



Ofwat PR19 Draft Methodology

Raising the bar

July 2017
PwC views

Introduction

Overview

Ofwat has published its draft methodology for the next water industry price review (PR19). The draft methodology provides the clearest indication yet of what Ofwat expects from the industry, and lays the foundation for the development of company business plans.

The regulator is raising the bar for the quality of the business plans it expects the companies to produce: *“We want companies to produce high-quality, ambitious and innovative business plans, pushing forward the performance of the sector as a whole and stretching the boundaries for delivery and efficiency.”*

Ofwat has set out four key themes for PR19: customer service, affordable bills, long term resilience and innovation. These themes underpin many of the changes set out in the draft methodology.

We consider that many companies will find it a much more challenging price control process. Indeed, Ofwat has acknowledged how hard it will be for companies to meet its high standards. The regulator has stated it is possible no company will achieve the new “exceptional” status (which replaces the “enhanced” category of business plan assessment used at PR14).

This is against a backdrop of a more complex price control process. PR14 saw the introduction of new review processes and price controls. The PR14 complexity will remain, but in addition Ofwat:

- expects the companies to “raise their game” on customer engagement;
- has extended the number of price controls;
- is promoting competition in the new water resources and bioresources markets;
- expects that companies will look for appropriate opportunities to procure services directly from third parties; and

- will use more complex techniques to benchmark the costs of the wholesale and retail businesses.

There are some welcome areas of standardisation and simplification. For example, there are more common performance commitments and a simplified approach to scenario analysis. Further, the early publication of business planning tables, Ofwat’s financial model and a commitment to publication of an initial allowed returns figure later this year, means the lessons learned during PR14 have been put into practice.

There are strong indications that the final determinations will leave the companies exposed to more performance risk, whilst facing a lower cost of capital. Ofwat is planning to remove the cap on the incentives for outperformance and underperformance. And the incentives will be rebalanced so that *“the average company is more likely to incur penalties on its Outcome Delivery Incentives (ODIs) than rewards”*. Although Ofwat has not indicated its view on the PR19 cost of capital, the messaging is clear: Ofwat expects a “significantly” lower cost of equity and cost of debt. This flows from the current period of ultra-low interest rates and Ofwat’s observations around the trends in the financing costs of utilities.

What does this mean for the water companies? There are many details to consider, but as a high level observation we think companies will need to do four critical things to make the most of PR19:

1. **Focus on where to make a real difference.** Even the best companies will find it challenging to be exceptional across the board - just one area of material weakness can eliminate the chances of an “exceptional” or “fast-track” plan. The key to success will be identifying strengths to capitalise on, and weaknesses to overcome.
2. **Work hard to identify and emulate best practice outside the industry.** This could range from retailers using digital technology to engage with their customers, through to the approach that leading construction firms follow when managing complex infrastructure programmes.
3. **Test the resilience of all aspects of the business** in an holistic way and engage with customers on the actions proposed to secure resilient supplies. This will add a new and important layer of complexity to the business planning processes.

4. **Be ready to implement plans with speed** - Ofwat expect high performance and efficient costs from the beginning of the next regulatory period - there will be no time for reflection after the Final Determinations. Companies should be ready to execute their plans before the end of 2018.

The remainder of this document provides a high level summary of the key areas of the methodology along with brief commentary and analysis. The tables present Ofwat's overall approach to assessing business plan as well as the nine "test" areas, scoring each key issue on two criteria:

- **Change:** The extent of change between Ofwat's proposed methodology for PR19, compared to the PR14 methodology; and
- **Challenge:** The extent to which Ofwat's approach might present a challenge to companies (for example, because the bar is materially higher, or the approach introduces greater risk or complexity).

For those with experience and an understanding of the PR14 price control, the "change" column is particularly important. While PR19 cannot be described as a revolution to the regulatory framework, there are important changes which require a new approach – companies cannot simply rely on the approach they adopted in PR14.

For those planning their approach to PR19, the "challenge" column guides prioritisation towards those areas we consider will be hardest to achieve.

How PwC can help

PwC is a trusted adviser to the water industry and has been at the forefront of industry change, for example:

- advising Ofwat throughout the PR14 process as its Delivery Partner and contributing to Ofwat's emerging thinking on Water 2020 and PR19;
- being heavily involved in the Open Water Programme as advisors to the central programme, MOSL, companies and other stakeholders; and
- advising multiple water companies on the development and implementation of programmes to deliver on their PR14 commitments in retail and wholesale.

We act as regulatory and strategic advisors to companies and investors:

- providing advice on the development of business plans;
- acting as a source of independent views on PR19 plans as a "critical, informed friend";
- assisting with the development of customer engagement plans;
- advising on cost-to-serve and on actions to deliver more efficient retail and wholesale operations; and
- advising on the development and implementation of Board assurance plans.

We also have wide experience and capability in portfolio and project management, including price review programmes.

Key areas of the PR19 Methodology

Ofwat's approach to assessing company business plans

Summary	Change	Challenge	PwC comment
<p>High quality, ambitious and innovative plans - Ofwat intends to assess company plans against three key characteristics - “high quality”, “ambition” and “innovation”.</p> <p>There are nine areas which Ofwat considers will help deliver the key PR19 themes and which will form the basis of Ofwat’s test:</p> <ul style="list-style-type: none"> engaging customers; addressing affordability and vulnerability; delivering outcomes for customers; securing long-term resilience; targeted controls, markets and innovation; securing cost efficiency; aligning risk and return; accounting for past delivery; and securing confidence and assurance. 	Medium	High	<p>The characteristics Ofwat will assess are broader than at PR14 (which focused on “high quality” as the key characteristic). However, there are some consistent themes - for example a requirement for companies to be “cost efficient” remains critical.</p> <p>On the whole, the assessment criteria look to be very challenging. While Ofwat expects all companies to be able to produce a high quality plan, there are tricky aspects to some of the tests. For example, demonstrating an effective approach to customer engagement on resilience is not trivial, requiring companies to develop new (and more complex) approaches.</p>
<p>Ofwat will categories plans in one of four ways, which will have different financial, process and reputational consequences:</p> <ul style="list-style-type: none"> Exceptional status will be awarded to plans that are high-quality with significant ambition and innovation for customers. Fast track status will be given to plans that are high-quality and do not require material intervention to protect customer interests, but which are not ambitious and innovative enough to attain exceptional status. 	Medium	Low	<p>PR19 expands the number of categories from three to four, introducing new hurdles to receive reputational, process and financial rewards. As for PR14, the ‘bar’ for achieving exceptional status (which is the only category to receive financial rewards) is very high. For example, in some areas, it will not be enough for a company to demonstrate it is leading the water industry - it will need to demonstrate that it is stretching itself beyond industry norms (in some cases to the point of achieving upper quartile performance in other industries).</p>

