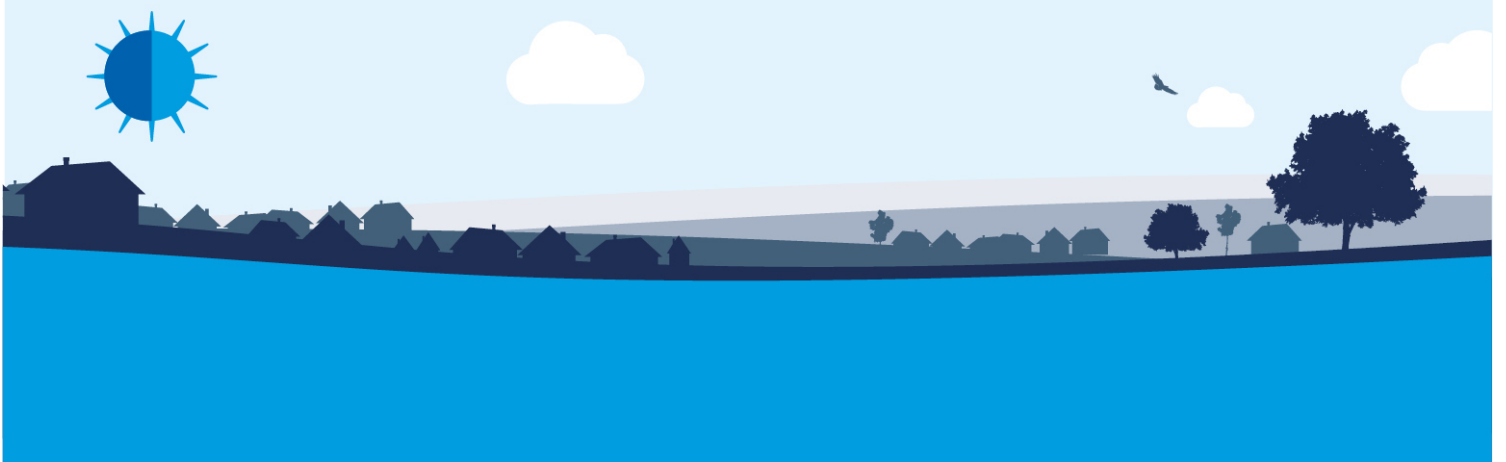


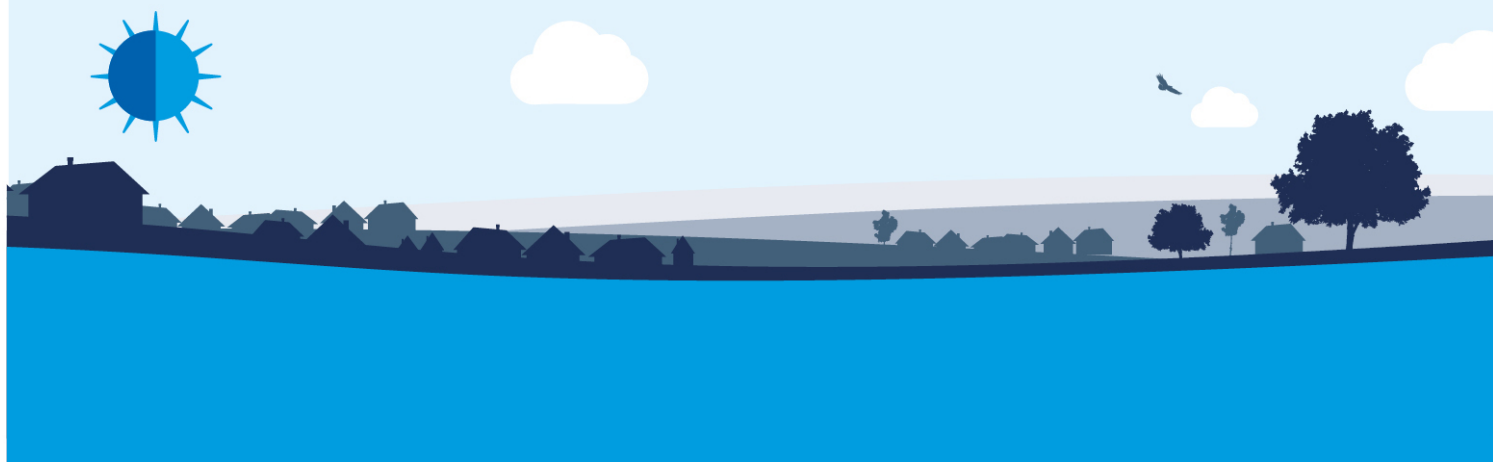
Appendix RA11

1. Board assurance statement
2. Jacob's independent assurance reports
3. Independent internal audit report

1 April 2019



1. Board assurance statement



Board assurance statement

The Board considers all the elements add up to a business plan that is high quality and deliverable

The Board of South Staffs Water owns and is fully accountable for the business plan that we are putting forward. We are able to provide to Ofwat and our customers and stakeholders comprehensive and robust assurance due in part to our scrutiny of the business plan being put forward but more importantly because we have been actively involved in its creation from the beginning and have challenged throughout its evolution. We believe that there have been some particular points where our input has been invaluable in shaping the plan we now submit:

From the outset our aim was to produce a business plan that was rooted in a genuine understanding of customer needs and also was innovative and ambitious. With this in mind we have mandated a substantial investment in a comprehensive and multi-faceted customer engagement programme. We have reviewed the outputs from this programme carefully and we have observed a number of the focus groups over the last two years. The plan reflects our customers' views and they have helped us create it.

The Board initiated an exercise to review the company's comparative performance in the industry across a number of key service measures as well as our cost efficiency. This led to the aspiration that we would put forward a plan that would place us as leaders in the industry on performance measures that matter most to customers. The package of performance commitments we are putting forward reflects customer priorities and we believe it is very ambitious.

Despite there being a challenging environment we are planning to invest substantially more than we have historically and in particular to overhaul our two major treatment works, Seedy Mill and Hampton Loade, to create clear water quality and resilience benefits for customers. We have carefully considered a wide range of options and sought advice from a variety of leading experts and the resulting cost adjustment claim has the strong support of our customers.

We have also taken time to consider many different approaches to the challenges we face. We have considered new technologies, different ways of working, ideas from other parts of the world and feedback from our own team. The plan we are putting forward is innovative and we believe it will help to move the sector forward in a number of areas benefitting customers beyond our geographical monopoly areas.

We have also considered our customers who are vulnerable and made special provision for them both economically but also through a tailored support package. We know that this is not the most economically efficient approach but it is the right approach for a public service provider with a universal service obligation to take.

For our resubmission we have carefully considered the feedback we received from Ofwat and other key stakeholders. In response to this feedback, the main changes made to our plan are as follows.

We have provided more detail around our long-term financeability on both our notional and actual structure. This includes pulling a financial lever to make a 3% adjustment on PAYG, which will improve our overall financial resilience as it gives us extra headroom. This revised proposal enables us to maintain a flat nominal bill profile of £147 that has the support of the majority of our customers – and that Ofwat has recognised as innovative in the area of affordability – and deliver a 9% reduction in bills in real terms over the period 2020 to 2025. We have also put in place a customer protection mechanism that minimises the risk of a bill shock in 2025/26.

We are pleased that Ofwat has recognised the high-quality approach we have taken to our performance commitments and stretching service levels. We have responded to Ofwat's feedback on both our overall package of outcomes and individual ODIs. We have looked again at our use of scaling factors and have reverted back to the natural willingness to pay data and using your formulae to work out the levels of incentives. We have also looked to balance the level of incentives across the overall package back to our customer engagement. And we have carried out more specific engagement with customers on incentives, including the use of caps, collars and rewards.

