

TA 2.3 PR19 Assurance Framework Technical Annex

September 2018
Version 1

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Navigation: TA 2.3 – PR19 Assurance Framework

Purpose:

This annex contains the Southern Water Services PR19 Assurance Framework (Assurance Framework). The Assurance Framework is the approach we have taken to assuring the quality of the business plan.

This annex should be read in conjunction with: Chapter 2 - Trust, Confidence and Assurance;

The table below summarises the Ofwat tests that are addressed by the evidence in this Annex.

Table 1 - Relevant Ofwat tests

Ref			Comment
Primary Focus Areas			
CA1	To what extent has the company's full Board provided comprehensive assurance to demonstrate that all the elements add up to a business plan that is high quality and deliverable, and that it has challenged management to ensure this is the case?	<p>In a high-quality plan: The company's full Board will own the overall strategy and direction of the plan in the long term and take collective responsibility for assuring its business plan.</p> <p>The Board will provide a statement of why it considers all the elements (including supporting data) add up to a business plan that is high quality and deliverable, providing strong evidence of where and how it has challenged company management.</p>	<p>The assurance framework set out in this Annex underpins our approach to ensuring the plan is high quality. The framework takes a risk based approach to assurance, and identifies key components of the plan subject to specific assurance.</p> <p>All third party assurance providers reported directly to the Board. The Board took this into account when developing their Board Assurance Statements.</p>
CA4	To what extent has the company's full Board provided comprehensive assurance to demonstrate that the business plan will deliver – and that the Board will monitor delivery of – its outcomes (which should meet relevant statutory requirements and licence obligations and take account of the UK and Welsh Governments' strategic policy statements)?	<p>The Board assurance statement will include assurance that the business plan will, over the next control period and in the long term, enable the company to meet its statutory and licence obligations, take account of the UK and Welsh Government's strategic policy statements and deliver operational, financial and corporate resilience.</p>	<p>In addition to internal review processes, the Board received independent technical assurance over PCs and ODIs from PwC. Herbert Smith Freehills and Jacobs were engaged to provide additional reassurance that the plan will enable us to meet legal obligations. Further detail regarding relevant statutory requirements and obligations, and relevant strategic policy statements, is provided in <i>TA.2.5 - Meeting our statutory and licence obligations</i>.</p>
CA5	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?	<p>The Board will also provide assurance that it will enable its customers' trust and confidence through high levels of transparency and engagement with customers.</p>	<p>Data is heavily reflected as a key component of our plan in the PR19 Assurance Framework. In this annex we outline the scope of assurance for different types of data, and the assessment undertaken across data tables to ensure our approach adequately reflected underlying risk.</p>
CA6	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?		<p>Further detail and analysis of our historical track record of producing data is set out at <i>TA.2.5 - Meeting our statutory and licence obligations</i></p>
Secondary Focus Areas			
CA4	Securing Confidence and Assurance		

Assurance Approach

We implemented a risk-based approach to assuring the PR19 business plan.

In developing this approach, we sought expert advice from PwC, as our strategic assurance partner. PwC worked with us to develop an overarching framework that builds on good practice within the industry (including lessons from what went well at PR14 and what could be improved) and examples of leading practices from other sectors¹. They provided an independent view and additional challenge on the areas of the plan where we should consider additional assurance (for example, where management’s view of risk was inconsistent for similar components), and in some instances reviewed the scope of proposed third-party assurance activity.

Overall, the Assurance Framework allowed us to identify aspects of the Plan which have material operational, corporate, financial or reputational risks, and to address these risks through greater focus and assurance activity.