Summary	Change	Challenge	PwC comment
<ul style="list-style-type: none"> • Slow track status will be given to plans where material interventions are required in some areas to protect the interests of customers. • Significant scrutiny status will be given to plans which fall well short of the required quality and where major interventions are required to protect the interest of customers. 			<p>Ofwat has acknowledged how hard it will be for companies to meet its high standards. The regulator has stated it is possible no company will achieve the new “exceptional” status. However, if companies meet the requirements for “exceptional” they will receive a financial reward of +0.2% Return on Regulatory Equity (RORE) as well as the early draft determination which fast track companies will also receive.</p> <p>We note the addition of a potential downside for companies in the “significant scrutiny” category - Ofwat proposes cost sharing incentives which are biased downwards and a “potential” (i.e. not certain) cap on ODI rewards.</p>
<p>Simplified submissions - Ofwat intends to address some of the practical issues associated with the PR14 price review process - both for companies, and for itself. For example, it is introducing a secure online portal for companies to submit price control data (to replace the spreadsheet-based approach used in PR14). It is also limiting the page length for the main company submission - 200 pages for water only companies (WOCs) and 300 pages for water and sewerage companies (WASCs). This excludes the supporting evidence, analysis and models companies have used in preparing their plans (which must also be submitted alongside the main company business plan narrative).</p>	<p>Little or none</p>	<p>Low</p>	<p>The introduction of a secure data capture system, along with more streamlined submissions, should be welcomed both by companies and the industry. We agree with Ofwat that this should help address some of the PR14 process issues, such as version control issues with data tables, and very lengthy and complex submission documents.</p> <p>Ofwat does not suggest a standard format/structure for business plan documents which could have made it even easier to compare business plan proposals across the industry. Instead, Ofwat is requiring companies to clearly signpost the areas of their plans that Ofwat should refer to when carrying out the tests involved in the initial assessment of business plans. This provides scope for companies to choose the best way to structure their main business plan narrative - for example, following Ofwat’s key themes, objectives, the test areas, or their key customer priorities.</p>
<p>Transparency - Companies are also required to make public the whole of their business plans and will need to provide very good reasons should they choose to redact any information from these plans.</p>	<p>Little or none</p>	<p>Low</p>	<p>The transparency of business plans and other information is once again a priority for Ofwat. This was a particular source of contention for some companies at PR14, particularly regarding sensitive commercial or financeability information. Companies should consider (well in advance) the areas of their plans (or supporting evidence) they do not want in the public domain and should develop a compelling rationale for redacting this information.</p>

Test Area 1: Engaging customers

Summary	Change	Challenge	PwC comment
<p>Customer engagement remains central to the assessment of company business plans - Ofwat has largely reiterated the approach for customer engagement set out in its <i>Customer Engagement Policy Statement and Expectations for PR19</i> document. The methodology highlights a principles-based approach to assessing the quality of customer engagement. The principles include the seven principles used at PR14, with seven new principles for PR19:</p> <ul style="list-style-type: none"> • Owning the relationship with their customers; • Using robust/balanced/proportionate evidence, drawing on a wide range of techniques; • Engaging customers as an ongoing process; • Ensuring a two-way and transparent dialogue; • Understanding the needs/requirements of different customer groups; • Setting the context by using comparative information; and • Involving customers in service delivery. 	Medium	High	<p>Ofwat has very high expectations of customer engagement, referencing a “step change” from PR14 (although there is little, if any, change from the ‘<i>Customer Engagement Policy Statement and Expectations for PR19</i>’ document released in May 2016). Ofwat requires companies to draw on a wider range of sources and techniques - companies will need to develop their own approach to reconciling and reflecting these sources in their business plans. Overall, the methodology underlines the need for significant, and ongoing customer engagement which will impact the timelines of the business planning process (and will now be challenging to meet if any company is still in the early stages of engaging with customers).</p> <p>We note that Ofwat is proposing to meet companies during 2018 to understand their approaches to customer engagement. These meetings are likely to influence the way that Ofwat applies its tests on customer engagement. For this reason companies will need to incorporate a degree of flexibility in their customer engagement programmes.</p>
<p>Customer Challenge Groups (CCGs) - The use of CCGs will remain a core component of the engagement strategy. CCGs will provide independent challenge to companies and independent assurance for Ofwat.</p>	Little or none	Low	<p>As expected, the outputs of the CCGs will remain a core element of the business plan submission. Companies have some freedom to develop the scope and input of these. Since PR14, Ofwat has highlighted the success of the CCGs, although it has also prompted companies to do more to ensure they provide information to ensure CCGs can provide an effective scrutiny and challenge.</p>
<p>Longer term issues - One of the new PR19 customer engagement principles is “engaging with customers on longer-term issues, including resilience”. Ofwat has signalled it expects companies to be “<i>creative in exploring the best ways to frame and interpret such engagement</i>”.</p>	Medium	High	<p>Companies will need to evidence that engagement on resilience has been conducted effectively and that it has taken customer views into account. We expect this to be complex to achieve. There is no set approach for doing this and we expect a variety of methods across the industry.</p>

Summary	Change	Challenge	PwC comment
<p>Customer participation - One of the new PR19 customer engagement principles is “<i>involving customers in service delivery</i>”. Water companies must demonstrate that they have begun to take into account four themes below:</p> <ul style="list-style-type: none"> • Futures – customer participation to improve the current and future sustainability of water services; • Action – customer behaviour change, including saving water and helping to reduce sewer blockages; • Community – community ownership of water as an essential resource; and • Experience – increasing customer control of water in their home and of the service experience. 	Medium	Medium	<p>Companies will need to evidence the role of customers in service delivery and the impact of this on their business plans. Once again, there is no set approach for doing so and we expect a variety of methods across the industry. In the past, Ofwat has alluded to the use of behavioural economics as a technique to improve customer involvement, though the methodology clearly goes beyond this. This is a new area of focus compared with PR14 - some companies might find it challenging to demonstrate approaches in this area.</p>
<p>Engagement required by wholesalers - Wholesalers must engage with business customers on the wholesale services they provide to them, as well as business retailers.</p>	Medium	Medium	<p>Ofwat is encouraging wholesalers to retain the link with their (end) business customers. This is unchanged from PR14. However, the requirement to engage with business retailers is new and flows from the new retail market reforms.</p>
<p>Customer data - Companies will need to evidence how they are making better use of customer data. This includes using insight and intelligence to do more for customers and improve efficiency, whilst protecting sensitive and confidential customer information.</p>	Medium	Medium	<p>There is an advance on PR14 (although there is little change from the Ofwat report “<i>Unlocking the value of customer data</i>”, published in June 2017). Companies may be required to optimise data processes and security. Ofwat will further define its expectations in a customer data report to be released in 2018. The timing of this report may have an impact on companies’ business planning timelines.</p>

