



# **AFW Securing Confidence and Assurance**

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## Evidence Document

March 2019

## Table of Contents

<b>1</b>	<b>High level response to Ofwat Feedback.....</b>	<b>3</b>
1.1	Summary.....	3
<b>2</b>	<b>Detailed response to Ofwat feedback actions .....</b>	<b>4</b>
2.1	AFW.CA.A1.....	4
2.2	AFW.CA.A2.....	7
2.3	AFW.CA.A3.....	9
2.4	AFW.CA.A4.....	12
2.5	AFW.CA.A5.....	13
2.6	AFW.CA.A6.....	14
<b>3</b>	<b>Appendices.....</b>	<b>16</b>

# 1 High level response to Ofwat Feedback

## 1.1 Summary

We have taken steps to appraise ourselves of where our September Plan fell short in meeting Ofwat’s expectations for securing confidence and assurance. In particular, we recognise that data forming part of our September Plan fell significantly short of Ofwat’s expectations for consistency and accuracy, As a ‘prescribed’ company under the Company Monitoring Framework, we are committed to making the improvements necessary to restore Ofwat’s confidence and to become a ‘self-assured’ company.

Having undertaken further consultation on our risks, strengths and weaknesses and assurance plan, we are publishing our Final Assurance Plan for 2018/19 alongside our Revised Plan.

In this Test Area Evidence document, we:

- (a) provide a forward looking statement from our Board providing assurance that our large investment proposals for AMP7 are robust;
- (b) confirm that we have amended our Dividend Policy to clarify that:
  - base dividends for the appointed business can exceed a nominal 5% yield on equity in any year, as long as an average nominal 5% yield over the AMP is not exceeded;
  - our Revised Plan includes a base dividend from the appointed business of £14.36m for AMP7 and for each year of AMP7 nominal dividend yield for the appointed business is below 5%;
- (c) confirm that we remain committed to adopting the expectations on performance related pay for AMP7 as set out in Ofwat’s “Putting the Sector back in Balance” publication and summarise how our Executive Remuneration Policy meets those expectations;
- (d) confirm that:
  - we have provided a revised financial model based on version 17z and the BPT mapping tool v8.1 released in March 2019;
  - all data tables have been populated using Ofwat’s model, we have addressed the material inaccuracies in financial ratios based on the company’s actual structure, and checked for consistency of allowed revenues; and
  - we have used Ofwat’s early view of long term CPIH of 2% and RPI of 3%
- (e) confirm that business plan tables WR6 and WR7 have been revised as required by AFW.CA.A6.

## 1.2 Evidence

Appendix	Description
CA.Summary.1	Assurance Plan

## 2 Detailed response to Ofwat feedback actions

### 2.1 AFW.CA.A1

#### 2.1.1 Overview of test area action

Table 1: Action details for AFW.CA.A1

Action Ref.	Action
AFW.CA.A1	<p>The company is required to restate a forward looking Board assurance statement. Please see 'Affinity Water: Securing confidence and assurance detailed actions.'</p> <p>"Reasons The Board's assurance statement does not confirm that the large investment proposals are robust.</p> <p>Actions Provide a restated and compliant Board assurance statement."</p>

Nature of adjustment: action completed

#### 2.1.2 Our response

We have provided a Supplemental Board Assurance Statement which provides assurance from the Board that our large investment proposals for AMP7 are robust and deliverable, that a proper assessment of options has taken place, and that the option proposed is the best one for customers. Our full Supplemental Board Assurance Statement (which assures this and other matters) is provided at Appendix CA.A1.1. Section 3 is reproduced below:

### 3. ROBUSTNESS OF LARGE INVESTMENT PROPOSALS

3.1 In our September 2018 Board Assurance Statement we provided assurance that:

- we had reviewed expenditure forecasts included in the September Plan to satisfy ourselves that they were robust, reliable and efficient, taking account of benchmarked cost data. In this regard, we took into account the Atkins Limited PR19 Assurance Report;
- we had challenged management about their plans to achieve the operating and capital cost efficiencies within the September Plan so that we were assured they were both stretching and deliverable;
- we had reviewed how the wholesale investment programme had been developed and the process by which options were assessed;
- we had reviewed the scope and deliverability of the investment programme and, where uncertainties in scope or cost had been identified by our assurance providers, we had satisfied ourselves that those risks and uncertainties were appropriate and that the relevant investment remained the best one for customers; and
- our September Plan was aligned with the revised draft Water Resources Management Plan we were preparing and that we did not envisage there would be any change to the investment programme included in the Business Plan for AMP7.

