

TA 2.1 Statements of Board Assurance Technical Annex

September 2018

Version 1.0

Purpose

Ultimate accountability for our Business Plan lies with the full Board. This technical annex provides the Board's full Assurance Statements for our plan, and how the Board satisfied itself with regard to each statement. This annex should be read in conjunction with Chapter 2 - Trust, Confidence and Assurance, alongside TA.2.2 Board Engagement and Challenge.

Summary

We, the Board of Southern Water, are pleased to submit our Business Plan for 2020-25. Together, the fourteen collective assurance statements we have made in this document summarise:

- Why the Board considers all the elements of the plan (including supporting data) add up to a business plan that is high quality and deliverable;
- How we have challenged company management; and
- The process we have used to arrive at the view that the plan is the best it can be.

These statements specifically address the areas where Ofwat has asked company boards to provide a statement regarding the business planning process and two additional areas of the plan (innovation and past performance). For each area we set out the key statement we wish to make, and the process and evidence we relied upon to satisfy ourselves with regard to making the statement.

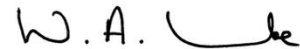
Signed by the Directors of the company:



Richard Manning
Company Secretary



Mike Putnam
Independent non-executive director



William Lambe
Chief Financial Officer



Wendy Barnes
Non-executive director



Sara Sulaiman
Non-executive director



Ian McAulay
Chief Executive Officer



Bill Tame
Chairman



Paul Sheffield
Senior independent non-executive director



Rosemary Boot
Independent non-executive director

Statement 1: Ownership of the plan

The Board provided strong leadership, governance and expertise in developing the overall long-term strategy and direction of the Plan – which is to become “brilliant at the basics” and to deliver transformational programmes to create a resilient water future for customers in the South East of England. This strategy has been informed and shaped by the views and priorities of our customers in the widest sense.

How the Board satisfied itself:

- As a Board, we provided substantial input and challenge throughout the development of the strategy and plan. Our involvement went far beyond our usual meetings and discussions. We worked closely with Management over a period of almost two years – to illustrate:
 - We held 11 dedicated PR19 Board engagement days. These each lasted at least a full day and were designed to provide a full opportunity for the Board to discuss, shape and challenge the key components of the Plan. At each session, we provided feedback and challenge to Management on the emerging Plan.
 - We established four dedicated PR19 Board sub-committees which met 33 times. Membership of the sub-committees was determined based on the expertise of individual Board members (see TA2.2). This allowed Board members to undertake ‘deep dives’ into the specific content areas which support the overall strategy. All NEDs played an active role in one or more of the sub-committees. The sub-committees reported back to the full Board via Board engagement days.
 - Individual Board members also contributed their expertise through regular 1-to-1 sessions with management (to address follow-up queries and feedback), and through reviewing the specific chapters of the Plan most relevant to their expertise. The full Board reviewed the Executive Summary and Ambition sections of the Plan (which summarise the overall strategy and long-term direction).
 - The Board was heavily involved in the company’s refinancing (Project Hydrus). This was the subject of a separate programme of Board engagement.
 - Management provided separate, regular briefing sessions to shareholders throughout the development of the plan. On some occasions, shareholders attended PR19 Board engagement days.
- The company consulted with customers and stakeholders on the long-term strategy at several points. This included three key strategy consultations - “Let’s Talk Water – Starting the Conversation”, “Let’s Talk Water - A resilient future for water in the South East” and “Water Futures in the South East – Towards 2050”. Management explained how feedback from these consultations informed the overall Ambition for the plan, including how it was used to update the company’s initial thinking regarding customer Outcomes. The Board Sub-Committee for Customer Engagement and Insight reviewed the results of bespoke research undertaken to validate customer views on the proposed Outcomes, and to further understand customer’s specific priorities. Final Outcome proposals were independently authenticated by Corporate Culture and tested with our customers to ensure the Plan adequately reflected their views. Outcomes were also reviewed and challenged by the CCG.
- We approved the final business planning decisions, including (but not limited to) bill levels, totex and efficiency plans, performance commitments, and risk and reward package. This approval was given in August 2018, only after management presented a summary of the key proposals (and explained how these key proposals addressed prior Board feedback/challenge) and after Independent Assurers presented their views

each higher-risk component of the Plan (which occurred in July).