Figure 1 - Developing the PR19 Assurance Framework

<p>Identify components</p>	<p>We held assurance workshops across the programme to understand the “components” of the plan (including models, analysis, key judgements, data tables and narrative). We reviewed the completeness of these components, with the assistance of PwC who benchmarked the components identified against other companies.</p>
<p>Assess risk</p>	<p>We assessed each component based on 10 risk criteria - for example, the monetary or reputational impact or the strategic importance of the component to the company and customers. We scored and determined the level of risk associated with each component (low, medium or high).</p>
<p>Determine appropriate assurance</p>	<p>Based on the level of risk, we assigned either 1st line, 2nd line or 3rd line assurance activities. Later, we kept the risk assessment under review and developed gap analysis against current assurance plans to ensure that assurance activities were aligned to the programme critical pathway and addressed new areas of risk.</p>

Step 1 - Identify components

Overall, we identified 28 key components to the plan. This included both input components (e.g. models, methodologies and approaches) and output components (e.g. data tables and narrative). For example, “performance commitments” is an input component of the plan, and “data tables” is an output component of the plan. We note there is some deliberate duplication between input and output components (for example, performance commitment information is recorded in data tables). All components identified for assurance are recorded in the Assurance Framework later in this annex.

Step 2 - Assess risk

Each component was subject to a risk assessment. This assessment focused on the likelihood of error, or the potential impact of an error for each component. The objective of the assessment was to determine which areas of the plan are higher risk, in order to develop an effective plan to address this risk. To conduct the assessment, we used a risk framework comprising 10 criteria – 7 criteria to judge the likelihood and strategic importance of error, and 3 criteria to judge the impact of an error.

Likelihood/strategic criteria:

¹ The features of good practice and how the assurance framework incorporates these features is described in the main business plan chapter.

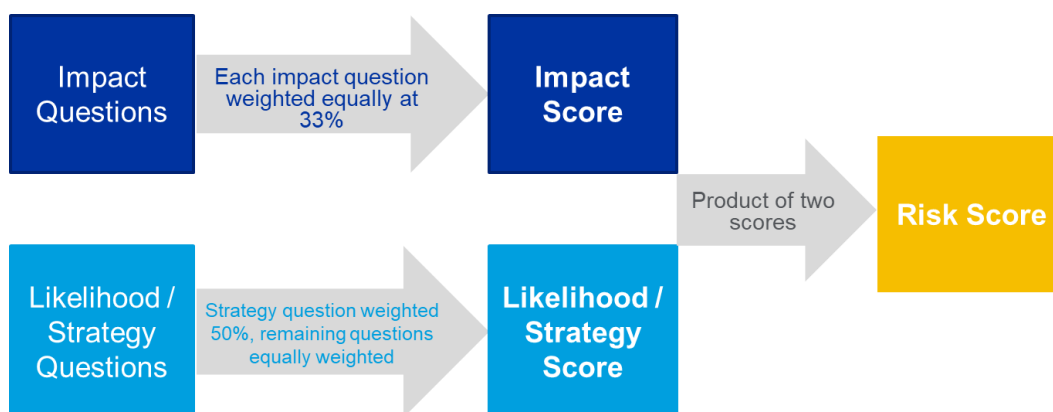
- Level of complexity (e.g. systems, processes and data);
- Judgements/assumptions and level of subjectivity;
- Ability to corroborate data sources;
- Risk of inadequate documentation/audit trail and controls;
- People risks (e.g. experience, accountability, oversight);
- History of errors or low-quality data; and
- Strategic importance (e.g. to Ofwat, Board, Customers and other stakeholders)

Impact criteria:

- Monetary impact (e.g. revenue, totex);
- Reputational impact (e.g. Ofwat, customers, stakeholders, statutory obligations); and
- Performance impact (e.g. operational, corporate, financial)

Each component was scored out of 10 overall – (out of 5) for likelihood/strategic importance and (out of 5) for potential impact. Scores were plotted on a risk matrix. This produced a high, medium or low overall risk score for each component.

Figure 2 - Calculating a risk score



Step 3 - Determine approach assurance

The risk scores were used to determine the level of assurance required. We used a three-lines of defence model for this, which allows clear responsibilities to be defined at each level of internal and external assurance. For example, it ensures independent third parties are engaged in the right areas – such as those with material operational, corporate, financial or reputational risk. In brief, the three lines of defence can be described as follows:

- **First line** – Each component of the Business Plan was subject to first line assurance. This represents the procedures and sign-offs by the workstreams responsible for developing components of the Plan. This process was broadly consistent across all workstreams and components, though additional checks were undertaken in some areas.
- **Second line** – As part of our second line, we implemented a review process for medium risk components. Internal teams, for example Internal Audit or the PR19 Assurance Workstream,

provided independent verification and a wider view from outside the programme team into the planning process.