While we welcome Ofwat's recognition of the high-quality evidence of the need and support for the upgrade of our two water treatment works, we have provided additional clarity around how the trunk mains cleaning element is integral to the commissioning of the works and in ensuring the benefits of the additional treatment stage reaches our customers at the earliest opportunity. Our plan also sets out our existing levels of base maintenance expenditure at both treatment works in the context of Ofwat's implicit allowance challenge, as well as providing further information in terms of water quality data supporting our claim. Finally, we have included the latest information from the supply chain process, which supports our original costing analysis carried out by Costain.

We have also considered some specific areas in providing our assurance.

Resilience

We have considered the approach taken to ensure that resilience will be managed in the interest of customers for the long term. At an early stage the Board saw an innovative approach to modelling resilience (our 'resilience lens') and this became embedded within our process for choosing the best investment options for our customers and our business.

We have also reviewed in detail our financial resilience in delivering our plan. As part of our annual reporting, we assessed the long term viability of the company based on our business plan projections. Based on the financial projections, the stress tests performed and the mitigations considered, we declared that the company is financially resilient for at least the

seven years to 2025. Our assessment of the financial resilience for the business plan is consistent with this.

Earning customers' trust

Recognising we are a public service provider, we recognise the importance of being transparent with our customers on corporate and financial structures. We need to measure that trust.

As part of our engagement with customers we proposed a performance commitment in relation to trust based on customer surveys carried out by us and by CCWater. We have also committed to being open and transparent through our website and our annual reporting. Our Annual Performance Report sets out in detail our group structure, our Board and governance arrangements and our approach to executive pay. We also recognise the importance of Ofwat's position statement on 'putting the sector back in balance' and have ensured that the specific points are appropriately covered in our plan.

Meeting statutory and licence obligations

We have a number of statutory and regulatory obligations as a Water Undertaker. These obligations are predominantly set down in the Water Industry Act 1991 and our Instrument of Appointment (the 'Licence'). Each year the Board considers its obligations as a water undertaker and that we understand and comply with them. The Board believes that these ongoing statutory and licence obligations will still be met in the future as we deliver our business plan.

As part of the business planning process, the Board have also considered whether our plan will ensure that we will also meet new specific obligations set out in the Water Industry Strategic Environmental Requirements (WISER) document. In June 2018, the EA asked companies to provide assurance that their business plans will include actions, investments and approaches that meet these expectations and we have been able to provide this assurance.

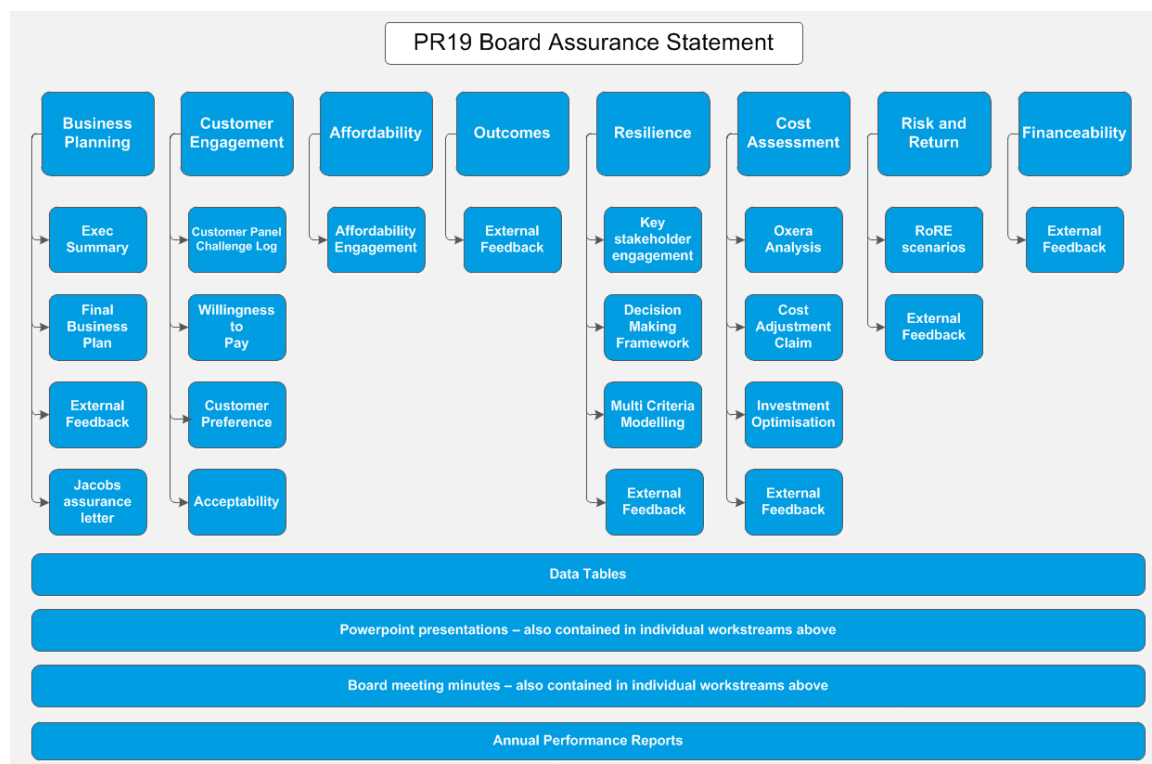
The Board has also ensured that the plan meets the expectations of the government's Strategic Direction Statement (SDS) in particular in the areas of resilience and protecting customers.

We are therefore able to provide our assurance that this plan is the right plan for our customers and we commend it to you.

Evidence of Board input and challenge

The Board has been fully involved in the development of the plan and has continually challenged management.

For the past 18 months, the Board has been presented with regular updates on proposals from presentations at the monthly Board meeting where there has been direct challenge on management. There has been a wealth of information and reports made available and as we have entered the final stages of finalising the plan, the Board has had access via an interactive matrix (see image below) to a secure Sharepoint site containing a library of information to enable us to make the specific assurance statements required.



Directors (including Independent Non-Executive Directors) have attended a number of quarterly independent customer panel meetings and have heard first hand feedback on the quality of the customer engagement. Members of the Board have also attended a number of customer focus groups held as we developed our plan to help ensure that our plan is consistent with customer views.

The Board has had access to both our independent internal assurance manager and external technical auditors (Jacobs) as well as other third party reports to provide further evidence of the quality of the plan. This assurance complemented the evidence base in a number of specific areas:

- Data quality.
- Strength of our investment proposals.
- Financeability, both on an actual and notional structure.
- Cost assessment modelling to confirm our view that the plan is efficient.

The Board has also been provided with additional external assurance on the overall quality of the plan by Jacobs who carried out a 'dry run' of Ofwat's Initial Assessment of Plans (IAP) test.

Board assurance requirements

Below are the specific areas where the Board has provided assurance and the evidence it has considered to enable it to make such a statement.