Further evidence contained in the plan:

- Chapter 1 - Executive Summary and Chapter 3 - Our Ambition and Pathway to PR19 sections of the Plan
- Chapter 4 - Customer and Stakeholder Engagement and Participation and annexes
- TA2.2 Board Engagement and Challenge

Statement 2: High quality and deliverable plan

The Board has challenged and satisfied itself that **all the elements add up to a Business Plan that is high quality, challenging and capable of being delivered**. The Board is satisfied that the Plan is appropriately ambitious and challenging in the areas that matter most to customers.

How the Board satisfied itself:

- As described in Statement 1, as a Board, we discussed, challenged, and ultimately approved final business planning decisions. We considered individual aspects of the Plan at Board Engagement Days and at “deep dive” sessions at meetings of the four PR19 Board sub-committees. The emerging plan was considered “as a whole” following each lock down milestone in the plan’s development, and was approved by the full Board in August 2018. During this process, the Board specifically challenged management to ensure that final proposals (including commitments to customers) are credible and appropriate in the light of the company’s historical performance and are consistent with Ofwat’s vision for the sector.
- We consider that the final plan is ambitious for Southern Water – for example, it includes challenging targets (upper-quartile targets on common industry PCs and a leakage reduction target of 15%), a programme of transformational initiatives (such as Target 100), and a significant efficiency challenge that will (with a lower WACC) help keep bills affordable.
- Going forward, the Board is committed to reviewing, challenging and assuring the detailed schedule of activities which are required to implement the Plan as these are developed, and ensuring appropriate mitigation is in place to manage implementation risks. This includes overseeing the sorting out of historic issues; the embedding of a values based culture change programme adopting ethical business practice; the effective move to a lower cost delivery partner for retail while improving C-Mex, and continuing to build the skills and capabilities required to deliver the scale of change required.
- The Board appointed PwC as Strategic Assurers for PR19. PwC completed a programme of 'review and recommend' assurance work at specific points in the development of the Plan. Their review focused on improving the overall quality and consistency of the Plan against Ofwat’s expectations – this covered both individual parts of the plan, and the plan as a whole. They provided their independent view directly to the Board at 3 separate milestone points and the Board took this view into account when challenging management’s proposals.
- The Board also received comprehensive technical and financial assurance on the components which make up the Plan (this is explained in the PR19 Assurance Framework which the Board Assurance Sub-Committee reviewed and challenged in detail, and includes engineering, economic and financial components). The level of assurance received on each item is based on the risk of the particular item, the company’s historical performance and categorisation in the CMF.

Further evidence contained in the plan:

- TA2.2 Board Engagement and Challenge
- TA2.3 PR19 Assurance Framework

Statement 3: Data

The Board has challenged and satisfied itself that the **overall strategy for data assurance and data governance**, for the PR19 Plan and for ongoing operations, **is appropriate having regard to the company's past shortcomings in data quality**.

The Board put in place a **risk-based assurance process** to help improve the accuracy and robustness of the data used to develop the PR19 Plan. The Board is committed to transparent reporting of high quality data that can be trusted.

How the Board satisfied itself:

- The Board recognises that the Plan has been prepared at a time where the company is under investigation by the EA and Ofwat, and under scrutiny by the DWI. In both cases, the company has fallen short of the standard of performance expected from the business and the required level of accuracy and consistency of relevant performance reporting. The Board takes these shortcomings very seriously. In this context, the Board has been closely involved with the company's plans to improve compliance generally, and data assurance and data governance on a business as usual basis. For example, the Board has been actively involved in the establishment of a new governance and assurance structure to monitor and address compliance and risk, including data risks. This includes a dedicated data team (with new capability in information management) and a new Compliance and Asset Resilience Directorate.
- We adopted an Assurance Framework for PR19 which follows the 'three lines of defence' model. All data tables were assured, and higher-risk data items were subject to additional layers of assurance by independent third parties. Deloitte reviewed the financial data tables (including allocation of costs, and consistency between models and data tables) and PwC reviewed the non-financial data tables. Jacobs provided more focused assurance regarding investment plan data.
- We established a Board sub-committee for Assurance which reviewed the proposed coverage/depth of third party assurance over data tables. The full Board also met directly with PwC, Deloitte and Jacobs in July 2018 to discuss their findings regarding the data accuracy and assumptions. Final reports were provided to the Board in August for consideration in approving the plan.