<i>Summary</i>	<i>Change</i>	<i>Challenge</i>	<i>PwC comment</i>
<p>Communications expectations - Companies must evidence how they have adopted the communications expectations set out below:</p> <ul style="list-style-type: none"> • Channels – Use of channels that are two-way in nature, accesible, and relevant for customers; • Messaging – Evidence of the way that engagement has taken place; • Governance – A business-wide approach to communications, with Board-level oversight and feedback; • Evaluation - Evidence of the impact of customer engagement on the business and the plan; and • Audiences - Appropriate customer segmentation, engagement with a range of audiences, plans for ongoing engagement. 	<p>Little or none</p>	<p>Medium</p>	<p>Ofwat considers that good communications is the foundation of effective customer engagement, and can drive important improvements in customer behaviour which can positively impact the cost base (e.g. reducing unnecessary calls).</p> <p>The Ofwat methodology does not elaborate on the details of how effective communications might be explicitly taken into account in the assessment of company plans, though it is reasonable to assume it would form part of Ofwat’s view on the quality of customer engagement activities as a whole.</p>

Test Area 2: Addressing vulnerability and affordability

Summary	Change	Challenge	PwC comment
<p>Three dimensions of affordability - Ofwat’s assessment of business plans will consider affordability across three dimensions: overall affordability (value for money); affordability in the long term; and affordability for those struggling (or at risk of struggling) to pay.</p> <p>Ofwat has adopted a principles-based approach for its assessment, drawing on five themes:</p> <ol style="list-style-type: none"> customer engagement on affordability and bills; customer support for proposals to address affordability; the effectiveness of companies’ plans in improving affordability; the efficiency of companies’ proposed measures for addressing affordability; and the accessibility of help/support for customers struggling to pay. <p>Ofwat will also consider CCG views on the way that company business plans are addressing affordability.</p>	Little or none	Medium	<p>Affordability is one of Ofwat’s key themes for PR19. As for PR14, Ofwat is expecting companies to provide quantitative and qualitative data to demonstrate the affordability of their plans. However, there is now a greater and more explicit emphasis on longer-term affordability and on affordability for different customer segments.</p> <p>Ofwat’s principles for addressing affordability recognise that affordability is impacted by all aspects of company business plans, especially cost efficiency and Outcome Delivery Incentives (ODIs) rewards/penalties (which clearly impact on the overall customer bill). This places even greater pressure on companies to strike the right balance between achieving bill reductions versus the cost of improving performance and resilience. In addition, Ofwat’s approach places a sharper emphasis on understanding the needs of different customer groups, and on obtaining broad-ranging customer support for targeted help.</p>
<p>Vulnerability - Ofwat is consulting on its approach and has put forward a preferred option. Under this option, companies will be required to propose bespoke performance commitments for addressing vulnerability, after engaging with customers and considering the views of their CCG. In addition, companies will be required to report publicly against common measures, though it is not proposed that the common measure will become a performance commitment at PR19.</p> <p>Ofwat has set out a number of factors it will take into account in assessing companies’ proposals on vulnerability (e.g. how well companies have used good quality data to understand their customers). It will specifically consider the CCG’s views on how company business plans are addressing vulnerability.</p>	Little or none	Medium	<p>Ofwat’s customer engagement tests will consider how well companies have engaged with customers in circumstances that make them vulnerable, and how well they have reflected the views of those customers in their plans. Ofwat is also expecting companies to adopt a more joined-up approach on vulnerability including engaging with other utilities and third party organisations on vulnerability issues.</p> <p>Ofwat’s proposals further reinforce the need for companies to have a coherent approach for segmenting their customer bases and differentiating the service and support they provide to different customer groups. Ofwat has recognised that there is no “one size fits all” approach - there will be a range of approaches across the industry. Ofwat is likely to look for examples of good practice and encourage all companies to consider and/or follow suit.</p>

Test Area 3: Delivering outcomes for customers

Summary	Change	Challenge	PwC comment
<p>More “common” performance commitments – Ofwat is expanding the scope of ‘common’ performance commitments from six to fourteen:</p> <ul style="list-style-type: none"> • Eight commitments relate to customers’ day-to-day experience of performance, four relate to asset health, and two focus on forward-looking resilience (to better reflect the Cabinet Office definition of resilience). • Four commitments will be subject to a common (upper quartile) performance level target - water quality compliance; water supply interruptions; internal sewer flooding; and pollution incidents. • On leakage, companies will be required to justify their proposals against options such as a 15% reduction by 2025, or upper quartile performance (this is more stretching than PR14 targets which were set on the Sustainable Economic Level of Leakage, “SELL”). <p>There are no default financial incentives for the two new (proposed) resilience metrics. For these, it will be up to companies to propose ODIs if appropriate and supported by customers.</p>	Medium	High	<p>While the overall outcomes framework remains largely the same as PR14, there are significant changes to the details. Further standardisation of performance commitments (via the fourteen “common” performance commitments) is a material change. Ofwat has recognised that this extensive standardisation will require some companies to make changes to how they collect performance data and that, in some cases, it will take some time to have robust data.</p> <p>Ofwat has drawn a clear distinction between common definitions and common performance levels. Only a small number of the common commitments will have a standard target based on the upper quartile performance level.</p> <p>Companies will be required to meet the forecast upper quartile level of performance in 2024-25 immediately, without any glide path. This is a significantly more challenging approach than at PR14.</p> <p>For the other commitments (which are not subject to upper quartile benchmarking), Ofwat is widening the approach it expects companies to take, moving away from (sole) reliance on cost benefit analysis to set the economically efficient level. Companies will likely adopt a range of approaches to setting performance levels, which Ofwat will evaluate in its assessment of business plans.</p>
<p>Bespoke commitments - Companies will be required to propose bespoke commitments in a number of prescribed areas - vulnerability, the environment, resilience, and the Abstraction Incentive Mechanism (“AIM”). Companies will also be required to demonstrate how their commitments cover each price control. Companies will have to provide strong evidence if they do not want to continue with any of their PR14 commitments.</p>	Little or none	Low	<p>Ofwat’s approach allows companies to innovate by setting bespoke performance commitments. However, Ofwat balances this against its desire for greater transparency and comparability. For example, companies must choose from a long list of asset health metrics with standard definitions, and avoid any aggregation of measures.</p> <p>Ofwat’s approach to bespoke commitments is likely to be less challenging than for the common commitments, though we expect some companies will look to revise their existing commitments.</p>