3.2 The Atkins Limited *PR19 Assurance Report* classified a number of our large AMP7 investment areas 'amber', highlighting uncertainties with respect to these investment areas. Since our September Plan, further work has been undertaken by management on the business cases for these investment areas and for the Supply 2040 scheme. We asked Atkins Limited to revisit these seven investment areas and the Supply 2040 scheme, in particular to provide assurance with respect to:

- their technical suitability;
  - the robustness of the challenge and decision-making process;
  - their consistency with proposed Performance Commitments; and
  - confirming that uncertainties either in relation to the quantum of activities or the costs were not material.
- 3.3 Atkins Limited has prepared a further assurance report which re-classifies each of the seven 'Amber' investment areas and the Supply 2040 programme 'Green'. The 'Green' classification indicates that these investment areas have clear drivers and that optioneering and costs are underpinned by an appropriate evidence base.
- 3.4 We recognise that investments driven by our Water Resources Management Plan form a substantial part of our AMP7 enhancement programme. We therefore established a Water Resources Management Plan Committee, chaired by Tony Cocker, to provide oversight and scrutiny of the preparation of our revised draft WRMP, to ensure it represents the most cost effective and sustainable long-term solution and meets legal requirements and relevant guidelines. As part of its duties, the Committee reviewed:
- technical assurance from Atkins Limited with respect to preparation of our rdWRMP and its adherence to the Water Resources Planning Guidelines and the Water Resources Management Plan (England) Direction 2017;
  - reviewed technical assurance from Ricardo Energy & Environment of our Strategic Environmental Assessment ("SEA"), Habitats Regulations Assessment ("HRA") and Water Framework Directive Assessment; and
  - legal assurance, with specific reference to the requirements of the SEA and HRA.
- 3.5 The Committee provided the following assurance in Chapter 8 of the revised draft Water Resources Management Plan:
- "We have reviewed this rdWRMP and the assurance reports provided by Atkins Limited and Ricardo Energy & Environment and comments and views provided by Counsel following legal review.*
- We are satisfied that the rdWRMP represents the most cost effective and sustainable long-term solution for managing and developing water resources so as to be able, and continue to be able, to meet the Company's water supply obligations under Part III of the Water Industry Act.*
- We are further satisfied that our rdWRMP takes account of all statutory drinking water quality obligations, and that it includes plans to meet our statutory obligations in this respect in full. We approve the rdWRMP on behalf of the Board."*
- 3.6 Taking all of these matters into account, we can provide assurance that our large investment proposals for AMP7 are robust and deliverable, that a proper assessment of options has taken place, and that the option proposed is the best one for customers."

### 2.1.3 Implications across the plan

The Board has provided appropriate governance and assured itself over the Revised Plan.

### 2.1.4 Assurance

Atkins Limited has revisited the technical assurance of the large investment proposals conducted for the September Plan (Appendix 11, Annex F of the September Plan), the outcomes of which are reflected in appendix CA.A1.2.

## 2.1.5 Evidence

*Table 2 Evidence to support the response to AFW.CA.A1*

<b>Appendix</b>	<b>Description</b>
CA.Summary.1	Assurance Plan
CA.A1.1	Supplemental Board Assurance Statement
CA.A1.2	Atkins Limited: PR19 Assurance Report Investment Case Supplement
CA.A1.3	Atkins Technical Assurance Report March 2019
CA.A1.4	Summary of Board Governance Relating to the Revised Plan

## 2.2 AFW.CA.A2

### 2.2.1 Overview of test area action

Table 3: Action details for AFW.CA.A2

Action Ref.	Action
AFW.CA.A2	On dividend policy the company is required to confirm/explain the statement in their plan that annual dividends are not to exceed 5%, as our calculations have resulted in yield figures above 5% in some years (noting that on average yield is below 5%). Please provide an update on the steps you are taking to fully meet the expectations as set out in our putting the sector in balance position statement.