Area: Business planning
<p>The Board has challenged and satisfied itself that:</p> <ul style="list-style-type: none"> • all the elements add up to a business plan that is high quality and deliverable; • the overall strategy for data assurance and governance processes delivers high-quality data; • the business plan will enable the company to meet its statutory and licence obligations, now and in the future and take account of the UK and Welsh Government's strategic policy statements; • the plan will deliver operational, financial and corporate resilience over the next control period and the long term through the company's governance and assurance processes, taking account of its track record of performance; • it will enable its customers' trust and confidence through high levels of transparency and engagement with customers on issues such as its corporate and financial structures; and • it has provided ownership of the overall strategy and direction of the plan in the long term.
Evidence
<p>Meetings</p> <ul style="list-style-type: none"> • PR19 Board Strategy Day held on 8th March 2017. We shared strategic challenges and Customer Engagement Plan. (Presentation available) • Board Meeting 4th May 2017, Minute reference 2508 - High Level Themes of Ofwat's Customer Engagement Presentation. • Board Meeting 29th June 2017 – Presentation given on PR19 Innovation Ideas – Minute Ref:2539 – (Presentation Available) • Board Meeting 2nd August 2017 – Managing Director's report provided an update on meeting with Cathryn Ross – Innovation Ideas (retail separation, customer segmentation/service plans, Customer Dash Board) • Board Meeting 2nd August 2017 – Ofwat published detailed Retail Methodology, and the summary was shared with the Board. • Board Meeting 2nd August 2017 – Price Service Trade Off research paper presented (Paper available) • Board Meeting 2nd August 2017 – Comparative Industry Performance Industry Benchmarking Report shared – Upper Quartile Challenge made by Board (Paper Available) • Board Meeting 28th September 2017, Minute reference 2544, Chairman met with Jonson Cox – Innovations well received but challenge to Board on ambitious plan delivery). • Board Meeting 28th September 2017, Minute reference 2545 – confirmation of the Company's ambition to pursue exceptional FastTrack plan. • Board Meeting 28th September 2017 – Noted in the PR19 report that the Company had

Area: Business planning
<p>submitted its response to the PR19 Draft Methodology. (Paper Available)</p> <ul style="list-style-type: none"> Board Meeting 19th October – Comparative industry performance for 9 common ODIs shared with board – scale of ambition in ODI package discussed Board Meeting 18th January 2018 – PR19 Board Report noted the Outline Approach to Cost Adjustment Claim. Discussion on Claim vs. Enhancement – concluded claim was appropriate Board Meeting 18th January 2018 – PR19 Board Report noted that Ofwat published its final methodology for PR19 Board Meeting 19th October – MD Report Jacobs contract award Board Meeting 22nd February 2018 – PR19 Board Report, confirmed commissioned Costain to improve robustness of costs for WTWs. Minute reference 2608 Board Meeting 28th March 2018 – presentation on retail strategy and proposed functional separation of retail activity from wholesale
<p>Documentation</p> <ul style="list-style-type: none"> Business plan narrative, against Ofwat summary Delivery against assurance plans, audit reports (internal and external) Risk and compliance statement – we believe that we already comply and have no reason to believe that the business plan would change this Business plan narrative, IAP test, independent assurance reports (eg, financeability) APR disclosures, company dashboard, dividend policy and executive performance related pay Evidence in Board minutes showing time taken in Board meetings to cover PR19 Executive summary and infographics Defra Strategic Direction Statement Company submission in response to the EA's Water Industry Strategic Environment Requirements (WISER) demonstrating that we will meet our statutory obligations.

Area: Customer engagement
<p>The company's business plan has been informed by:</p> <ul style="list-style-type: none"> customer engagement; and feedback from the company's CCG about the quality of its customer engagement.
<p>Evidence</p> <p>Meetings</p> <ul style="list-style-type: none"> June 2017 – Board members inputted into Price and Service Trade off Customer Engagement workstream in response to board challenge to seek an initial view of customers' preferences to a flat or declining bill profile 12th June 2017 - board member observed two Focus Groups with HH and NHH customers in Cambridge region (Foundation Research on customers' priorities). Challenged that the PR19 engagement needs to demonstrate innovation in terms of approach Board Meeting 2nd July 2017 – Price and Service Trade off Customer Engagement Shared Board Meeting 28th September 2017, Board reference 2565 - Customer Panel shared their

Area: Customer engagement
<p>Annual report</p> <ul style="list-style-type: none"> • Board Meeting 19th October 2017 – PR19 Board Report, Approach to Willingness to Pay Engagement shared • Board Meeting 16th November 2017 - Customer Engagement and Insight Manager presented update on PR19 engagement strategy and key findings from customer priorities research. Board challenged that the follow up WTP study should include a sample of customers seeing a lower bill profile. This challenge was confirmed as being incorporated into the follow up study • Ofwat customer engagement meeting 24th January 2018 – attended by Managing Director • Board Meeting 18th January 2018 update on Customer Engagement work steams provided • Board Meeting 28th March 2018 – PR19 Board Report update on ODI Customer Engagement • 24th April 2018 - board member observed morning session of workshop event with HH and NHH customers in Cambridge region (PC/ODI customer engagement) • Board meeting 1st May 2018 – Customer Engagement and Insight Manager presented update on all PR19 Engagement. Board requested to see the full priority ranking of the WTP attributes tested, with a particular focus on reliability of supply options. This was circulated to the board post meeting • Board Meeting 7th August 2018 – Proposal for a flat nominal bill presented including the overwhelming evidence of support from customers • Board Meeting 7th August 2018 – Attendance by Chair of CCG to give feedback on the Panel's report and their views on customer engagement • Board Meeting 7th August 2018 – Presentation of results of customer acceptability testing
<p>Documentation</p> <ul style="list-style-type: none"> • Response to customer panel strategic challenges • Customer panel challenge log • Cost adjustment claim – co-created with customers • Performance commitments – co-created with customers • Scope of work, outputs and dissemination slides for all engagement • Academic peer review of WtP – approach and results • Academic peer review of approach to triangulation • Outputs of Customer Acceptability testing

Area: Affordability
<p>The company's business plan is affordable for all customers, including in the long term and including appropriate assistance for those struggling, or at risk of struggling, to pay.</p>
<p>Evidence</p>
<p>Meetings</p> <ul style="list-style-type: none"> • Board Meeting 28th June 2017 – Approval of increase in Assure social tariff from £1.50 to £3.00 following customer research.

Area: Affordability
<ul style="list-style-type: none"> • Board Meeting 2nd July 2017 – Price and Service Trade off Customer Engagement Shared • Board Meeting 7th August 2018 – Presentation of results of customer affordability testing
<p>Documentation</p> <ul style="list-style-type: none"> • Assure social tariff • Vulnerability sub-group action logs

Area: Outcomes
<p>The business plan will deliver – and that the Board will monitor delivery of – its outcomes and performance commitments.</p> <p>The company's proposed outcomes, performance commitments and outcome delivery incentives (ODIs) reflect customer preferences and are stretching.</p> <p>The company's proposed approach to reporting on its performance commitments, ODIs and projections of outcomes is robust.</p>
<p>Evidence</p>
<p>Meetings</p> <ul style="list-style-type: none"> • Board meeting on 20th January 2017 paper provided on PR19 Outcomes Framework Consultation • Board Meeting 4th May 2017, Minute reference 2499 – Scale and Ambition of Performance Commitments discussed • Board Meeting 28th June – latest list of ODI's and projected targets discussed • Board Meeting 28th September 2017 – Managing Director's report, current performance on 9 common AMP7 PC's reported • Board Meeting 19th October 2017 – scale of ambition of ODI package discussed • Board Meeting 18th January 2018 – Paper shared development of performance commitments for AMP7 • Board Meeting 22nd February 2018 presentation of draft ODI package shared. Minute reference 2611 • Board Meeting 7th August 2018 – final ODI targets presented with agreement to target upper quartile performance in each and review of the financial rewards and penalties and resulting RoRE range
<p>Documentation</p> <ul style="list-style-type: none"> • Evidence of customer co-creation of PCs • Feedback on customer engagement, including WTP and acceptability testing results • Details of how PC levels have been set in relation to forecast UQ level • Review of plans how we will report and communicate performance 2020/25 • Annual assurance plans