Summary	Change	Challenge	PwC comment
<p>WaterworCX replaces Service Incentive Mechanism (SIM) in household retail - WaterworCX comprises two mechanisms to incentivise an improved experience for residential customers and developer services customers: the Customer Measure of Experience (C-MeX) and the Developer services Measure of Experience (D-MeX), respectively.</p> <p>There is scope for higher rewards for the best performing companies - up to 12% of residential retail revenue. This is an increase from the current reward cap (6% of residential retail revenues) and will only be available if a company performs at or above a threshold based on the all-sector UK Customer Service Index (UKCSI) converted into a C-MeX equivalent. The threshold could be the upper quartile all-sector UKSI performance. The annual financial incentives are capped at 2.4% of retail revenues.</p> <p>C-MeX will be piloted. The preferred option for C-MeX is a combined score comprising customer service and customer experience metrics, with complaints providing a reputational incentive.</p>	Medium	Medium	<p>Ofwat has previously consulted on options for replacing the SIM. The methodology puts forward a preferred option to be piloted before the start of AMP7. Ofwat’s proposed new incentive increases the potential rewards for excellent customer experience - it effectively doubles the reward cap. However, these additional rewards will only be available if a company performs at or above a threshold based on out-of-sector customer service excellence.</p>
<p>Enhanced rewards for frontier-shifting performance – Where performance on outcomes is exceptional, companies can propose large incentive rates. The bar for attaining these larger rates is very high though. Specifically, Ofwat set out that performance would have to be beyond the best level currently achieved by any company.</p>	Medium	Medium	<p>Currently, most ODIs have caps and collars which limit the scope to earn large rewards for exceptionally strong performance. The proposed approach would allow companies who deliver a ‘step-change’ in performance to earn rewards at a scale that is currently unavailable. However, the bar is high, and we expect other aspects of ODI design are likely to have a larger impact on most companies.</p> <p>In explaining this development, Ofwat acknowledges that it is moving away from its previous approach of calculating rewards and penalties based purely on customer valuations. It considers the previous approach does not take into account the wider benefits that (all) customers should obtain from shifts in performance that set a new benchmark for industry performance.</p>

Summary	Change	Challenge	PwC comment
<p>No ODI cap – Ofwat has proposed that the aggregate cap on ODI performance is removed - this was set at +/-2% Return on Regulatory Equity (RORE) at PR14. However, at the individual ODI level, companies can propose caps (rewards) and collars (penalties) if supported by customer engagement.</p>	<p>Medium</p>	<p>High</p>	<p>Ofwat’s proposed approach builds on the PR14 approach, but with a significant increase in the amount of revenue at risk from outcomes performance. Ofwat now expects RORE of between +/-1% and +/-3% linked to ODIs, though has noted that the upper end will only be achievable in extremely stretching circumstances, where companies deliver step changes in performance across all their performance commitments.</p> <p>Ofwat has stated that an “average company with average performance would expect to incur penalties on its ODI package, rather than rewards”. This present a significant challenge for companies on a ‘catch up’ performance trajectory in AMP6.</p>

Test Area 4: Securing long-term resilience

Summary	Change	Challenge	Comment
<p>Principles-based approach to securing resilience - Ofwat expects companies to consider resilience for AMP7 and in the longer term. Ofwat's expectations are based on seven principles. Companies should:</p> <ul style="list-style-type: none"> Consider resilience in the round, which Ofwat considers includes: <ul style="list-style-type: none"> corporate resilience - the ability of an organisation's governance, accountability and assurance processes to help avoid, cope with, and recover from, disruption, and to anticipate trends and variability in its business operations, operational resilience - an organisation's ability to avoid, cope with, and recover from, disruption to its finances, and financial resilience - the ability of an organisation's infrastructure, and the skills to run that infrastructure, to avoid, cope with, and recover from, disruption in its performance; Work towards resilient ecosystems and biodiversity; Be informed by their customers' expectations on levels of service; Consider a full set of mitigating actions and interventions, including cooperation and collaboration with other companies at a regional or even national level; Consider the best value solutions for customers in the long term; Link the outcomes they propose to their plans to manage resilience; and Provide Board assurance that plans have been informed by considerations on resilience. 	High	High	<p>Ofwat consider that resilience has always been part of how it regulates the water sector. However, PR19 substantially increases the focus on resilience and for the first time it has become an explicit and separate part of the price control process.</p> <p>The complexity of resilience as an issue, and the way in which it is incorporated into Ofwat's assessment process presents a significant challenge for companies. Compounding this, Ofwat's approach is not yet final. It intends to publish further work on resilience in September 2017, which might have a bearing on the final methodology in December.</p>

Summary	Change	Challenge	Comment
<p>Assessing and prioritising resilience risks - Ofwat’s initial assessment of business plans will look specifically at companies’ operational, financial and corporate resilience, measured against the seven principles described above. It will use two tests:</p> <ul style="list-style-type: none"> • How well the company has assessed and prioritised the risks and engaged effectively with customers on the risks and consequences? • How well the company has assessed the full range of mitigation options and chosen the interventions that represent the best value for money over the long term and support from customers? <p>Ofwat has said it will consider the extent to which this appraisal is “supported by sophisticated and global best practice techniques”.</p>	<p>High</p>	<p>High</p>	<p>Ofwat has provided some broad suggestions for assessing and prioritising resilience risks, but has not set out a recommended approach. By leaving it up to companies to determine and apply “<i>global best practice techniques</i>” this is likely to drive innovation and a divergence in approaches.</p> <p>There is a significant risk that companies will fail to meet Ofwat’s expectations. This will also make Ofwat’s assessment more challenging - there is a risk that new standards or requirements will emerge later in the price control process based on the best examples that emerge across the industry.</p>

Test Area 5: Targeted controls, markets and innovation

Summary	Change	Challenge	PwC comment
<h3>Wholesale controls</h3>			
<p>Four wholesale controls - Ofwat has confirmed it will use four controls: water resources, network plus water activities, network plus wastewater activities and bioresources (with an additional control for Thames Water's Tideway Tunnel activities). The scope and form of network plus controls is broadly the same as the PR14 wholesale controls.</p> <p>The building block approach to determining allowed revenues which was used in PR14 will be retained.</p> <p>Existing RCV will be indexed 50% by the RPI and 50% by the relevant index (CPI/CPIH). New RCV additions will be indexed by the relevant index (CPI/CPIH).</p>	Medium	Medium	<p>This is an evolution from PR14 which opens up the potential for more targeted controls in water resources and bioresources activities. The adoption of four controls will add complexity and granularity to data requirements.</p> <p>Revised RCV indexation approach should be value neutral, but is likely to introduce inflation cashflow mismatches (e.g. RPI linked contracts, RPI-index linked debt etc).</p>
<p>Protection of water resources RCV until 31 March 2020 – Ofwat will use an “unfocused” RCV allocation approach (an approach that allocates pre-2020 RCV proportionately between network plus and water resources). An “unfocussed” allocation implies allocating less of the RCV to water resources, thus placing less of the RCV at risk.</p> <p>As a consequence of market opening, future investments in water resources could be underutilised. Efficient investment will be protected up to 31 March 2020.</p>	Medium	Low	<p>The water resources control is new for PR19 (although there is little change from the Water 2020 conclusions paper). Water resources is a relatively small proportion of the value chain, but the protection of historic investment will nonetheless provide some comfort for companies and investors.</p>
<p>Water resources risk-sharing and forecasting incentives – Ofwat will require water companies with significant investment in new water resources after 2020 to propose long term arrangements for sharing market-wide utilisation risks with their customers.</p> <p>Ofwat also expect companies to propose risk arrangements for material overestimation and underestimation of demand. Ofwat think this could take the form of a multi-period ODI in which financial adjustments are introduced in later regulatory periods.</p>	Medium	Medium	<p>The water resource risk-sharing incentive may be complex to design and will expose companies to increased risk.</p> <p>Companies will be familiar with incentives to improve the accuracy of their forecasting. The application of these incentives to water resources is a natural extension of PR14 policy.</p>