- **Third line** – Independent assurance for higher-risk components. The depth of assurance/review work was aligned to the scale of risk, including those with material operational, corporate, financial or reputational risks.

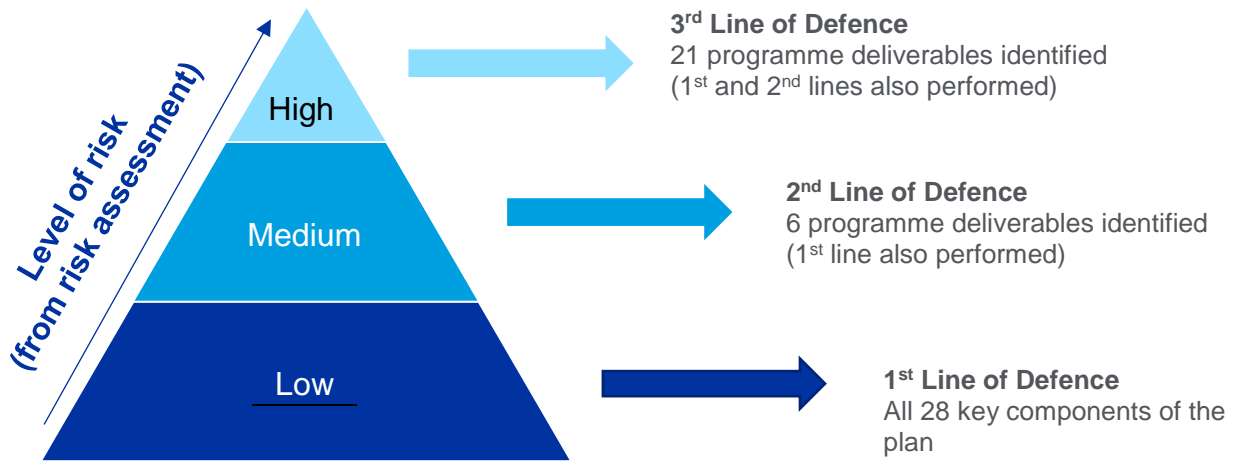


Figure 3 - The three lines of defence model

Assurance Framework

The populated assurance framework is set out below. It identifies each of the components, the overall risk rating, whether first/second/third line assurance has been undertaken, and the nature of the relevant assurance activity.

There are a number of common types of assurance activity:

- **Line management review and sign-off** – first line of defence review from management, closely aligned to the initial development of content
- **Workstream lead (WSL) review and sign-off** – first line of defence review from the individual running a specific workstream, often after initial checks by line management
- **Executive sponsor review and sign-off** – each PR19 workstream was sponsored by a member of the Executive Leadership Team (ELT), who reviewed and signed-off after the WSL
- **Editorial steering group (ESG)** – a central steering group comprised of members of the Executive (including CEO) and independent advisors. This central steering group reviewed and challenged business plan chapters
- **Board review and challenge** – The Board reviewed and challenged many components of the plan, through the engagement processes outlined in TA2.2 Board Engagement and Challenge. This process provided direct feedback to workstreams to action
- **Board review and sign-off** – Alongside providing feedback to workstreams, the Board formally signed off key components of the plan in formal Board meetings
- **Independent input** – in several instances, independent third party organisations were commissioned to provide input into analysis associated with specific plan components
- **Agreed-upon procedures** (for third party assurance providers) – a range of third party assurers reviewed key business plan components. In the case of data, this was done in line with agreed-upon procedures