Area: Resilience
<p>The company's business plan has been informed by:</p> <ul style="list-style-type: none"> • a robust and systematic assessment of the resilience of the company's systems and services; • customers' views about managing resilience; and • a comprehensive and objective assessment of interventions to manage resilience in customers' long-term interests.
Evidence
<p>Meetings</p> <ul style="list-style-type: none"> • PR19 Board Strategy Day held on 8th March 2017. We shared strategic challenges including Supply Capability Challenges • Board Meeting 29th June 2017 – Long Term Plan Progress Update shared with Board • Board Meeting 29th June 2017 – Presentation re PR19 and Innovation shared. Board Reference 2539 • Board Meeting 28th September 2017 – Multi criteria analysis including resilience was shared with the Board • Board Meeting 28th September 2017 – Approval of Draft WRMP • Board Meeting 19th October 2017, Minute reference 2555 – Approach to operational resilience included in multi criteria further explored • Board Meeting 19th October 2017 – Managing Director's report – shared positive meeting with DWI re WTW • Board Meeting 30th November 2017 – Draft WRMP for submission
<p>Documentation</p> <ul style="list-style-type: none"> • Resilience lens • Multi criteria analysis • Multi region support for cost adjustment claim. • Customer engagement • Long term plan presentations/papers

Area: Cost assessment
<p>The expenditure forecasts included in the company's business plan are robust and efficient. Large investment proposals are robust and deliverable, that a proper assessment of options has taken place, and that the option proposed is the best one for customers.</p>
Evidence
<p>Meetings</p> <ul style="list-style-type: none"> • PR19 Board Strategy Day held on 8th March 2017. We shared strategic challenges including early outputs of Long Term Plan • Board Meeting 29th June 2017 – Long Term Plan Progress Update shared with Board • Board Meeting 19th October 2017, Minute reference 2555 – Least cost scenarios for long term plan and associated sensitivity analysis shared

Area: Cost assessment
<ul style="list-style-type: none"> Board Meeting 30th November 2017 – PR19 Board Report – Approach to Base Capex Programme discussed. Board Meeting 22nd February 2018 – PR19 Board Report, confirmed commissioned Costain to improve robustness of costs for WTWs. Minute reference 2608 Board Meeting 28th March 2018 – Presentation shared on Draft AMP7 Totex position Board Meeting 28th March 2018 – cost adjustment claim for enhancement expenditure at Hampton Loade and Seedy Mill including the positive customer support gained Board Meeting 1st May 2018 - cost adjustment claim for enhancement expenditure and Hampton Loade and Seedy Mill approved Board meeting 28th June 2018 – Presentation on latest Totex position and comparison of Botex to Oxera modelling with conclusion that upper quartile on efficiency
<p>Documentation</p> <ul style="list-style-type: none"> Oxera benchmarking reports Jacobs review of capex optimisation Productivity analysis Efficiency analysis (KPMG presentation) Cost adjustment claim and Jacobs DPC review

Area: Risk and return
<p>The Board has identified the risks associated with delivering the plan.</p> <p>The risk mitigation and management plans the Board has in place are appropriate.</p>
<p>Evidence</p>
<p>Meetings</p> <ul style="list-style-type: none"> Board Meeting 28th September 2017 – Multi criteria analysis including approach to costings was shared with the Board Board meeting 28th June 2018 – requirement for a cost of capital adjustment discussed and agreement not to pursue a claim Board meeting 7th August 2018 – RORE range discussed
<p>Documentation</p> <ul style="list-style-type: none"> Risk section of business plan narrative

Area: Financeability
The company's business plan is financeable on both the notional and actual capital structure and that the plan protects customer interests in both the short and the long term. The statement should clearly set out the steps taken to provide this assurance.
Evidence
Meetings <ul style="list-style-type: none"> Board Meeting 29th June 2017 – Cost of Capital Adjustment Claim in PR19 report Board Meeting 2nd July 2017 – PR19 report shared Oxera's analysis of Financeability Board Meeting 28th September 2017, Minute reference 2538 dialogue with RBS re embedded debt Board Meeting 19th October 2017 – Paper shared re embedded debt Board Meeting 28th June 2018 – Discussion on the merits of putting forward a specific cost of capital adjustment claim Board Meeting 28th June 2018 – Paper presented on the Company's long term viability statement covering the seven years to 2025 Board Meeting 7th August 2018 – Presentation on financeability tests on both actual and notional structure. Sensitivity analysis shared on the commitment to a flat nominal bill for AMP7
Documentation <ul style="list-style-type: none"> Jacobs' independent assessment that the plan is financeable Financial resilience and review of stress testing scenarios Consistency with long-term viability statement

The Board has convened to consider the evidence regarding the business plan resubmission. The following table provides a chronology for these actions ahead of resubmission.

Business Plan Resubmission
Meetings <ul style="list-style-type: none"> Board Meeting 7th February 2019 – Assessment of IAP and direction for plan resubmission Board Conference Call 14th March 2019 – Base costs, enhancement and Financeability Board Conference Call 26th March – ODI Package revisions Board Meeting 28th March – Review and sign off of plan for resubmission, Ofwat actions, Financeability, Total expenditure, ODI Package, Assurance
Documentation <ul style="list-style-type: none"> 29th March 2019 Jacobs' Independent Business Plan update assurance letter 29th March 2019 – Jacobs Independent PR19 post IAP financeability assurance

The Board provides this comprehensive assurance statement that confirms our business plan submission is both of high quality, ambitious and in accordance with the requirements of Ofwat's PR19 methodology.

Sir James Perowne
Independent Chairman
South Staffordshire Water Plc



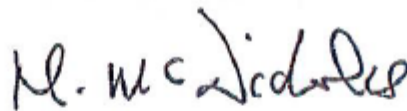
Stephen Kay
Independent Non- Executive
South Staffordshire Water Plc



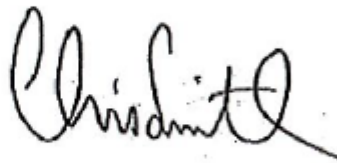
Catherine May
Independent Non- Executive
South Staffordshire Water Plc



Michael McNicholas
Independent Non- Executive
South Staffordshire Water Plc



Lord Smith of Finsbury
Independent Non- Executive
South Staffordshire Water Plc



Keith Harris
Investor
Arjun Infrastructure Partners



Peter Antolik
Investor
Arjun Infrastructure Partners



Michihiko Ogawa
Investor
Mitsubishi



Adrian Page
Group Chief Executive
South Staffordshire Plc



Phil Newland
Managing Director
South Staffordshire Water Plc



1. Summary of assurance for the Business Plan resubmission

We have followed the same approach for assurance as we did for our submission in September. This involved considering an assessment of the likelihood of an error and the impact of such an error. This has determined the level of assurance as follows:

Score	1	2	3
Category	Low assurance risk	Medium assurance risk	High/critical assurance risk
Audit	Senior manager review	Senior manager review and independent internal assurance	Senior manager review, independent internal assurance and third-party assurance (Jacobs)

In this section we set out where we have made changes to our resubmission and the level of assurance we have used.