Further evidence contained in the plan:

- Assurance from PwC and Deloitte on data (see TA2.3 PR19 Assurance Framework)
- Action plan sent to Ofwat – PR19 version

Statement 4: Statutory and Licence obligations

The Board is satisfied that the Plan will enable the company to meet its current and – within reasonable expectations – its future **statutory and licence obligations** and takes account of Government's strategic policy statements.

The company is taking active and significant measures to strengthen its processes and systems of control to meet and report on those obligations. **The Board will continue to monitor and review compliance risks now and in AMP7.**

How the Board satisfied itself:

- The plan includes a detailed report on meeting our statutory and licence obligations, developed with the assistance of the external law firm, Herbert Smith Freehills, and made available to the Board as part of the assurance process. The Board sub-committee for Assurance reviewed this report and discussed and provided feedback on the contents with management and with Herbert Smith Freehills. Herbert Smith Freehills also presented its views of the report to the full Board at the Board Engagement Day in July 2018.
- The full Board also received technical assurance from PwC on the alignment of PC definitions to relevant obligations, technical assurance from Jacobs regarding the extent to which specific investment cases enable the delivery against obligations, and technical assurance from KPMG on financeability (including testing scenarios).
- As explained above, the Board notes that the company is currently under investigation into the performance of wastewater treatment sites and the reporting of relevant compliance information. The company is committed to working proactively with the EA and Ofwat to resolve their investigations which are still evolving. The Board is committed to monitoring the implementation of activities which will strengthen both information management and the cultural change which is required to make sustained improvements in working practices, and wastewater reporting processes and systems. An action plan setting out specific actions to address issues arising from the investigations was specifically prepared and provided separately to Ofwat on 27 June 2018. A version of this is available for PR19 purposes.
- To ensure the Board is kept abreast of compliance issues as they arise and can react accordingly, all board meetings have a standing agenda item for an update on compliance matters, delivered by the Director of Compliance and Asset Resilience. The Management team will also keep the Board updated and involved in forward planning around new statutory and licence obligations.
- As part of this activity, the Board specifically notes that the company is undertaking transformational cultural change across the business, including working with independent experts in establishing and embedding an appropriate ethical business framework and implementing a new Modern Compliance Framework. The overall goal of the Modern Compliance Framework is to ensure that Southern Water has three effective lines of defence in place when it comes to compliance matters. Progress is reported quarterly to the Board Audit and Risk Committee.

Further evidence contained in the plan:

- TA2.2 Board Engagement and Challenge
- TA2.3 PR19 Assurance Framework
- TA2.5 Meeting Our Statutory and Licence Obligations
- TA2.6 Legal Instruments (WINEP and DWI Notices)

Statement 5: Resilience

The Board is satisfied that the Plan, and the company's governance and assurance processes, will **deliver enhanced operational, financial and corporate resilience** over the next control period and in the longer term.

The investment plan is focused on improving the resilience of water and wastewater services. The company has and will continue to put in place a set of actions, reflecting ethical business practice, to improve corporate and financial resilience. **This has been informed by assessments of resilience and risk, the options for managing resilience, and reflects customer views.**

How the Board satisfied itself:

- The Board is committed to maintaining high standards of leadership, transparency and governance, and recognises the process of governance and assurance is key to resilience. We have adopted the Southern Water Code of Board leadership, transparency and governance, which fully reflects the Board leadership, transparency and governance principles issued by Ofwat and draws extensively from, and places emphasis on, appropriate principles from the UK Corporate Governance Code issued by the Financial Reporting Council. The code is reviewed on a regular basis to ensure that it reflects appropriate changes to UK Corporate Governance Code.
- Resilience has featured heavily in Board discussions over the past two years. The full Board reviewed and provided input into the company's approach to "resilience in the round" and on specific resilience and risk issues (spanning operational, corporate, and financial issues, alongside information, cyber, culture and skills issues). In terms of the PR19 plans, this includes detailed discussions at the May and June 2018 Board Engagement Days. The Plan explains the company's assessments of resilience, the approaches to mitigation, and options considered for managing resilience.
- We recognise the importance of financial resilience with respect to our services for customers. This is reflected in our proactive approach to our capital structure that has culminated with plans to reduce gearing to 70%.
- The Board received independent assurance on certain aspects of resilience, including financial resilience. KPMG provided assurance over the financial resilience and financeability of the Plan on a notional and actual basis. To support this, the Board also sought advice on the future deliverability of the target capital structure from Rothschilds. Jacobs reviewed the extent to which the wholesale business cases support resilience.
- We have put in place an ongoing process to evaluate and monitor resilience risks going forward. Resilience risks are identified and managed as part of the company's risk system, which is discussed regularly with the Executive Leadership Team (ELT) and quarterly with the Board Audit and Risk Review Committee (ARRC). Further improvements are planned for monitoring around operational resilience risks, including the development of 'leading indicators' which the ELT will monitor (as part of redesigning the company's performance metrics) and escalate emerging issues to the Board. The company plans to undertake a dedicated holistic resilience assessment on an annual basis (our current resilience assessment is appended to the plan) which the Board will review.

Further evidence contained in the plan:

- TA2.2 Board Engagement and Challenge
- Chapter 7 - Delivering Resilience in the Round and supporting annexes

TA2.3 PR19 Assurance Framework Statement 6: Trust and confidence

The Board is committed to **continuing to build trust, confidence and legitimacy**. The Plan is informed by our customers' expectations regarding transparency and trust, and we are committed to continuing to meet their expectations.

In addition to continuing (and increasing) high levels of transparency and engagement, the Board is committed to being transparent with customers and stakeholders in external reporting, and to demonstrating how we are achieving **a fair balance between customers and investors**.

How the Board satisfied itself:

- We are overseeing development of a five-pronged approach to developing customer trust and confidence to ensure we put customers at the heart of everything Southern Water does – a new and effective customer engagement and participation strategy; a customer experience that is refreshingly easy to deal with; using research to inform our approach to customer communication; developing a PC on trust; and how we are responding to financial and structural issues that are identified as reducing trust. The CCG has helped us with this (and engaged directly with the Board) for example by contributing to the design of the research we used to develop our approach to customer trust and confidence.
- We used insights from our customers and stakeholders to inform our specific proposals on increasing transparency and best practice governance. For example, management commissioned research with over 1,000 customers and stakeholders on how we can engender trust, and what information presented in what way would support the development of trust. This research was used to develop principles about how Southern Water will communicate with customers in contacts with them.
- Our Board sub-committee for Customer Engagement and Insight met 6 times to discuss the programme of engagement (including engagement and transparency around financial structures). At appropriate times, information on the company's historical performance was provided to customers and stakeholders both through the programme of engagement and indirectly via updates on the website and annual report. The Sub-committee also discussed our future customer engagement and participation strategy beyond PR19, exploring the wider customer experience and ensuring feedback from customer views into our future plans.
- We have already committed to (or undertaken) action regarding financial and structural arrangements, which the Board intends to implement in line with Ethical Business Practice and Public Sector Values:
 - We announced the closure of the Cayman Islands subsidiary.
 - The planned re-financing of the company will create a simple and clear holding company structure.
 - We have started a process to review and refine our existing dividend policy to reflect Ofwat's 31 July 2018 position statement. We expect to publish the revised dividend policy in our 2018/19 Annual Report and Annual Performance Report. The formulation of this revised dividend policy will incorporate a wide range of measures, including financial measures, customer performance measures and public service value measures that apply to our wider stakeholders and gauge our contribution to society at large.
 - We intend to reflect the principles set out in the Ofwat consultation on performance-related executive pay in line with our response to the consultation. Our plans to further revise our executive pay policy will build on the principles in our existing remuneration policy (updated less than 12 months)

ago), which already considers performance across a balanced set of outcomes for stakeholders. We will maintain a link to things our customers value; we will continue to report transparently on performance against bonuses; and we will formally review our policy annually.

Further evidence contained in the plan:

- Chapter 4 - Customer and Stakeholder Engagement and Participation and annexes
- Chapter 16 - Risk, Return and Financeability
- TA4.5 CCG Challenge Log

Statement 7: Customer Engagement

The Board is satisfied that management has undertaken a wide ranging and thorough customer engagement programme, and that the Plan has been **informed by the results of customer engagement and collaboration**.