Nature of adjustment: action completed

### 2.2.2 Our response

To provide clarity, we have amended the following provisions of our Dividend Policy:

**“Section 2 Dividend Policy Summary and Reporting**

*In determining the level of dividend, the financial performance of the appointed and non-appointed businesses are considered separately. The base dividend for the appointed business will be in reference to the company’s internal business plan and will not exceed a nominal 5% ~~annual~~ yield on equity as an annual average over the AMP Asset Management Period (‘AMP’), based on the company’s actual financial structure.”*

**“Section 3 Calculating the Value of the Dividend**

*The base dividend of the appointed business is set in line with the company’s internal business plan approved by the Board following the determination of the price controls for each asset management period and will not exceed a nominal 5% ~~annual~~ yield on equity as an annual average over the AMP, based on the company’s actual financial structure”*

Base dividends for the appointed business can exceed a nominal 5% yield on equity in any year, as long as an average nominal 5% yield over the AMP is not exceeded. Nevertheless our Revised Plan includes a lower base dividend from the appointed business of £14.36m for AMP7 with a different profile. This, together with an increased equity, means that each year nominal dividend yield for the appointed business is below 5%.

Dividends and yield under our Revised Plan across AMP7 are shown below.

Table 4 Appointed Business Dividends and yield under our Revised Plan across AMP7

	2020-21	2021-22	2022-23	2023-24	2024-25	Total
<b>Appointed Business Dividends £m</b>	-	-	-	3.38	10.98	<b>14.36</b>
<b>% Equity</b>	0.0%	0.0%	0.0%	0.7%	2.0%	0.5%

Our updated Dividend Policy for the Revised Plan is included at Appendix CA.A2.1.

### 2.2.3 Implications across the plan

There are no other implications for the plan.

### 2.2.4 Assurance

The dividend figures stated above have been reviewed through the assurance of our calculations by KPMG and the data table assurance by PwC.

### 2.2.5 Evidence

*Table 5: Evidence to support the response to AFW.CA.A2*

Appendix	Description
CA.A2.1	Affinity Water Limited Dividend Policy March 2019
CA.A2.2	KPMG assurance report: financial model
CA.A2.3	PwC (financial): Data Table Assurance Report



## 2.3 AFW.CA.A3

### 2.3.1 Overview of test area action

Table 6: Action details for AFW.CA.A3

Action Ref.	Action
AFW.CA.A3	<p>On executive pay the company is required to confirm that it is committed to adopt the expectations on performance related pay for 2020-25 as set out in 'Putting the sector in balance' to include:</p> <ul style="list-style-type: none"> <li>• Clear explanation of stretching targets and how they will be applied.</li> <li>• Commitment to report how changes, including the underlying reasons, are signalled to customers.</li> </ul> <p>Please provide an update on the steps you are taking to fully meet the expectations as set out in our putting the sector in balance position statement.</p>

Nature of adjustment: action completed

### 2.3.2 Our response

#### Our commitment

We confirm that we remain committed to adopting the expectations on performance related pay, for 2020-25 as set in Ofwat's publication 'Putting the sector back in balance'.

We believe that our Executive Remuneration Policy (set out in full in Section 10.13 of Appendix 10 to our September Plan) demonstrates this commitment. We have published our Executive Remuneration Policy on our website. For AMP7, our policy builds further on the changes introduced from 2018/19 to better align incentives to the delivery of stretching customer service and operational performance.

Where changes are made to our Executive Remuneration Policy during AMP7, we are committed to setting out (in our Annual Performance Reports and our separate annual reports on remuneration) those changes, the reasons for them, and how they take due account of the customer interest.

#### Meeting the expectations in 'Putting the sector back in balance'

We consider that our Executive Remuneration Policy included in our September Plan fully meets these expectations and sets out fully the steps we are taking. We have summarised in the table below how our Executive Remuneration Policy meets each expectation.

Table 7: Meeting the expectations in Putting the Sector Back in Balance

Expectations in 'Putting the sector back in balance'	Our Executive Remuneration Policy
Transparency and relevance of policy	Our Executive Remuneration Policy provides a clear framework of short term and long term incentives for executives, balanced across the service we provide to customers and stakeholders, our financial performance and the individual performance of each executive director.