1.1 Data tables

We have updated the following data tables as a result of feedback from the AIP. Each has been scored as described above:

Table	Brief description of changes	Risk assessment
App 1	PCs and ODIs	2
App1a	ODIs - additional information	2
App 1b	App1b – PC and ODI supplemental measurement information	2
App 2	Leakage	2
App 3	AIM	2
App 4	Customer metrics	2
App7	Proposed price limits and average bills	2
App8	Appointee financing	2
App10	Financial ratios	2
App11/11a	Income Statement	2
App12/12a	Balance Sheet	2
App15/15a	Cash flow statement	2
App16	Tangible fixed assets	2
App17	Model Outputs: Appointee revenue summary	2
App18	Dividend level	2
App19	Debt Level	2
App26	RORE scenarios	3
App28	Developer services	3
App29	Wholesale tax	2
App32	Weighted average cost of capital for the Appointee	2
WS1/1a	Totex	3

WS2	Enhancement Totex	3
WS2a	Enhancement Totex (Cumulative)	3
Wr3	Water resource revenue	2
Wr4	Water resource PAYG and RCV run-off	3
Wn2	Cost drivers - network plus (Distribution)	3
Wn3	Water network+ revenue	2
Wn4	Water network+ PAYG and RCV run-off	3

1.2 Other areas we have assured

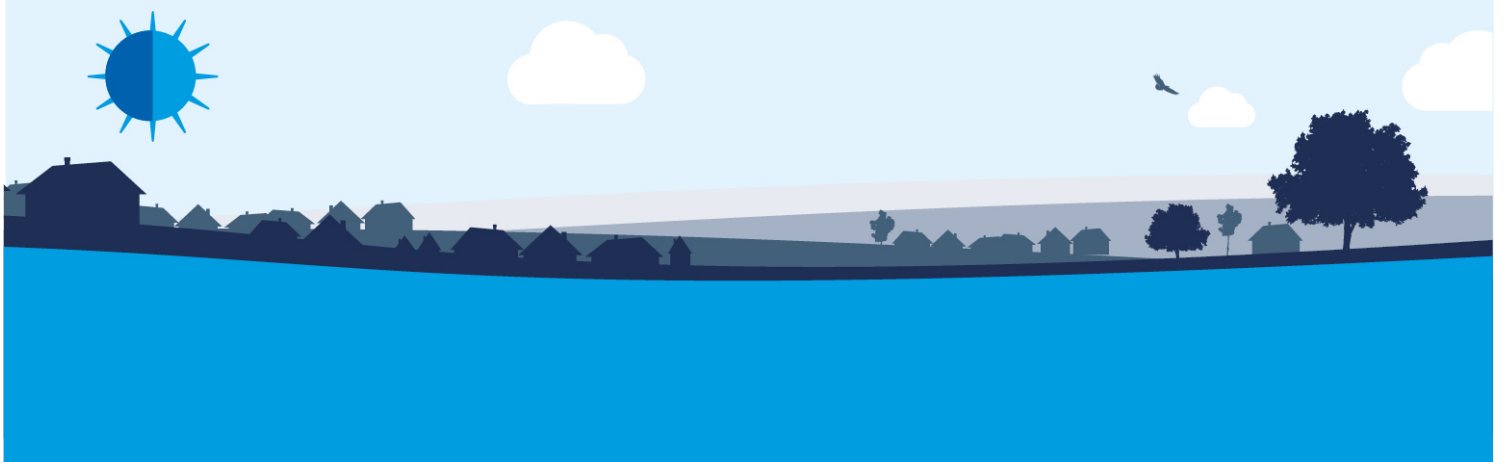
As well as the data tables, we have also had assurance undertaken on a number of areas where we have had actions from the IAP. Below is a summary table setting this out:

Action area	Assurance undertaken	Assurer
Financeability	Review that the resubmission addresses the actions from the IAP including the use of financial levers and the impact on financial metrics	Jacobs UK Ltd
	Review of the stress testing calculations	Independent internal assurance
	Updated RORE outputs	Jacobs UK Ltd
	RCV run off evidence	Independent internal assurance
Cost drivers – Booster stations	Site audits to confirm the total number of booster stations and that it complies with the data table definition	Jacobs UK Ltd

1.3 Assurance reports

The outcome of the assurance undertaken is included as an appendix to this section.

2. Jacob's independent assurance reports





SSC PR19 assurance

South Staffs Water

PR19 BP update assurance letter - South Staffs Water plc

29 March 2019

Final



SSC PR19 assurance

Project No: B2342800
Document Title: PR19 BP update assurance letter - South Staffs Water plc
Document No.:
Revision:
Date: 29 March 2019
Client Name: South Staffs Water
Project Manager: Chris Roxburgh
Author: Andrew Day

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Letter of Assurance

Attention: South Staffordshire Water Board
South Staffordshire Water
Green Lane
Walsall
WS2 7PD

29 March 2019

Subject: PR19 assurance – updated business plan

Dear Regulation Director

On 1 April 2019 you are submitting an updated PR19 business plan to Ofwat. This follows its Initial Assessment of Plans (IAP), through which it categorised your plan as 'slow-track'.

In response, we understand you are making a number of changes to your plan. Some of these changes impact the data tables, models and model outputs that accompany your plan.

Scope

As your technical assurance partner, you asked us to assure a limited number of the changes to your tables, models and model outputs. During March 2019 we carried out the following assurance work.

- **Pumping stations:** Following an exchange of queries with Ofwat, we understand you are planning to report additional booster pumping stations in Wn2 L31 – compared to both your business plan submission and your annual performance reports. You asked us to confirm the configuration of 50 potential additional pump sets through a combination of sample site visits and desk-based schematic reviews and identify any potential risks associated with reporting them against Wn2 L31 only. We note the scope of our work did not extend to assuring any updated figures in table Wn2, or the years when the pump sets would be reportable.
- **Changes to business plan tables:** We carried out risk and sample-based audits on your changes to App28 and WS1 (and consequent changes to WS2) for 2020-25. As agreed, the focus of our audits was on the calculation of the updated figures rather than the underlying rationale for the change. We note that determining the consistency of the changes with changes to your business plan, other parts of the business plan tables, and the ongoing IAP query process remained the responsibility of your teams.
- **Financial modelling and financeability:** We reviewed your approach to financial modelling for your updated plan. We considered the rationale supporting some of the associated decisions (e.g. use of PAYG and run-off levers); your assessment of your return of regulated equity (RoRE); and your broad approach to overall financeability – including your responses to IAP actions. We agreed the appropriateness of any changes or clarifications to your bill proposal (including the mechanism(s) by which you might keep them flat in nominal terms) were outside the scope of our review. We have provided you with a separate letter detailing the scope of our work and our findings ('PR19 assurance – financeability post initial assessment of plans' 29 March 2019). We continue to note that any statement about the financeability of your plan is the preserve of your Board.

As with our previous PR19 and annual assurance, our feedback and observations focused on identifying reporting and regulatory risks. This letter summarises our observations. We have provided your teams with detailed feedback and comments.

Observations

For the limited number of changes we reviewed, we observed your teams appeared to understand the feedback set out in Ofwat's IAP and build on the September business plan to produce an improved proposal for all stakeholders.

We set out below our general observations on the areas you asked us to look at.

Pumping stations

During our review of the fifty additional pumping stations you asked us to review in relation to Wn2 L31 reporting, we observed the majority of the configurations were as you described. Where there were discrepancies between our and your understanding from the schematics, you were able to clarify these.