The Board is satisfied that the approach to, and application of, customer engagement results has had appropriate input and challenge from the CCG.

How the Board satisfied itself:

- Management presented the results of customer engagement to the Board throughout the development of the Plan. Specific proposals were presented to us and discussed in the context of customer views and priorities.
- We established a dedicated Board sub-committee for Customer Engagement and Insight to allow deeper dive into both PR19 and future customer engagement plans. The sub-committee met 6 times and discussed the key customer insights and how management's proposals for how these would inform the strategic priorities and trade-offs across the Plan (alongside wider considerations).
- Management presented the areas of the engagement programme that adopt more innovative approaches, and how certain Outcomes were co-created with our customers and stakeholders. The Board recognises that a key theme of the customer and stakeholder engagement programme is collaboration. The outcome of this is reflected in the collaborative Transformational Initiatives included in the plan, such as Catchment First.
- We provided input into the company's wider approach to customer engagement, beyond the price review process. The Board Sub-Committee for Customer Engagement and Insight discussed and provided input into the creation of a future engagement and participation strategy, designed with the aim of co-imagining and co-creating a resilient water future for the South East with our customers, stakeholders and communities.
- The Board notes that strategic priorities and other results from customer research were shared in detail with the CCG through presentations from subject matter experts in the business. Feedback from the CCG to the PR19 planning team and the Board has been captured and formal responses made to CCG. The CCG chair, Anna Bradley, has attended Board meetings on a quarterly basis and met monthly with CEO Ian McAulay. A Board member has also attended each CCG meeting. This has allowed the CEO and Board to understand the CCG's view on what is going well and what is not, and areas requiring further focus. In July 2018, the CCG Chair presented her views on the Plan to the full Board regarding the quality of customer research and how the results are reflected in the Plan. The company will continue to engage with our CCG throughout the remainder of AMP6 and into AMP7, ensuring customer views remain at the heart of the business.
- We sought assurance from RAND on the quality of customer research and the accuracy of conclusions, and from PwC regarding the extent to which proposals are supported by customer evidence. RAND presented their views to the Board at the Board Engagement Day in July 2018 as part of the Board's deliberations on the Plan, and provided a final report in August 2018.

Further evidence contained in the plan:

- Chapter 4 - Customer and Stakeholder Engagement and Participation and annexes
- TA4.5 CCG Challenge Log
- RAND Assurance on customer engagement (see TA2.3 PR19 Assurance Framework)

Statement 8: Affordability and Vulnerability

The Board is satisfied that the Plan is designed to keep **bills affordable for all customers**, now and in the longer term. The Plan delivers an average bill reduction of c.3% in real terms in AMP7, and provides specific support for those struggling, or at risk of struggling to pay.

The Plan offers a step change in the breadth and quality of support for **vulnerable customers** – this includes, but now goes beyond, support for customers that are financially vulnerable.

How the Board satisfied itself:

- Management presented its proposed approach to affordability and vulnerability at Board Engagement Days on 6 separate occasions. We challenged management to include interventions that ensure bills remain affordable to all. For example, we discussed and provided challenge on both wholesale and retail costs at 4 milestones during the development of the Plan (at Board Engagement Days). The Board sub-committee for Delivery and Efficiency also conducted deep dives into efficiency plans.
- Management explained to the Board how they had considered the impact of the plan on all customers. The Plan includes a real term reduction in bills in AMP7 of c.3%, which will improve affordability for all customers. The Plan includes a range of assistance schemes to specifically ensure appropriate support is provided for customers who are struggling to pay their bills. Independent assurance over the supporting models used to develop these proposals was provided by Oxera, who presented their views to the Board at the Board Engagement Day in July 2018.
- The Board discussed how the Plan will improve our ability to deliver accessible and effective support to customers in circumstances that might make them vulnerable and is tailored to the needs of individual customers. The Board notes that the Plan includes a different approach to understanding vulnerability than the company has taken in the past, through working with trusted partners in our Customer Inclusion Partnership Network (CIPN), formed of experts in vulnerability including AgeUK, MIND, StepChange and Citizens Advice Bureau.
- The Regulation, Finance and Pricing Sub-Committee undertook a deep dive on PCs and ODIs. This included consideration of the proposed performance commitments for both the effectiveness of financial assistance and provision of additional support for vulnerable customers as part of providing an inclusive service. Management presented draft and final proposals to the full Board at two Board Engagement Days. To assist with the Board's review, PwC provided targeted assurance regarding the appropriateness of the definitions and targets (as for all PCs).
- The Board's Customer Engagement and Insight Sub-committee considered the reflection of customer engagement in the plan, and addressing feedback from the CCG. This included specifically our approach to affordability and supporting vulnerable customers.