Summary	Change	Challenge	PwC comment
<p>Water resources access pricing and 'bidding in' – Companies will submit a proposed access price by Water Resource Zone (WRZ) and demonstrate how this aligns with their own costs.</p> <p>Companies are required to produce an assessment framework (which they will use when bidding into Water Resource Management Plans). This is designed to build confidence with third parties that their bids will be fairly assessed.</p>	Medium	Low	This is a change from PR14 (although there is little change from the Water 2020 conclusions paper). We note Ofwat may not offer further guidance on access prices, which places the onus and the risk on companies to present proposals that are compliant with competition law and tariff principles.
<p>Water trading incentives – Ofwat will retain existing water trading incentives, which will need to be allocated between water network plus and water resources for trades in AMP7. This is designed to accommodate the development of the bilateral market, expected to open “later in the 2020-25 period”.</p>	Little or none	Low	These are only limited changes from PR14. The materiality of this issue will vary regionally depending on the capacity for water trading. As above, we note that Ofwat may not offer further guidance on cost allocation between controls before the business plans are submitted.
<p>Protection of bioresources efficient investment until 2020 – Ofwat has confirmed that efficient investment will be protected to 31 March 2020. There will be an in-period reconciliation between collected revenue and allowed revenue.</p> <p>Ofwat has confirmed it will use a “focused” Regulatory Capital Value (RCV) allocation approach for bioresources, with companies proposing the RCV allocation for Ofwat to approve. Under the “focused” approach, the bio-resources RCV will be determined by the net Modern Equivalent Asset Value (“MEAV”) of bio-resources assets. Efficient investments from 1 April 2020 will not receive the same regulatory protection – these will be exposed to the market for bioresources services.</p>	Medium	Low	<p>The bioresources control is new for PR19. By allocating the net MEAV for sludge assets to the bioresources control, the control should reflect economic pricing in contestable markets.</p> <p>The use of a “focused” RCV allocation approach will result in more RCV being allocated to bioresources, and thus more of the RCV is at risk, than would be the case under an “unfocussed” allocation approach. However, the protection of pre-2020 investment will provide some comfort for companies and investors.</p>
<p>Form of bioresources price control – Ofwat intend to use an average revenue control, using tonnes of dry solids (TDS) as the volume measure.</p>	Medium	Medium	<p>The designation of TDS as the volume measure is new (however, there is little change from the position discussed previously in Water 2020). Adopting TDS volumes as a driver of revenue will have an impact on revenue actually recovered by companies.</p>

Summary	Change	Challenge	PwC comment
<p>Financial incentive for forecasting of TDS volumes – Ofwat is proposing that companies should face financial penalties if there are significant inaccuracies in sludge volume forecasts.</p> <p>Actual volumes can vary by up to 3% from forecast volumes before any penalty is applied. The penalty rate will vary according to size of the forecasting error. Ofwat recognises the difficulty of measuring TDS (companies may not have data in the prescribed form and need to take account of the new boundary with network plus activities) so there will be a smaller penalty if the forecast gap can be shown to be due to measurement improvements, rather than forecasting errors. Ofwat propose to place a cap (of 7%) on the extent to which revenue can exceed expectations.</p>	Medium	Medium	<p>The draft methodology is the first time the incentive details have been published. We note that the quality and volume of TDS may vary depending on factors such as the weather. Companies will be exposed to forecasting errors. Given TDS volumes are not measured now, the scale of these errors may be material.</p> <p>Ofwat is welcoming views on its approach to penalties, but expects companies to provide evidence if they consider that an alternative deadband or cap should be applied.</p>
<h2 style="text-align: center;">Direct procurement for customers</h2>			
<p>Direct procurement for customers (DPC) – Companies will need to consider DPC for discrete, large-scale enhancements projects with a whole-life cost over £100m (on a totex basis). Companies will need to demonstrate that they have considered DPC and that they have adopted a robust DPC framework.</p> <p>Direct procurement will not apply to bioresources as Ofwat regards bioresource sites as contestable.</p>	Medium	Medium	<p>Direct procurement for customers is an addition since PR14. Thus far, companies have struggled to identify suitable projects and to make them attractive to a competitively appointed provider (CAP).</p> <p>We do not think DPC will feature in all water company business plans, so this is not a universal consideration for fast-tracking. However, it is unlikely that those companies where DPC is relevant will obtain an exceptional of fast-track status without seriously engaging with Ofwat’s DPC model.</p>
<p>Types of DPC tender model – Ofwat considers there is scope to adopt the DPC tender model at different stages in the project lifecycle. Ofwat also considers that having a single tender model could realise benefits and increase investor interest. The regulator is looking for stakeholder views on the form of tender model that will work best.</p>	Medium	Low	<p>There are still opportunities for companies to influence Ofwat thinking in this important policy area.</p>

