Jacobs providing assurance over the non-financial data including our performance commitments and associated customer ODIs.

Last year we provided to Ofwat additional cost assessment information which was submitted alongside, but separate to, the Annual Performance Report. This year, we are again providing this information however this will be included in the Annual Performance Report as additional regulatory information. 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.

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 except where indicated 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.
- We have reviewed our governance to ensure the regulated company maintains the principles as if it is a separate public listed company.

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
Unplanned Outage	Shadow PC for AMP7	Unplanned outage is a new measure, and improvements are being made to ensure our data recording aligns fully with the new methodology published in March 2018. We have a plan in place to improve the confidence in our data over the coming year.