Table 2 - Assurance framework

Ref	Area	Business plan 'component' (output or building block)	Risk Rating	Lines of Defence			1st Line	2nd Line	3rd Line	
				1st	2nd	3rd	Assurance Activity	Assurance Activity	Assurance Activity	3rd party input / Assurance scope
1	Strategic assurance	PR19 Chapters and Technical annexes	High	Y	Y	Y	> Review and sign-off by individual WSL's (developed with input from relevant SW and external technical SMEs)	> Review and challenge by the "Editorial Steering Group" > Review and sign-off by relevant ELT sponsors for each Chapter > Review and challenge by individual Board	> External review by PwC	PwC reviewed early drafts of the business plan and supporting evidence (IAP evidence tracker) against Ofwat's expectations for high-quality, ambitious and innovative business plans. They provided detailed comments and feedback against these expectations. This helped to identify areas where the evidence might fall short of expectations, and to challenge emerging proposals.
2		Overall approach to Assurance (as illustrated by the Assurance Framework)	High	Y	Y	Y	> Sign-off on individual components by relevant WSLs > Overall review by Assurance WSL	> Review and sign-off by ELT sponsor (independent of the main PR19 programme) > Review and challenge by the Assurance Board Sub-committee	> External review by PwC	PwC advised on the SWS PR19 Assurance Framework and plan. They provided an independent view and additional challenge on the areas of the plan where we should consider additional assurance (for example, where management's view of risk was inconsistent for similar components), and in some instances reviewed the scope of proposed third-party assurance activity.
3	Data tables	Data tables (non-financial)	High	Y	Y	Y	> Review and sign-off by line management > Review and sign-off by WSL	> Review and sign-off by Assurance workstream > Review by Risk Information and Controls (RICS) Team	> External review by PwC	PwC undertook a risk-based review of non-financial data tables following Agreed Upon Procedures.
4		Data tables (financial)	High	Y	Y	Y	> Review and sign-off by line management > Review and sign-off by WSL	> Review and sign-off by Finance workstreams	> External review by Deloitte > External review by Jacobs	Deloitte undertook a risk-based review of relevant data tables following Agreed Upon Procedures, including the allocation of costs into the correct price controls. Jacobs carried out sample checks on the transfer of information from the final Investment Plan to Ofwat tables WS1, WS2, WWS1 and WWS2.
5		Cost assessment tables (non-financial)	High	Y	Y	Y	> Review and sign-off by line management > Review and sign-off by WSL	> Review and sign-off by Assurance workstream	> External review by PwC	This review was undertaken as part of the annual reporting process and included a risk-based review of non-financial data tables following Agreed Upon Procedures.
6		Cost assessment tables (financial - including cost allocations)	High	Y	Y	Y	> Review and sign-off by line management > Review and sign-off by WSL	> Review and sign-off by Finance workstreams	> External review by Deloitte	This review was undertaken as part of the annual reporting process and included a risk-based review of financial data tables following Agreed Upon Procedures.

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				1st	2nd	3rd	Assurance Activity	Assurance Activity	Assurance Activity	3rd party input / Assurance scope
7	Costs and controls	Cost estimation	High	Y	Y	Y	> Review and sign-off by Cost Estimation Team (CET)	> Review by Wholesale WSL's, and central PR19 programme team > Review and sign-off by ELT sponsor	> External review by Jacobs	Jacobs reviewed the methodology and application of our cost estimation strategy. They tested whether the methodology was fit for purpose and commented on any opportunities for improvement (which we implemented). Jacobs also conducted a risk-based deep dive on cost models and cost curves and reviewed the appropriateness of efficiency assumptions adopted in the plan.
8		Wholesale cost projections (business / investment cases)	High	Y	Y	Y	> Review and sign-off by Wholesale WSL's	> Detailed review by independent asset management SME (against a defined checklist at 'bronze' 'silver' and 'gold' stages of development) > Review and challenge by SW "star chamber" > Review and sign-off by Wholesale ELT sponsors for water and wastewater	> External review by Jacobs	Jacobs reviewed and commented on the justification for business cases, and the robustness of evidence. They also reviewed the source of costs back to outputs from the SWS cost estimation team.
9		Cost Adjustment Claims (CACs)	High	Y	Y	Y	> Review and sign-off by Wholesale and Regulation WSL's	> Review and challenge by Assurance workstream > Review and challenge by central PR19 programme team > Review and sign-off by ELT > Review and sign-off by Board > Independent feedback from PwC	> External review by Jacobs	Jacobs reviewed and commented on the evidence to support our CACs, including customer support.
10		Benchmarking	Medium	Y	Y		> Review and sign-off by Delivery WSL	> Review and challenge by the ELT > Independent input from Mott Macdonald		<i>Mott Macdonald benchmarked elements of our cost and delivery model.</i>
11		Top-down benchmarking (cost envelope)	Medium	Y	Y		> Review and sign-off by the Regulation WSL	> Review and sign-off by ELT sponsor > Review and challenge by star chamber > Independent input from Oxera		<i>Oxera provided expert input on top down benchmarking</i>
12		Water RCV allocations	High	Y	Y	Y	> Review and sign-off by Regulation WSL	> Review and sign-off by ELT and Board prior to submission	> External review by Deloitte > External review by Jacobs	Deloitte reviewed the consistency of published and internal source data, and our submission to Ofwat. Jacobs reviewed relevant data tables and commentary against Ofwat guidance.
13		Bioresources RCV allocations	High	Y	Y	Y	> Review and sign-off by Regulation WSL	> Review and sign-off by ELT and Board prior to submission > Independent input from Oxera	> External review by Deloitte > External review by Jacobs	Deloitte reviewed consistency of published source data, internal source data and submission to Ofwat. Jacobs reviewed detailed information on sludge treatment centres. Data was sampled from specific sites, with capacity and throughput data on sludge treatment centres reviewed
14		Retail cost-to-serve model	High	Y	Y	Y	> Review and sign-off on cost to serve model by Retail WSL	> Review and sign-off by ELT sponsor > Review and challenge by the Board	> External review by Deloitte	Deloitte reviewed and commented on the cost-to-serve model, including alignment to accepted practice for Excel-based models, and the appropriateness of sign-off procedures.
15		Affordability model	High	Y	Y	Y	> Review and sign-off by tariff SME	> Review and sign-off by Retail WSL	> External review by Oxera	Oxera reviewed and commented on inputs and outputs of the model. They also reviewed the modelling approach against Ofwat's expectations, and the robustness of the method.