Summary	Change	Challenge	PwC comment
<p>Managing perceived and actual conflicts of interest – Ofwat considers there would be potential or actual conflicts of interest if companies were able to bid in their own tender process. Whilst these conflicts could be managed by strict governance arrangements and by ‘Chinese walls’ between appointee and bidder, Ofwat considers this would create complexity and dilute accountability. Ofwat therefore proposes that existing appointees and associated companies should not be able to bid in their own processes.</p>	Medium	Medium	Companies may be surprised that they stand to be excluded from their own procurement processes. The requirement that appointees should not bid in their own tenders will increase the impact of DPC.
<p>Companies could bear the risk of failed procurement – Ofwat acknowledges that DPC tenders may not always be successful. When a DPC fails and the project is still required, the appointee will need to step in to provide the project. Companies will have a licence obligation to use all reasonable endeavours to ensure a successful DPC process and Ofwat could take enforcement action if it considered a company was not compliant. If the appointee could have prevented a procurement failure, they might be required to bear the procurement or tendering costs.</p>	Medium	Medium	Ofwat’s proposals reflect the regulator’s strong commitment to direct procurement for customers. Companies will need to work hard to make DPC a success if they are to avoid potential enforcement action and/or adverse financial consequences.
<h2>Retail controls</h2>			
<p>Weighted average revenue controls – At PR14, Ofwat adopted a weighted average retail revenue control. This reflected the fact that there were differences in the cost to serve across customer types. For PR19, Ofwat will retain this approach so long as differences in retail costs remain. There will be continued use of average revenue control for business retail customers in Wales for all sewerage services, and for water supplies less than 50 megalitres a year.</p>	Little or none	Low	This approach is substantially the same as for PR14.
<p>Three year retail controls - Ofwat consider that a three-year control may be appropriate for the household price controls and the non-household price control in Wales. This is based on the view that the introduction of competition to the business market in England could reveal valuable information on the cost of retail activities and service benefits.</p>	Medium	Low	This is a new policy direction designed to address the fact that the PR19 process will only capture limited information from the operation of the business retail market. While the impact of this is likely to be low in context of the overall PR19 process, there will be an additional impact on companies who will now need to operate under a shorter price control duration.

<i>Summary</i>	<i>Change</i>	<i>Challenge</i>	<i>PwC comment</i>
<p>Non-household price control not yet determined - Ofwat is considering whether it needs to set price controls for the business retail activities of incumbent English and Welsh companies that are subject to competition. If Ofwat determines this is necessary, the approach will be consistent with that used at PR16. There will be no price controls for companies that have exited the market, former customers of these companies will be protected by the retail exit code which will be reviewed by the end of the 2017-2020 period.</p>	<p>Little or none</p>	<p>Low</p>	<p>At PR14, Ofwat set default tariffs as part of the non-household price control. At PR19, if Ofwat does determine that these are still required, there will be only limited incremental impact on companies.</p>

Test Area 6: Securing cost efficiency

Summary	Change	Challenge	PwC comment
<p>Approach to benchmarking wholesale costs – To set totex baselines, Ofwat will use benchmarking analysis alongside a range of aggregated and granular models.</p> <p>Ofwat’s models will draw on evidence from outside the sector, to inform the efficiency challenge for water companies.</p> <p>Ofwat acknowledge the difficulties of benchmarking enhancement expenditure, which typically has unique characteristics. Thus, as for PR14, Ofwat will use a range of techniques to determine efficient enhancement costs.</p>	High	High	<p>During PR14, Ofwat relied heavily on a limited set of econometric benchmarking techniques. The way that Ofwat intends to assess costs in PR19 will take water regulation closer to the “rich picture” approach adopted by Ofgem. Ofgem’s approach relies on the use of multiple techniques, the results of which are applied with judgement rather than using a mechanistic approach.</p> <p>Challenging Ofwat’s views on efficient costs will involve technical analysis and complex arguments. As for PR14, the ability of the companies to engage in a meaningful exchange with the regulator will be hampered by the lack of cross-industry data and if Ofwat does not share their benchmarking models early in the process.</p> <p>Drawing on out-of-sector practice will challenge companies to test their efficiency targets against new comparators.</p>
<p>Baselines – As for PR14, Ofwat will set efficiency baselines in a way that includes an element of catch-up and assumed, future productively increases. Ofwat will expect companies to be efficient from the start of the new regulatory period.</p> <p>During PR14, Ofwat set a benchmark at the “upper quartile” of historical cost performance. Ofwat is considering whether to set a tougher benchmark for PR19.</p>	Little or none	Medium	<p>Ofwat’s approach appears unchanged from PR14. As before, companies that are efficient will benefit from the benchmarking approach. Companies that are not efficient will need to work hard to reduce costs.</p> <p>If Ofwat adopts a more challenging benchmark than “upper quartile”, all companies will face a more challenging environment.</p>
<p>Setting efficient expenditure for residential and business retail – Ofwat propose to use econometric benchmarking to assess cost efficiency in residential retail activities.</p> <p>In PR14, there was no adjustment of the retail controls to reflect inflation and Ofwat consider that this approach is still appropriate for PR19.</p> <p>Ofwat will look for evidence on retail efficiency from other sectors.</p>	Medium	High	<p>Moving to an econometric approach to set allowable retail costs is likely to change the “efficiency league table”. It will also complicate the approach to cost adjustment claims (see below).</p> <p>Companies will need to test their efficiency against a broader range of comparators, including non-water companies. Identifying suitable comparators will be challenging, and there is a risk that Ofwat focus on comparators which cast the sector in a bad light.</p>

Summary	Change	Challenge	PwC comment
<p>Evidence to support cost adjustment claims – Ofwat will assess cost adjustment claims against six tests:</p> <ul style="list-style-type: none"> • Need for adjustment - is there evidence that the costs are not included in the modelled baseline? • Robustness and efficiency - is there evidence that the costs are efficient? • Management control - is there evidence that the company has taken all reasonable steps to control costs? • Need for investment - is there evidence that the investment is required and supported by customers and the relevant CCG? • Best option - does the option chosen represent the best value for customers? • Customer protection - will customers’ interests be protected if the investment is cancelled, delayed or the scope is reduced? <p>Ofwat is also seeking to address one of the criticisms of the PR14 cost adjustment process - that claims tended to be asymmetric in nature. In other words, companies only had an incentive to identify adjustments which would increase their cost allowance. Companies will be required submit information on their expected claims earlier in the process (on 3 May 2018). This will allow Ofwat (and potentially other parties) to comment and challenge companies’ proposals. Companies will not be required to assure this early information and Ofwat states that the initial claims will not <u>automatically</u> have an impact on the way that Ofwat assesses the business plans.</p>	<p>Little or none</p>	<p>High</p>	<p>The tests against which Ofwat will evaluate cost adjustment claims build on the tests which were applied during PR14. Ofwat is setting a high evidential bar, but does not prescribe the evidence required in support of individual claims. This increases the risk that companies will not pass all of the six tests.</p> <p>During PR14, companies typically found it challenging to assess whether cost were included in the modelled baseline and to demonstrate that the most cost effective option had been selected to deliver a given level of customer outcome:</p> <ul style="list-style-type: none"> • Assessing whether the costs are already modelled can require complex econometric analysis. The assessment will be further complicated in PR19 by the way that Ofwat proposes to use a blend of top down and granular benchmarking techniques. • Demonstrating that the most cost-effective option has been selected will require companies to show they have considered the full range of options and assessed these in an objective way. Ofwat will expect to see sophisticated analysis including the use of ‘real option valuation’. This will be complex to undertake. <p>The requirement to submit cost adjustment claims four months earlier than the business plan creates at least two challenges: companies will need to advance this aspect of their business planning process; and companies should expect to receive and need to respond to challenges from Ofwat (and potentially from third parties). The fact that the early submission on cost claims does not need to be assured and will not automatically impact on the categorisation of business plans will be welcomed by the companies.</p>
<p>Approach to funding unconfirmed environmental requirements – There is a mismatch between the five-year price review and the six-year river basin management planning cycles. This creates uncertainty around certain environmental programmes.</p> <p>Ofwat is consulting on two approaches to provide funding for these uncertain environmental requirements. One option would involve making an allowance for only a proportion (less than 100%) of the uncertain expenditure; the proportion of funding would vary between programmes.</p>	<p>Medium</p>	<p>High</p>	<p>Both of Ofwat’s preferred options will involve the detailed review of complex programmes and the application of regulatory judgement. The fact that evaluations are not mechanistic in nature will allow companies greater opportunity to make robust arguments to influence Ofwat’s thinking.</p>