Expectations in 'Putting the sector back in balance'	Our Executive Remuneration Policy
	<p>Our Executive Remuneration Policy is published on our website and we will ensure that the latest version of the policy is published on our website throughout AMP7.</p> <p>We have committed in our Executive Remuneration Policy to publish a separate annual report on remuneration, with the first report published in July 2019. Changes and the underlying reasons for those changes will be included within the report.</p>
<p>A substantial link to stretching performance delivery for customers, for example related to ODIs, totex or other regulatory mechanisms</p> <p>Evidence of stretching incentives (stretching by reference to the business plan)</p>	<p>Performance-related pay is substantially linked to stretching performance delivery for customers. The purpose of our Executive Remuneration Policy is to continue to align executive pay to the company's performance and strategy of delivering value through high quality customer and operational performance whilst ensuring the cost of water remains affordable for customers by incentivising financial efficiencies as well as the value created for shareholders.</p> <p>Our Executive Remuneration Policy provides that for AMP7:</p> <ul style="list-style-type: none"> <li>• 40% of the annual bonus incentive is to be determined according to performance achieved against our AMP7 performance commitments and our health and safety performance;</li> <li>• 50% of the long term incentive plan ("LTIP") incentive is to be determined according to performance against our AMP7 performance commitments, and targets set for CMEX and DMEX;</li> </ul> <p>The policy links bonus and long term incentive plan incentives to delivering the stretching targets set for our AMP7 performance commitments, CMEX and DMEX.</p> <p>In particular:</p> <ul style="list-style-type: none"> <li>• bonus and LTIP incentive targets for AMP7 performance commitments will be set at the levels of the relevant performance commitments;</li> <li>• executives will not be rewarded under the bonus or LTIP schemes for performance (for any measure) which falls short of the applicable AMP7 performance commitment target for the relevant year;</li> <li>• where performance (for any measure) exceeds the target set (including for the relevant AMP7 performance commitment, CMEX and DMEX), executives will receive a higher LTIP award than the award for the relevant 'on-target' performance; and</li> <li>• bonus and LTIP incentives are subject to maximum limits.</li> </ul> <p>Our bonus also includes safeguards to ensure that financial performance and personal performance are not incentivised to the detriment of delivering stretching customer service and operational performance (and vice versa). This is achieved by requiring a minimum 70% performance across financial performance, customer service and operational performance, and personal performance.</p>
<p>Evidence that policies will be rigorously applied</p>	<p>Our Executive Remuneration Policy provides that:</p> <ul style="list-style-type: none"> <li>• payment of any bonus and LTIP is at the discretion of the Remuneration Committee. Executives have no contractual entitlement to be paid incentives;</li> </ul>

Expectations in 'Putting the sector back in balance'	Our Executive Remuneration Policy
	<ul style="list-style-type: none"> <li>our Remuneration Committee's discretion to approve an incentive payment in the event of under-performance is limited; and</li> <li>there are no triggers in the event of change of circumstances (for example, on change of control) for automatic payment of incentives.</li> </ul>

### 2.3.3 Implications across the plan

No implications to Revised Plan.

### 2.3.4 Assurance

No assurance required.

### 2.3.5 Evidence

*Table 8: Evidence to support the response to AFW.CA.A3*

Appendix	Description
CA.A3.1	Executive Remuneration Policy

## 2.4 AFW.CA.A4

### 2.4.1 Overview of test area action

Table 9: Action details for AFW.CA.A4

Action Ref.	Action
AFW.CA.A4	Provide a revised financial model (based on version 16z released on 31 January 2019) and data tables on 1 April 2019 that: a) uses the Ofwat model; b) addresses the material inaccuracies in financial ratios based on the actual company structure; and c) ensures consistency of allowed revenues.

Nature of adjustment: action completed

### 2.4.2 Our response

We confirm:

- the revised financial model (based on version 17z and the BPT mapping tool v8.1 released in March 2019) has been completed and used in our Revised Plan;
- all data tables have been populated using Ofwat's model;
- we have addressed the material inaccuracies in financial ratios based on the company's actual structure; and
- we have checked for consistency of allowed revenues.

### 2.4.3 Implications across the plan

Not applicable

### 2.4.4 Assurance

KPMG has reviewed the Company's model, the outputs and the completion of the Ofwat financial model based on v17z. PwC has assured the output data tables from Ofwat's model.

### 2.4.5 Evidence

Table 10: Evidence to support the response to AFW.CA.A4

Appendix	Description
CA.A2.2	KPMG Assurance Report: financial model
CA.A2.3	PwC (financial): Data Table Assurance Report
CA.A4.1	Ofwat email on new financial model dated 6 March 2019

## 2.5 AFW.CA.A5

### 2.5.1 Overview of test area action

Table 11: Action details for AFW.CA.A5

Action Ref.	Action
AFW.CA.A5	The company should revise its business plan and associated financial modelling to be based on our 'early view' of long term CPIH of 2.0% and RPI of 3.0%, or provide compelling evidence why this is not appropriate.