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				1st	2nd	3rd	Assurance Activity	Assurance Activity	Assurance Activity	3rd party input / Assurance scope
16	DPC	DPC assessment and value for money	Medium	Y	Y		> Review and sign-off by Delivery WSL	> Review and challenge by star chamber > Review and sign-off by ELT sponsor > Review and sign-off by the Board		
17	Outcomes	PCs	High	Y	Y	Y	> Review and sign-off by Wholesale, Retail and Regulation WSL's	> Review and challenge by star chamber > Review and sign-off by ELT sponsor > Review and sign-off by the Board	> External review by PwC	PwC reviewed our PC definitions and targeted level of performance against Ofwat's published criteria and guidance.
18		ODIs	High	Y	Y	Y	> Review and sign-off by Wholesale, Retail and Regulation WSL's	> Review and challenge by star chamber > Review and sign-off by ELT sponsor > Review and sign-off by the Board	> External review by PwC	PwC reviewed the type and form of ODIs against Ofwat's published guidance.
19	Risk and Return	Financeability and financial resilience	High	Y	Y	Y	> Review and sign-off by Finance WSL	> Review and challenge by the ELT > Review and sign-off by the Board	> External review by KPMG	KPMG reviewed financeability of the Plan on an actual and notional basis, and our plans for financial resilience.
20		WACC	Low	Y			> Review and sign-off by Finance WSL and ELT sponsor			
21		RORE analysis	Medium	Y	Y		> Review and sign-off by Regulation WSL	> Independent input from Oxera > Review and challenge by the Board		<i>Oxera provided expert input on RORE analysis</i>
22		Tax	Medium	Y	Y		> Review and sign-off by Finance WSL	> Review and sign-off by ELT sponsor > Independent input from Chandlers KBS		<i>Chandlers KBS provided expert input on tax capital allowance schedules.</i>
23	Customer engagement and insight	Insight and engagement	High	Y	Y	Y	> Review and sign-off by Insight WSL	> Review and challenge at the Insight and Engagement Board Sub-committee	> External Review by RAND > Challenge from the CCG	RAND undertook a technical peer review of research methods, and the quality of outputs. The CCG reviewed and commented on the quality of our customer and stakeholder engagement.
24		Application of customer engagement	High	Y	Y	Y	> Review and sign-off by Insight WSL	> Review by the Editorial Steering Group (via chapter review process) > Review and challenge at the Insight and Engagement Board Sub-committee	> Challenge from the CCG > External review and comment by PwC (as part of Chapter reviews above)	The CCG independently challenged the extent to which customer views demonstrably influenced and changed the plan. PwC reviewed the consistency of the draft plan with Ofwat's guidance regarding the use of customer engagement (part of their overall review of the plan).
25		Ongoing customer engagement strategy	Medium	Y	Y		> Review and sign-off by Insight WSL	> Review and challenge by the Editorial Steering Group > Review and challenge at the Insight and Engagement Board Sub-committee		