Summary	Change	Challenge	PwC comment
<p>The other option would link the allowance to an outcome and a unit cost mechanism.</p>			<p>Under both of Ofwat’s options, companies will face the risk that they will be unable to recover some of the costs of unconfirmed environmental programmes.</p>
<p>Cost sharing incentive – Ofwat is moving away from the “menu approach” for determining the cost sharing incentive. Instead, the cost sharing incentive will be determined in a mechanistic way by comparing company business plans to the outcome of Ofwat’s cost assessment.</p> <p>For companies whose plans are assessed to need “significant scrutiny”, Ofwat will set cost sharing for underperformance at 75% and cost sharing for outperformance at 25%.</p>	<p>Medium</p>	<p>Medium (for plans requiring “scrutiny”) Low (for other plans)</p>	<p>The PR14 menu approach was widely criticised for its complexity and for the limited extent to which the mechanism provided meaningful incentives for companies. The Competition & Markets Authority (CMA) underlined these criticisms during the appeal lodged by Bristol Water. Although the removal of the menu is a significant change, it will not heighten the challenges that companies face. If anything, it makes it marginally easier for the companies by removing one of the decisions they will need to make.</p> <p>The imposition of asymmetric cost sharing for companies whose plans need “significant scrutiny” will create strong incentives for companies to reduce costs, and provide only limited upside when they are able to do so.</p>
<p>Business rates - In PR14, Ofwat treated business rates as a notified item. Ofwat do not propose that business rates should be a notified item in PR19. Ofwat expects companies to seek opportunities to minimise these costs.</p>	<p>Medium</p>	<p>Medium</p>	<p>Although companies have an influence on the level of business rates, some aspects of the business rates process are beyond company control. Ofwat’s position on business rates will increase the volatility of company earnings.</p>
<p>Aspects of policy where Ofwat has yet to decide its approach</p> <p>There are a couple of other areas where the policy is still to be formulated:</p> <ul style="list-style-type: none"> Ofwat is considering whether to retain the Transition Programme, through which companies can advance expenditure between regulatory periods. Ofwat is considering options around the way that allowances flow through company accounts. These options will only have cash flow implications but, as a consequence, may impact on financeability. 	<p>Unclear</p>	<p>Unclear</p>	<p>The implications of these other aspects of policy are either low (in the case of unchanged policies) or difficult to determine at this stage (in the case of open policy positions).</p>

Test Area 7: Aligning risk and return

Summary	Change	Challenge	PwC comment
<p>Lower cost of debt and equity - Current market evidence indicates lower costs of debt and equity, so Ofwat expects the return on capital to be “significantly” lower for PR19.</p>	High	High	<p>Ofwat is continuing to do work in connection with the Weighted Average Cost of Capital (WACC) and considers it is too early to take a definitive view on the cost of equity for PR19. Ofwat plan to consider both responses to the draft methodology and further evidence on market returns before releasing an initial view on the WACC in December 2017.</p> <p>We note that Ofwat’s proposal places increased weight on current market evidence compared to previous price controls - with less weight placed on long-run historical averages. Nominal total market returns in the range 8.0% to 8.5% would, using the PR14 final determination gearing and asset beta, imply a nominal cost of equity in the range 6.7% to 7.4%, compared with 8.6% at PR14. Although Ofwat has not indicated its view on the PR19 cost of capital, the messaging is clear: Ofwat expects a “significantly” lower cost of equity and cost of debt.</p>
<p>Cost of new debt indexation - Cost of new debt indexation will be based upon movement in iBoxx indices, rather than being fixed up-front. A forecast assumption will still be required and a true-up mechanism will be applied at the end of the price control period.</p> <p>We note Ofwat have retained the possibility for including an additional factor to account for (any) industry-wide outperformance relative to the iBoxx index.</p>	Medium	Medium	<p>This is a significant change in policy from PR14. In terms of materiality, the cost of new debt assumption impacts 25% of debt financing costs (15% of allowed return). This will reduce the potential for financial outperformance and underperformance. Companies can still outperform by beating benchmarks for the embedded cost of debt.</p> <p>The cost of embedded debt is the bigger challenge for companies. It varies significantly across the industry, and for some this will be a major drag on financial performance over the period 2020-2025.</p>
<p>Single wholesale WACC - There will be no differentiation in WACC across the four wholesale price controls.</p>	Little or none	Low	<p>There is no change in policy from PR14. Differential WACCs for different controls could have altered relative returns across the separate controls. This is a welcome, pragmatic step from Ofwat.</p>

<i>Summary</i>	<i>Change</i>	<i>Challenge</i>	<i>PwC comment</i>
Notional capital structure – Ofwat will retain the use of the notional capital structure from PR14. Taxation allowances will remain calculated with reference to the notional gearing, or the actual gearing if higher (and there are additional taxation refinements to better align tax allowances with actual tax costs).	Little or none	Low	It is likely that the notional capital structure will be retained at 62.5%, as debt capacity and financial gearing across the industry has not moved significantly since PR14.
Price indexation - Ofwat has confirmed the use of CPIH as preferred measure of inflation (but 50% of the existing RCV will still be indexed by RPI).	Little or none	Low	The shift to CPIH changes the mechanics of RCV and revenue indexation. The impact of this change is expected to be minimal, as indexation should be value neutral. Any differences in inflation indexation could be adjusted by re-profiling revenues (if strictly necessary).
Financeability – Ofwat proposes to continue to use financeability ratios and that financeability issues will be resolved by using pay-as-you-go (PAYG)/RCV run-off, dividend constraints and equity injection levers.	Little or none	Low	There are minimal changes in the policy position compared with PR14. Financeability assessment will still be carried out using a notional capital (assume 62.5% gearing for initial business plan preparation). Board assurance is required for financeability at the notional capital structure and the appointee’s actual capital structure (see below).