We note you sought to clarify reporting against this line with Ofwat. We observed that your proposed reporting approach aligned with a reasonable understanding of the Wn2 L31 definition given the nature of your assets. You also noted that your approach aligns to how you allocate the associated power costs and pumping head across the value chain. We consider there does remain some residual definition risk around reporting the count of a small number of pumping stations. To mitigate this, we understand your updated business plan narrative or commentary will clearly set out your approach to reporting your various combinations of direct, high lift and network booster pumping stations against Wn2 L31 (and Wr1 L20) to stakeholders – and the rationale behind it.

We understand your changes to Wn2 L31 have a material impact on your modelled cost allowances using Ofwat's published models and process. We note there is a risk that Ofwat's models, allowances or process may change following IAP representations from all companies. The impact of such changes on your cost allowance and financial position would be uncertain.

Changes to business plan tables

For our assurance of your data tables, we consider there are no remaining potentially material issues. For WS1, we observed the team had not aligned the figures it had changed to the price base of the table before the audit – it provided updated figures following the audit, though not the workings to fully verify the price base alignment.

Financial modelling and financeability

As with your business plan submission in September 2018, and based on the material we have seen, we again considered your approach to modelling appeared consistent with both Ofwat's methodology, its updated rulebook and with your own policies and decisions (e.g. in relation to PAYG rates) – for the limited number of areas where you are making different assumptions, you set out clearly your justification. Prior to finalising your submission, we also advised you to review Ofwat's feedback on other companies plans to help inform your understanding of how Ofwat interprets its guidance – and to identify where companies might have successfully justified applying different assumptions.

We observed that due to you maintaining a flat nominal bill profile, your ratios continue to display a declining trend over the period 2020-25. We note though that your updated, higher ratios provide greater headroom against a downgrade to a non-investment grade credit rating. Your ratios are higher because you have increased your PAYG rates and are proposing higher overall bills for 2020-25. We also observed that financial ratios for your updated business plan are again weaker when modelled on Ofwat's notional structure compared to your actual structure. Due to the higher overall bills though, they again provide greater headroom against a downgrade to a non-investment grade credit rating. You explained that you and your Board have reviewed your pre-legacy adjustment financial ratios, including under your scenario stress testing, and are comfortable with the results.

We understand you plan to clearly set out the justification for your use of financial levers in your updated business plan narrative (including any considerations of customers' views and intergenerational impacts) to mitigate the risk of challenge from stakeholders. For similar reasons, you are also planning to explain how representatives of your investors have been engaged in supporting the Board's view on the financeability of your plan. Given the ratios now decline to a higher level than in your September business plan, you consider your explanation will sufficiently address Ofwat's IAP action in this area. We discuss our observations in relation to financeability more fully in a separate letter ('PR19 assurance – financeability post initial assessment of plans' 29 March 2019).

As noted above, we provided your teams with more detailed feedback (and actions where appropriate) on the areas discussed above. We understand you and your Board have reflected on our observations in finalising your updated business plan. Consistent with the agreed scope, you managed the completion of any actions and recommendations.

Conclusion

Overall, and from the limited areas we reviewed, the changes your teams have made to the business plan appear to largely align with Ofwat's guidance or move you closer to its expectations. Your financeability appears to have improved since September 2018 for example, and you consider you are providing sufficient evidence to address its concerns about investor engagement in this area – though we consider there remain some areas of potential residual risk. We also note that for pumping stations, you have worked to align your reporting to the latest clarifications of the definition and your approach to allocation across the value chain – and will explain your rationale – though we consider there remain some residual risks that might impact your cost allowance.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'C Roxburgh', with a stylized flourish at the end.

Chris Roxburgh
Divisional Director

chris.roxburgh@jacobs.com

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SSC PR19 assurance

South Staffordshire Water

PR19 post IA financeability assurance - South Staffs Water plc

29 March 2019

Final



SSC PR19 assurance

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Letter of Assurance

Attention: South Staffordshire Water Board
South Staffordshire Water
Green Lane
Walsall
WS2 7PD

29 March 2019

Subject: PR19 assurance – financeability post initial assessment of plans (IAP)

Dear Regulation Director

Ofwat requires each company's business plan to demonstrate that:

- proposed revenues, relative to assumed costs, are sufficient for an efficient company to finance its investment and so deliver its activities, on reasonable terms, while protecting the interests of customers now and in the long term; and
- an efficient company would be able to generate cash flows sufficient to meet its financing needs (once plan components such as totex, cost of capital, PAYG and RCV run-off levers are taken into account).

Ofwat made an Initial Assessment of the financeability of your original (September 2018) business plan submission. This assessment inferred that your September 2018 business plan contained insufficient evidence that it was financeable. Consequently, Ofwat, cited related issues that should be addressed for your business plan resubmission on 1 April 2019, primarily:

- providing better evidence that your target credit rating is reasonable for the notional company and/or setting out the impact of actions that could be taken to improve the rating;
- supporting the assumption that your relatively poor credit rating would be temporary, including providing more evidence to support the expected improvement to your financial ratios from 2025 and engaging with investors in relation to the profile of the ratios;
- providing more evidence to support the RCV run - off rates as you had not set out how current cost depreciation or asset lives had been determined; and
- providing further evidence that the bill profile over 2020-30 is consistent with customer preferences.

Scope

As agreed, our assurance focused on:

- your understanding of Ofwat's Initial Assessment;
- the appropriateness of your response to Ofwat's guidance (and assumptions you made) in your financial modelling;
 - on your actual capital structure;
 - on Ofwat's notional structure (including RORE scenarios); and
- the narrative supporting your assumptions and subsequent proposals (though we agreed the appropriateness of any changes or clarifications to your bill profile and associated mechanism(s) by which you might keep them flat in nominal terms were outside the scope of our financeability review).

To deliver the above scope, we carried out risk-based reviews of a range of material – through both desktop reviews and face to face meetings with your team.

As agreed, our assessment of materiality was guided by the impact on price limits and risk of reputational damage.

We agreed the derivation of the inputs to the financial model under the Company's actual capital structure, and the downside scenarios under your actual capital structure, were out of scope. We also agreed that any statement about whether your plan is financeable is the preserve of your Board.

Overall, we consider that:

- **you have appropriate processes in place to populate the Ofwat financial model with data consistent with the Ofwat requirements;**
- **when running Ofwat's financial model you have followed both the general guidance in Ofwat's PR19 methodology statement (including clarifications provided in its Initial Assessment documents) and the specific guidance provided in the latest version of Ofwat's financial model – or you have explained any variations in assumptions/interpretation; and**
- **the commentaries we saw are consistent with the outcome of your financial modelling and respond to the issues and actions raised by Ofwat in its Initial assessment.**

Conclusion

You have used the revised version of the financial model and largely followed both the general guidance in Ofwat's PR19 methodology statements and the specific guidance provided in Ofwat's financial model.

As part of our work we reviewed your revised business plan narrative and confirmed that it was consistent with your modelling; and the outputs from your modelling. As requested we provided challenge on your key modelling assumptions, for example your arguments to support your decision to use the financeability levers (PAYG rates) and the level and profile of your financial ratios. We observed that all your modelling assumptions align with your agreed policy decisions and understand that these assumptions have been fully discussed at SSC Board.

We note your financeability appears to have improved since your September 2018 submission, and you consider you are providing sufficient evidence to address Ofwat's concerns about investor engagement in this area – though we consider there remain some areas of potential residual risk.

We provided your team with feedback that set out in detail the scope of our work, the specific activities we undertook and our findings.

Yours sincerely



Chris Roxburgh
Divisional Director

chris.roxburgh@jacobs.com

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1. Introduction

Financeability is a core feature of Ofwat's price reviews and its approach is driven by two of its primary duties – to protect consumers' interests and to secure that efficient companies can finance their functions. One of the primary indicators of a companies' financeability is its credit rating. Ofwat requires water companies to maintain an investment grade credit rating. This is demonstrated by evidence that they can cover key financial ratios.