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				1st	2nd	3rd	Assurance Activity	Assurance Activity	Assurance Activity	3rd party input / Assurance scope
26	Obligations	WRMP	High	Y	Y	Y	> Review and sign-off by Wholesale WSL's	> Review and sign-off by Wholesale ELT sponsors	> External review by Jacobs	Jacobs undertook a risk-based review of the draft Water Resources Management Plan (WRMP). This included a deep dive review of consistency against regulatory priorities and guidance. They also reviewed the revised WRMP, ensuring revisions set out in the Statement of Response were addressed.
27		Other statutory and legal obligations	High	Y	Y	Y	> Review and sign-off by Wholesale WSL's	> Review and sign-off by Assurance ELT sponsor > Independent input from Herbert Smith Freehills LLP	> External review by Jacobs	Jacobs undertook a risk-based review regarding the extent to which investment cases enable the delivery of obligations. Herbert Smith Freehills LLP provided expert advice on statutory and licence obligations more broadly.
28	Legacy	Legacy mechanisms and data tables	High	Y	Y	Y	> Review and sign-off by Regulation and Finance WSL	> Review and sign-off by ELT sponsors	> External review by PwC	PwC reviewed our proposed reconciliations (and data tables) against Ofwat's published guidance and source data. They also conducted a targeted review of forecasts to the end of AMP6.

Key

- **WSL:** Workstream Lead
- **ESG:** Editorial Steering Group
- **ELT:** Executive Leadership Team
- **RICS:** Risk Information and Controls Team
- **CET:** Cost Estimation Team
- **Star Chamber:** forum of technical experts and regulatory specialists (internal and external), and ELT members, providing critical, constructive challenge of the approach, analysis and evidence on key topics

Data tables risk rating

The content of the data tables was risk assessed by assurers based on the complexity and potential material impact of the content and assured as laid out below. The table also identifies the number of tables reviewed both internally and by each of the external assurance providers.

Table 3 - Data tables risk ratings

Risk rating	PwC	Deloitte	Oxera	Jacobs	Internal audit
Critical	15	-			-
High	9	7	2	12	-
Medium	-*	40	-	-	7
Low	-*	16	-	-	2

*Note: PwC undertook reviews of some medium and low risk data items within tables.

Note: some tables cover multiple issues or impact multiple parts of the business, requiring specialist knowledge. In these cases, tables were reviewed by more than one third party. These have been counted separately against each relevant assurer.

Challenge Panel

As discussed in Chapter 2 (Trust, Confidence and Assurance), we appointed a Challenge Panel of prominent, independent, global subject matter experts to inject new thinking into our plan and help calibrate our level of ambition. Table 4 below provides further details on the expertise brought to the Panel by its members.

Table 4 – Challenge panel expertise

Area of focus	Contribution to the Challenge Panel
Natural capital	Expertise in policy advice on the sustainable use of natural capital
Asset management and infrastructure	Expertise in leading large public infrastructure projects in the transport sector
Water Resource Management	Expertise in environmental regulation, and approaches to water resource management to deliver environmental protection and improvement.
Environment	Expertise in environmental regulation and natural capital approaches.
Customer service	Expertise in employee engagement, customer service strategies and organisational performance
Customer engagement & vulnerable customer strategy	Expertise in the energy sector, and long standing consumer advocate.
Innovation and new technology	Expertise in cleantech, and it's use within utility companies, innovation management and entrepreneurship
Circular Economy	Expertise in environmental pollution and waste management, alongside carbon related issues.
Culture	Expertise in Ethical Business Practices, corporate and ethical culture
IT and cyber	Expertise in IT information management in financial services, leading business, technology and operation teams globally