Further evidence contained in the plan:

- TA2.2 Board Engagement and Challenge
- Chapter 8 - Helping customers who need our support – our response to the challenges of affordability and vulnerability.
- Oxera assurance on our affordability model (see TA2.3 PR19 Assurance Framework)

Statement 9: Outcomes

The Plan includes **ambitious outcomes for customers** which are informed by the needs and priorities of customers and the environment, both now and in the longer term.

These outcomes are backed-up by a suite of **stretching PCs and ODIs** which will require the business to deliver a significant improvement in performance in some areas. While the targets set out in the Plan are challenging, the Board is satisfied that the Plan has been designed to **enable the company to deliver on its outcomes and PCs**.

The Company is putting in place enhanced procedures and assurance to ensure that it will **report robustly on PCs and ODIs, and projected performance**. The Board is committed to **monitoring delivery** of outcomes and PCs now and in the longer term, and strengthening the processes used to capture and report information on performance.

How the Board satisfied itself:

- Management presented detailed proposals on Outcomes, PCs and ODIs at Board Engagement Days in August 2017, and March, April, May and June 2018. We discussed the appropriate balance between ambition and deliverability of commitments, and the costs required to deliver different levels of performance. We provided feedback to management on specific PCs and ODIs – for example, we had extensive discussions with management regarding the appropriate penalty for wastewater treatment compliance, recognising the improvements we need to make.
- We established a Board sub-committee for Regulation, Finance and Pricing. The sub-committee conducted a 'deeper dive' into the PC/ODI proposals and rationale (amongst other matters). We also established a sub-committee for Customer Engagement and Insight, which reviewed how customers' views were incorporated into the proposals.
- We received independent technical assurance over PC definitions, targets, and ODI structures from PwC. The Board Assurance Sub-Committee reviewed the scope of this assurance. PwC presented their views to the Board at the Board Engagement Day in July 2018 and provided a final report in August 2018 (PwC's initial report on PC definitions was made available to the Board prior to Board approving the draft list of PCs for early submission to Ofwat in May 2018).
- The Board is committed to delivering outcomes for customers and reporting robustly on PC and ODI performance, and to continuing to strengthen the company's procedures around monitoring and reporting. In particular, the Board has been extensively involved in plans to address previous feedback from regulators on how the company reports performance. For example, the Audit and Risk Review Committee is monitoring the completion of a risk-based programme of assurance activities designed to strengthen the practices, procedures and systems used to secure compliance with Licence and related Statutory obligations (including reporting against PCs and ODIs). This programme of activities is planned to continue into AMP7.

Further evidence contained in the plan:

- TA2.2 Board Engagement and Challenge
- PwC Assurance on PCs and ODIs (see TA2.3 PR19 Assurance Framework)
- Chapter 6 - Outcomes, Performance Commitments and Outcome Delivery Incentives

Statement 10: Cost assessment

The Plan uses **efficient and robust expenditure forecasts**. The Board notes that the expenditure forecasts included in the Plan include a significant efficiency challenge. Large investment proposals presented in the Plan were robustly developed to ensure they are the best ones, taking account of customer, engineering and environmental evidence.