Nature of adjustment – action completed

### 2.5.2 Our response

We have revised our plan and associated financial modelling based on Ofwat's 'early view' of long term CPIH of 2% and RPI of 3%.

### 2.5.3 Implications across the plan

Not applicable.

### 2.5.4 Assurance

KPMG has assured the Company's financial model and that Ofwat's 'early view' of long term CPIH of 2% and RPI of 3% has been correctly adopted in the data tables.

Please refer to data table App 23 for further detail.

### 2.5.5 Evidence

Table 12: Evidence to support the response to AFW.CA.A4

Appendix	Description
CA.A2.2	KPMG Assurance Report: financial model
CA.A2.3	PwC (financial): Data Table Assurance Report

## 2.6 AFW.CA.A6

### 2.6.1 Overview of test area action

Table 13: Action details for AFW.CA.A6

Action Ref.	Action
AFW.CA.A6	<p>Provide revised tables Wr6 and Wr7 that reconcile and address the following issues:</p> <ul style="list-style-type: none"> <li>- The benefit from the Sundon treatment should not appear as a post 2020 capacity increase because the company is already entitled to this water resource and the current constraining issue is the treatment of the water. Therefore it does not represent an increase in water resources capacity.</li> <li>- Identified benefits appear to be included from 2020-21 onwards in Wr6 and this does not reconcile with the dates for delivery of benefit as shown in table Wr7. The benefits identified under the zone titles in Wr7 appear to be associated with different zones in Wr6. The company has provided a range of asset lives but the 5 year asset life for a building is unexpectedly low.</li> <li>- The company does not follow the definition of bilateral entry capacity and confuses it with bilateral trades. The company has explained that it has assumed third party and neighbouring water company trades should be recorded in bilateral capacity. These are not bilateral entrants and therefore should be removed from this line and included in the company post 2020 capacity lines if they represent new trades or increases of existing trades and in the pre-2020 capacity line if they are associated with the capacity from renewal of an existing trade.</li> </ul>

Nature of adjustment: action completed

### 2.6.2 Our response

Our business plan tables WR6 and WR7 have been revised as required by AFW.CA.A6.

As noted in our revised draft Water Resources Management Plan (rdWRMP), although the Sundon import has a capacity of 91MI/d, the benefit it has to *Water Available for Use* (WAFU) is only 50MI/d and has effectively been limited to this value since before privatisation because of water quality constraints. This constraint is reflected in our baseline modelling for the rdWRMP. The proposed scheme allows us to make full use of our statutory entitlement to water from Grafham. It is a fundamental part of balancing supply and demand within our Central region, and allows us to provide 1 in 200 year drought resilience without the use of drought permits or orders from 2024.”

### 2.6.3 Implications across the plan

Not applicable.

### 2.6.4 Assurance

Atkins have provided assurance of data tables Wr6 and Wr7 and the associated commentaries.

## 2.6.5 Evidence

*Table 14: Evidence to support the response to AFW.CA.A6*

<b>Appendix</b>	<b>Description</b>
CA.A1.3	Atkins Technical Assurance Report March 2019

### 3 Appendices

All the appendices listed below for this evidence document are included in the appendices titled AFW Securing Confidence and Assurance Appendix.

*Table 15: Full summary of securing confidence and assurance appendices*

<b>Appendix</b>	<b>Action ref(s)</b>
CA.Summary.1 Assurance Plan	High Level Summary, AFW.CA.A1
CA.A1.1 Supplemental Board Assurance Statement	AFW.CA.A1
CA.A1.2 Atkins Limited: PR19 Assurance Report Investment Case Supplement	AFW.CA.A1
CA.A1.3 Atkins Technical Assurance Report March 2019	AFW.CA.A1; CA.A6
CA.A1.4 Summary of Board Governance Relating to the Revised Plan	AFW.CA.A1
CA.A2.1 Affinity Water Limited Dividend Policy	AFW.CA.A2
CA.A2.2 KPMG Assurance Report: financial model	AFW.CA.A2; AFW.CA.A4, AFW.CA.A5
CA.A2.3 PwC (financial): Data Table Assurance Report	AFW.CA.A2; AFW.CA.A4, AFW.CA.A5
CA.A3.1 Executive Remuneration Policy	AFW.CA.A3
CA.A4.1 Ofwat email on new financial model dated 6 March 2019	AFW.CA.A4