Test Area 8: Accounting for past delivery

Summary	Change	Challenge	Comment
<p>Ofwat will assess two aspects of past delivery:</p> <ol style="list-style-type: none"> 1. how well the company gave evidence of its proposed reconciliations for the period 2015-20; and 2. how well the company <i>delivered</i> its business plan to customers over 2015-20 and how well it engaged with customers on its performance. 	Medium	Medium	In addition to accurate and transparent evidence of performance, Ofwat intends to use evidence of whether companies have met (or not) their AMP6 plans as an indicator of how achievable AMP7 plans might be. This was not explicitly tested at PR14 and underlines Ofwat's desire for companies to be accountable to their customers. This is likely to require significant focus from companies with a track record of underperformance.
<p>Applying reconciliation adjustments - Ofwat has confirmed the approach set out in the Reconciliation Rulebook (published in 2015).</p> <p>Wholesale water RCV adjustments will be allocated across water network plus and water resources, whereas wastewater RCV adjustments will be applied to the network plus price control only. For simplicity, the default assumption is that revenue adjustments will be applied to network plus price controls. Companies have flexibility to propose the period over which adjustments are applied.</p>	Little or none	Low	Ofwat has confirmed that companies should use the Reconciliation Rulebook to account for past delivery. At PR14, the rules for accounting for past delivery were not spelt out in detail. As a consequence, a number of companies struggled to meet Ofwat's aspiration in this area. Adoption of the Reconciliation Rulebook should reduce this challenge.

Test Area 9: Securing confidence and assurance

Summary	Change	Challenge	Comment
<p>Board assurance of business planning - Companies and their Boards are responsible for submitting high-quality business plans. These plans need to rest on good governance processes and be underpinned by robust assurance. Each (full) company Board must provide an assurance statement that demonstrates:</p> <ul style="list-style-type: none"> • how it has challenged and satisfied itself that all the elements add up to a plan that is high quality; • how it has challenged and satisfied itself that the overall strategy for data assurance and governance processes delivers high-quality data; • how it has challenged and satisfied itself that the business plan will enable the company to meet its statutory obligations, now and in the future; • how it has challenged and satisfied itself that its plan will deliver operational, financial and corporate resilience over the next control period and long term through its governance and assurance processes, taking account of its track record of performance; and • how it has provided ownership of the overall strategy and direction of the plan in the long term. <p>Board's are also expected to assure that:</p> <ul style="list-style-type: none"> • The Plan has been informed by customer engagement and CCG feedback; • Outcomes, performance commitments and ODIs reflect customer preferences and are grounded in customer engagement, and the proposed approach to reporting on performance commitments is robust; • Expenditure forecasts are robust and efficient; • the business is financeable on the notional financial structure. Ofwat also expects Boards to provide assurance that the company is financeable based on its actual financial structure. Companies should set out clearly the steps taken to provide this assurance. 	Medium	Medium	<p>The requirement for Board's to assure the PR19 business plans is in line with Ofwat's expectations for the previous price control review.</p> <p>The draft methodology implies an expectation that Boards will need to be involved in multiple aspects of the plan and explain how they have undertaken assurance. This might be regarded by some companies as a change in emphasis, however, a number of companies adopted this approach in PR14.</p> <p>The requirement for Boards to provide assurance on operational, financial and corporate resilience raises the bar on the oversight that Boards will need to provide. We expect analysis and decisions in this area to be complex.</p> <p>The explicit requirement that the Board should assure the way that delivery risks will be mitigated will extend Board oversight of the planning process.</p>

Summary	Change	Challenge	Comment
<ul style="list-style-type: none"> the Board has identified the risks to the delivery of the plan and that it has in place appropriate risk mitigation and management plans. <p>Whilst it is still up to companies and their Boards to determine how best to provide this assurance, Ofwat has said it will obtain confidence from the process that the Board followed in obtaining when undertaking assurance.</p>			
<p>Role of assurance in the initial assessment of business plans - “securing confidence and assurance” is one of the core elements of the initial assessment of company business plans. Ofwat will assess the extent to which the company’s full Board:</p> <ul style="list-style-type: none"> Has provided comprehensive assurance to demonstrate: all the elements add up to a business plan that is high quality, deliverable; and has challenged management to ensure this is the case. Has been able to demonstrate that its governance and assurance processes provide operational, financial and corporate resilience. Ofwat consider this will require companies’ Boards to assure that companies’ business plans have been informed by: <ul style="list-style-type: none"> - a robust and systematic assessment of the resilience of the company’s systems and services; - customer views on managing resilience; and - comprehensive and objective assessment of interventions to manage resilience in customers’ long-term interests. Has provided comprehensive assurance to demonstrate the business plan will deliver and monitor its outcomes and that the plan is consistent with relevant obligations. <p>And, Ofwat will assess:</p> <ul style="list-style-type: none"> The extent to which the company has a track record in producing high quality data (taking into account the 2018 company monitoring framework assessment); and The quality of PR19 tables, including cost allocation, information on corporate tax and associated assurance and commentary. 	<p>Little or none</p>	<p>Medium</p>	<p>The role of assurance in the initial assessment of business plans appears similar to the way that assurance was assessed in the PR14 risk-based review.</p> <p>Ofwat has made clear that the 2018 company monitoring framework assessment will be an input to the initial assessment of business plans. By implication, companies that do not perform well in the 2018 assessment are less likely to secure fast track or exceptional status. Companies will need to maintain a focus on monitoring at the same time as they are developing their business plans.</p>

<i>Summary</i>	<i>Change</i>	<i>Challenge</i>	<i>Comment</i>
<p>Direct Procurement assurance – Ofwat expect companies to provide appropriate assurances that they will be able to meet their obligations if they appoint competitive appointed providers. In the event that Direct Procurement for Customers results in a failed procurement process, Ofwat expects companies to analyse the reasons for the failure, including by using independent assurance to assess the process.</p>	<p>Medium</p>	<p>Low</p>	<p>Although the requirement for independent assurance in the event of a failed Direct Procurement process is new, this will only impact a few companies.</p>
<p>Other aspects of policy retained from PR14 - There are a number of other areas where Ofwat is looking to retain the policy position it adopted at PR14:</p> <ul style="list-style-type: none"> • As for PR14, assurance will need to cover: customer engagement, outcomes and cost assessment. • Again, as for PR14, a business plan can only be of high quality where the data and information provided within the plan has been subject to good assurance processes to ensure it is consistent and accurate. 	<p>Little or none</p>	<p>Low</p>	<p>These other aspects of assurance are in keeping with the position adopted by Ofwat at PR14.</p>

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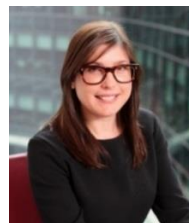
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