Companies were required to provide evidence in their PR19 Business Plans that they have used robust processes, data and information, plus appropriate strategies, to satisfy themselves that they remain financeable at appointee level.

In addition, Ofwat expects companies to align the interests of companies and their investors with those of their customers. Therefore, they were required to make an assessment of the balance between risk and return in their plan, ensuring it is compatible with their risk appetite. One of the ways Ofwat expects companies to assess this is by using return on regulated equity (RoRE) modelling to assess the potential range of risk and return exposure.

Ofwat has made an initial assessment of the financeability of your original (September 2018) business plan submission. This assessment cited issues that should be addressed for your business plan resubmission on 1 April 2019, primarily:

- providing better evidence that your target credit rating is reasonable for the notional company and/or setting out the impact of actions that could be taken to improve the rating;
- supporting the assumption that your relatively poor credit rating would be temporary, including providing more evidence to support the expected improvement to your financial ratios from 2025 and engaging with investors in relation to the profile of the ratios;
- providing more evidence to support the RCV run - off rates as you had not set out how current cost depreciation or asset lives had been determined; and
- providing further evidence that the bill profile over 2020-30 is consistent with customer preferences.

2. Scope and approach

We agreed the scope of our assurance would cover:

- your understanding of Ofwat's Initial Assessment;
- the appropriateness of your response to Ofwat's guidance (and assumptions you made) in your financial modelling;
 - on your actual capital structure;
 - on Ofwat's notional structure (including RORE scenarios); and
- the narrative supporting your assumptions and subsequent proposals (though we agreed the appropriateness of any changes or clarifications to your bill profile and associated mechanism(s) were outside the scope of our financeability review).

To deliver the above scope, we reviewed a range of material, including:

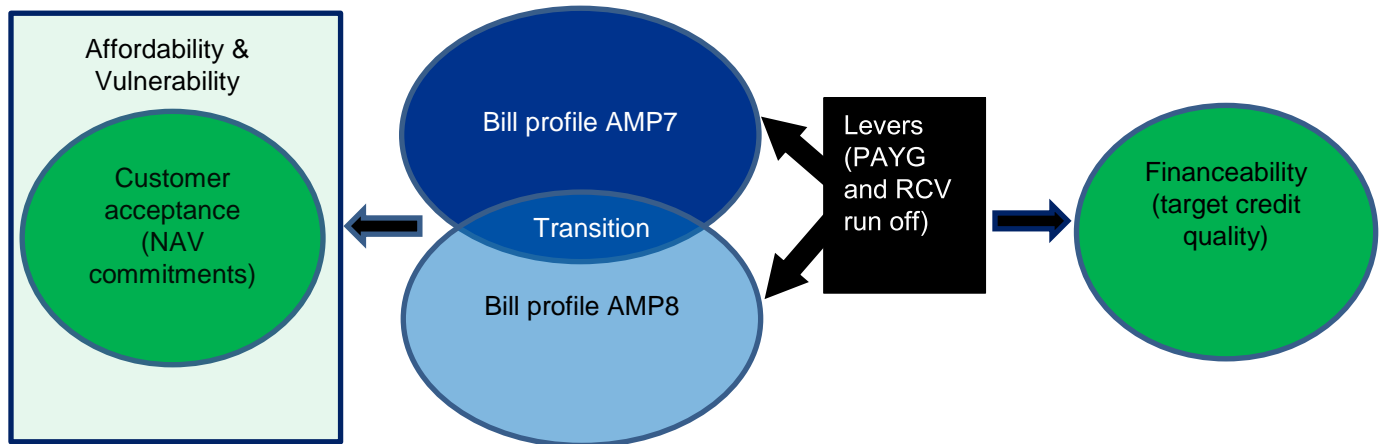
- the key assumptions underpinning data inputs;
- your modeling processes;
- the financial model outputs; and

- the consequential commentary on key assumptions the financial model and outputs.

Our review and assurance of these materials was based on challenging your teams' processes, data and assumptions via a combination of face to face meetings and desk top reviews.

We note Ofwat's Initial Assessment feedback was presented by Business Plan element/theme but the issues are inter-related. There is tension between these elements (ie: they need to be calibrated balanced. – see Figure 1 below).

Figure 1



Consistent with our other assurance work for you, we agreed we would take a risk-based approach to reviewing the above.

We agreed the following components were out of scope:

- derivation of the inputs to the financial model under the Company's actual capital structure;
- assessment of the downside scenarios under your actual capital structure; and
- the appropriateness of any changes or clarifications to your bill profile and associated mechanism(s) were outside the scope of our financeability review.

We also agreed that any statement about whether your plan is financeable is the preserve of your Board.

We note this data was subject to your own internal assurance processes.

3. Observations

We worked closely with your financial modelling team in a constructive and collegiate manner. Any material issues identified during the assurance process were subsequently resolved to your team's satisfaction. Based on the material we saw, the team demonstrated that, when running Ofwat's financial model, it largely followed the general guidance in Ofwat's PR19 methodology statements and the specific guidance provided in the latest version of Ofwat's financial model. For the limited number of areas where the team is making different assumptions, you set out clearly your justification. Prior to finalising your submission, we also advised you to review Ofwat's feedback on other companies plans to help inform your understanding of how Ofwat interprets its guidance – and to identify where companies might have successfully justified applying different assumptions.

The team also demonstrated that your financial model input data, and your assumptions, reflect your agreed policy decisions and we understand that these assumptions have been fully discussed at SSC Board.

When we assured the financial modelling underpinning your original business plan, we observed that your then chosen bill profile resulted in ratios displaying a declining trend – and to a level that gave you limited headroom against a non-investment grade credit rating. We also observed that financial ratios were weaker when modelled on Ofwat's notional structure compared to your actual structure.

We observed that due to you maintaining a flat nominal bill profile, your ratios continue to display a declining trend over the period 2020-25. Your financial ratios are stronger though as a result of the changes you have made for the update of your business plan (eg: increasing your PAYG rates) and consequently, you are proposing higher overall bills for 2020-25. These stronger financial ratios provide greater headroom against a downgrade to a non-investment grade credit rating. We also observed that financial ratios for your updated business plan are again weaker when modelled on Ofwat's notional structure compared to your actual structure. Due to the now proposed higher overall bills though, they again provide greater headroom against a downgrade to a non-investment grade credit rating. You explained that you and your Board have reviewed your pre-legacy adjustment financial ratios, including under your scenario stress testing, and are comfortable with the results.

We consider your narrative is consistent with your modelling assumptions, the subsequent outputs from that modelling and responds to the issues and actions raised by Ofwat in its initial assessment of your September 2018 business plan – see Appendix A

In addition to the overall observations noted above, we also note the following specific observations.

- For the notional modelling you have assumed dividends that are more consistent with the dividends you have assumed for your actual structure. This is not consistent with Ofwat's guidance, but you have justified your approach as an appropriate remedy to a potential financeability constraint.
- You are not reporting the Adjusted ICR ratios produced by Ofwat's financial model under your actual structure. You consider this to be appropriate because, instead, you are reporting an Adjusted ICR that you have recalculated off-line, to reflect how Moody's treat your interest income.
- You plan to clearly set out the justification for your use of financial levers in your updated business plan narrative (including any considerations of customers' views and intergenerational impacts) to mitigate the risk of challenge from stakeholders.
- You are planning to explain how representatives of your investors have been engaged in supporting the Board's view on the financeability of your plan. Given the ratios now decline to a higher level than in your September business plan, you consider your explanation will sufficiently address Ofwat's IAP action in this area.