How the Board satisfied itself:

- Management presented its latest expenditure forecasts at Board Engagement Days following each 'lock down' milestone. We challenged Management hard to find opportunities to reduce costs further (and corresponding implications for performance and risk).
- We established a Board sub-committee for Delivery and Efficiency to enable a deeper dive on cost assessment. The sub-committee reviewed emerging efficiency assumptions and cost estimates, as well as the plan for delivering investment proposals - this was a particular area of focus given the significant step change in the company's cost base.
- The Board received technical assurance over the bottom-up cost forecasts, and independent input on the top-down cost forecasts used to prepare the plan. Jacobs reviewed both the company's approach to cost estimation and conducted a risk-based review of individual investment cases to test the appropriateness, strength of evidence (including appraisal of options using a multi-criteria assessment framework), and that the conclusions represent the best option for customers over the longer term. Oxera conducted an independent analysis of the top-down Botex modelling and possible cost allowance. Jacobs and Oxera presented their views to the Board at the Board Engagement Day in July 2018.

Further evidence contained in the plan:

- TA2.2 Board Engagement and Challenge
- Chapter 14 - Wholesale Cost Efficiency
- Jacobs assurance on bottom-up cost estimates (see TA2.3 PR19 Assurance Framework)

Statement 11: Risk and return

The Board notes that the plan represents a **step change in performance**, as benchmarked against best practice elsewhere in the water industry and beyond. The intent of the plan is very clear and there is a detailed understanding of what needs to be achieved in the remainder of AMP6 and beyond.

The **scale of change** gives rise to delivery risks and management plans will continue to be refined to address these. The Board will continue to monitor delivery and execution of the plan through to 2025.

How the Board satisfied itself:

- Management presented a view of the risk associated with different plan options at Board Engagement Days following each 'lock down' milestone. The Board acknowledges that the final plan presents risks across a number of areas (e.g. the existing cost base for both retail and wholesale areas of the plan are above the company's estimates of industry efficient costs for both retail and wholesale areas of the plan).
- A key area of focus for the Board sub-committee for Delivery and Efficiency was the deliverability of the totex forecasts set out in the plan. As outlined above, from May 2018 the Delivery and Efficiency Board Sub-Committee carried out an initial review of high level delivery plans. Going forward, the Board is committed to reviewing and challenging the detailed schedule of activities which are required to implement the Plan as these are developed, and ensuring appropriate mitigation is in place to manage implementation risks.
- Management presented a consolidated assessment of risk on the Business Plan (including stress testing around financial resilience) at the Board Engagement Day in July 2018. The Board approved the final risk and reward package included in the Plan.
- The Board is also focused on ensuring the company has the right organisational capability, alongside the right governance structure, to enable the delivery of the Plan. Challenges from the Board regarding capability and culture helped to refine the approach to transforming the business, and the Board will continue to monitor progress. This includes overseeing rectifying historic issues, embedding a values-based culture change programme adopting ethical business practice, the effective move to a lower cost delivery partner for retail while improving C-Mex and continuing to build the skills and capabilities necessary to deliver the scale of change required.
- Notwithstanding these delivery risks, the Board is confident that the plan will enable the company to maintain (and improve) resilience for the benefit of current and future customers. As part of its ongoing monitoring and assurance programme, the Board will provide oversight of management's plans to deliver the cost targets and is committed to protecting customers from failing to deliver the commitments set out in the plan.

Further evidence contained in the plan:

- TA2.2 Board Engagement and Challenge
- Chapter 16 - Risk, Return and Financeability

Statement 12: Financeability

The Board has considered the financeability of the Plan and confirms that it is **financeable on both the notional and actual capital structure** and the Plan protects customer interests in both the short and long term.

How the Board satisfied itself:

- We were fully engaged on the strategies for securing financeability. Management presented its initial views on financeability to the full Board as early as August 2017 (in context of the company's proposed refinancing) with regular updates following each 'lock down' milestone. We were also heavily involved in the recent review of the company's capital structure and refinancing plans.
- We established a Board sub-committee for Regulation, Finance and Pricing. Amongst other matters, the sub-committee's role was to undertake 'deeper dives' on the financing implications of the plan, as well as to review financeability risks and scenarios. The Board sub-committee reviewed information and evidence to support the financeability of the plan on both a notional and actual basis.
- The Board notes that the plan meets our actual target credit ratings for S&P, Fitch and Moody's respectively. This provides security of service for our customers, being more stringent than the minimum licence requirement of investment grade, and is consistent with the terms of our financing arrangements. The notional capital structure is also financeable - it meets the requirements of a BBB credit rating, albeit with limited headroom.
- KPMG reviewed and provided advice to the Board on the financeability of the Plan on a notional and actual structure. This included stress testing under a range of individual and combined scenarios. The Board also sought advice from Rothschild on the deliverability of the capital structure which KPMG took into account in their work. KPMG presented their views to the Board at the Board Engagement Day in July 2018 and provided a final report in August which the Board took into account when approving the Plan.