4. Conclusions

We note your financeability appears to have improved since your September 2018 submission, and you consider you are providing sufficient evidence to address Ofwat's concerns about investor engagement in this area – though we consider there remain some areas of potential residual risk.

The team demonstrated that, when running Ofwat's financial model, it followed the general guidance in Ofwat's PR19 methodology statements and the specific guidance provided in the latest version of Ofwat's financial model. Where it has made different assumptions, you have clearly set out the justification in your plan.

The team also demonstrated that your financial model input data, and your assumptions, reflect your agreed policy decisions and we understand that these assumptions have been fully discussed at SSC Board.

We observed that due to you maintaining a flat nominal bill profile, your ratios continue to display a declining trend. However, your financial ratios are stronger because you have increased your PAYG rates and consequently, you are proposing higher overall bills for 2020-25. These stronger financial ratios provide greater headroom against a downgrade to a non-investment grade credit rating.

We also observed that financial ratios for your updated business plan are again weaker when modelled on Ofwat's notional structure compared to your actual structure. Due to the higher overall bills though, they again provide greater headroom against a downgrade to a non-investment grade credit rating.

Appendix A

Tables 1 and 2 below signpost where in your updated business plan narrative you appear to have responded to Ofwat's actions

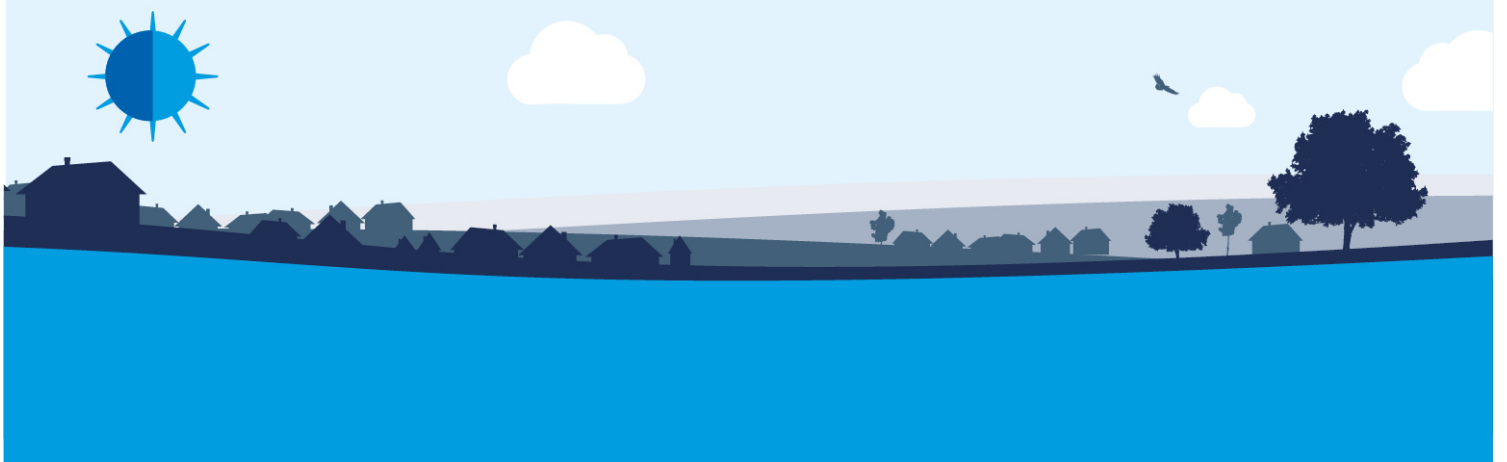
Table A.1 – Key driver of chosen bill profile and credit quality

Table 1	Summary	Document reference
Weak financial ratios [SSC.RR.A5]	Ratios are now stronger	Use of financial levers
Appropriate credit rating [SSC.RR.A4]	Implied credit rating now improved	Remaining financeable over the longer term
Board assurance that financeable [SSC.RR.A3]	Provide evidence to address its concerns about investor engagement in this area.	Explicit separate query response to Ofwat
Bill profile beyond 2025 [SSC.RR.A7]	Smoother bill profile between AMP7 and AMP8 that you consider is more in line with customer preferences	Use of financial levers Remaining financeable over the longer term

Table A.2 – Technical issues

Table 2	Summary	Document reference
WACC incorrect by 0.1% [SSC.RR.A1]	Modelling inputs revised accordingly	Financial Model
Evidence to support RCV run-off rates [SSC.RR.A6]	Rates are consistent with depreciation	Use of financial levers
Revise assessment of revenue risk in RoRE analysis [SSC.RR.A2]	Now reflects contemporaneous nature of Revenue correction mechanism	Financial Model

3. Independent internal audit report



INTERNAL AUDITOR'S REPORT TO SOUTH STAFFORDSHIRE WATER PLC

Stress Testing

Independent Assurance and Audit Objectives

In accordance with the Company's Assurance Framework, the Group Internal Audit function (provided by South Staffordshire Plc) was requested to carry out a review and to provide independent assurance of the stress testing work and results performed by the Business.

The business benefits from independent reviews performed by an Internal Audit function operated by the Company's parent South Staffordshire Plc. The function is managed by Glyn Palmer BA (Hons) FCA a qualified Chartered Accountant with over 25 years professional experience within the water industry.

Internal Audit was requested to provide independent reasonable assurance over the information. Reasonable assurance is considered to be a detailed review, but is not a guarantee that the audit will detect all misstatements or errors. The production and accuracy of the calculations is the responsibility of South Staffordshire Water.

Audit Scope

The business has flexed the base business model against eight specific scenarios which were defined by Ofwat. The results of the stress testing are incorporated within the resubmitted PR19 Business Plan.

The spreadsheet model supporting the figures being reported is extremely complex. Internal Audit was not requested to review the calculations and accuracy of the base model. The audit work was focused upon the anticipated impacts of each scenario against the base case model and comparing these with the results reported.

Internal Audit agreed to review a sample of three scenarios which would have the greatest impact on the three key measures namely:

- Moody's AICR
- Ofwat's FFO/Net Debt alternative (actual)
- Gearing Calculations

The three scenarios audited were:

- Scenario 1 - 10% overspend of totex each year
- Scenario 3 - 1% higher inflation each year and
- Scenario 8 - 10% totex overspend each year, ODI penalty of RORE 1.5% for 2022/23-2024/25, financial penalty of 1% appointed revenue in 2024/25

Audit Findings and Observations

Based upon the specific scenario Internal Audit determined the likely impact on key figures including but not limited to turnover, opex, IRE, Operating profits, tax, interest capex and cash. These key figures were then compared with the results produced by the scenario models.

In the majority of cases the results were as expected, where results differed from expectations Internal Audit obtained satisfactory explanations from the Senior Management within the business.

A key audit task was to confirm that the stress testing results were linking to the appropriate sources of information. Internal Audit has confirmed this for the scenario models as listed above.

Audit Opinion

Whilst the audit work undertaken was designed to reveal inconsistencies and errors in data tested, the complexity and volume of information contained within the tables means that Internal Audit can only provide reasonable assurance that the tables are reliable and accurate.

Based upon the audit work undertaken and appropriate evidence obtained, Internal Audit has evaluated the stress testing results within its scope and these are, in the opinion of Internal Audit consistent with supporting documentation received and explanations provided by the management of the business.

Glyn Palmer BA (Hons) FCA
Group Internal Audit Manager
26 March 2019