Further evidence contained in the plan:

- Chapter 16 - Risk, Return and Financeability
- TA2.4 Trust and Transparency
- KPMG assurance on financeability and financial resilience (see TA2.3 PR19 Assurance Framework)

Statement 13: Innovation

The Board recognises the **importance of innovation for customers** and notes that innovation underpins most of the proposals put forward in the Plan.

The Plan represents a very different way of working for Southern Water, involving extensive collaboration and coordination with other organisations.

How the Board satisfied itself:

- Management presented its proposed approach to innovation at three Board Engagement Days in August 2017, January and May 2018. This included the overall strategy for innovation, and specific investments/proposals such as bluewave and the outcome of its assessment of eligible projects for Direct Procurement for Customers (DPC).
- We recognise that the transformational initiatives set out in the Plan (such as Target 100, Catchment First, and Resource Hubs) reflect a different and more collaborative way of working with customers and stakeholders and will help the company to achieve its longer-term ambition.
- A panel of prominent independent subject matter experts was appointed (the “Challenge Panel”) to inject new thinking into the Plan and help calibrate management’s view on the level of ambition. The Board sub-committee for Assurance reviewed the comments made by the Challenge Panel Members and management’s proposals for how these should be adopted in the Plan.

Further evidence contained in the plan:

- TA2.2 Board Engagement and Challenge
- Chapter 10 - Innovation

Statement 14: Past performance

The Plan accurately **accounts for past performance**. The Board notes that some performance information (related to wastewater treatment works) has been restated and is subject to ongoing discussions with Ofwat and the EA. The Board is committed to providing an appropriate degree of transparency with customers and stakeholders regarding the reasons for this and how the company's data processes are, and continue to be, strengthened.

How the Board satisfied itself:

- As described above, Southern Water's 2018 Annual Report includes information regarding the restatement of past performance information (which is subject to ongoing discussion with the EA and Ofwat). The Board has been closely involved in this issue and is committed to working proactively with the EA and Ofwat to resolve their investigations which are still evolving. In this context, the Board has been closely involved with the company's plans to improve data assurance and data governance (described further under Board Statement 3 – Data).
- In our 2018 Annual Report, the Chairman, Bill Tame, said that the Board is clear that Southern Water is facing a number of historical issues with aspects of internal culture and behaviours that have not always led to the right outcome for customers, regulators, the environment and other stakeholders. It is the Board's priority to address these legacy matters, as they directly affect the company's ability to deliver the transformational improvements set out in the Plan.
- The Board has overseen the significantly improved the level of internal technical assurance of the company's performance data spanning 2017 to 2010, including the engagement of Jacobs to undertake independent external assurance of the internally reviewed data and ensure full confidence in the assured data (this work is yet to complete at time of submitting the Plan).
- The Board is also committed to monitoring the implementation of activities which will strengthen both information management and the cultural change (embedding of a values based culture adopting ethical business practice) which is required to make sustained improvements. We are encouraged by the progress that has been made to date and confident that the groundwork has been laid to enable the company to embed the change that is required in a timely manner. We will continue to prioritise this work leading into, and throughout AMP7.
- The Board received assurance from PwC over the AMP6 performance and financial data included in the PR19 business Plan (and July submission on legacy mechanisms). As part of their review, PwC also assessed the reasonableness of forecasts to the end of the AMP, in light of recent performance. The scope of this assurance was reviewed by the Board sub-committee for Assurance in March 2018. PwC presented their findings to the Board at the Board Engagement Day in July 2018 and issued a final report in August 2018.
- The Board notes that additional internal technical assurance over wastewater performance reporting is being conducted by Jacobs.

Further evidence is contained in all parts of the plan, but especially in:

- Chapter 17 - Accounting for Past Delivery
- TA2.2 Board Engagement and Challenge
- TA2.5 Meeting Our Statutory and Licence Obligations

- PwC Assurance on Legacy Mechanisms (see TA2.3 PR19 Assurance Framework)