Contents

3  1. Overview
3  2. Our current approach to assuring performance data
5  3. Engagement with stakeholders on our reporting and assurance
8  4. Risks, Strengths, and Weaknesses
11 5. Enhancing our reporting
12 6. How to respond to this document
13 Appendix 1: Our promises
14 Appendix 2: Governance and risk management
1. Overview

In our business plan for the period 2015–20 we made 26 promises to our customers - a set of clear targets that we committed to delivering by 2020.

Our regulator, Ofwat, also set out a number of additional targets, or “performance commitments” in its determination of our price limits for this period, some of which included financial penalties and rewards. This document is concerned with how we report and assure performance against these targets and other performance information in our Annual Performance Report (also referred to as the Annual Report). It sets out an assessment of our Risks, Strengths, and Weaknesses and invites views on our draft assurance plan for 2015–16.

We currently have a comprehensive risk and assurance framework, which governs the reporting of regulatory performance and financial data. This framework provides us with confidence that the information we report to customers and stakeholders through our Annual Report is robust and fit for purpose.

For the period 2015–20, Ofwat has developed a new Company Monitoring Framework for ensuring the quality and accuracy of information that water and wastewater companies provide to their customers and stakeholders. As part of this framework Ofwat has specified the minimum level of information that companies are required to report in an annual performance report (APR).

They have also undertaken an assessment, placing companies into one of three categories:

- self assurance
- targeted assurance
- prescribed assurance

In line with the vast majority of water companies, Ofwat assessed Southern Water as requiring targeted assurance. This means we are required to engage with stakeholders to identify key risks and areas of weakness against which additional targeted assurance will be required.

This document sets out the results of that engagement exercise and our proposals to enhance our assurance framework to maintain our strengths, to address our risks and weaknesses and deliver the commitments that we made in our business plan to independent scrutiny and challenge of our performance.

In the remainder of this document we:

- provide an overview of our current approach to data governance and assurance (Section 2)
- set out the findings of our stakeholder engagement exercise (Section 3)
- set out our proposals to enhance our reporting (Section 4) and
- how we will enhance our reporting of performance (Section 5).

2. Our current approach to assuring performance data

In this section we describe our current approach to the assurance of our performance data. Further details of our corporate risk management process, which underpins the framework described here, are provided in Appendix 2.

The assurance framework described here formed the basis of the proposals we set out in our 2015–20 business plan for assuring the quality, accuracy and reliability of our performance reporting. In its final determination of our price limits in December 2014, Ofwat was content that our assurance proposals were appropriate, stating that:

"Southern Water has provided sufficient evidence demonstrating the approach it will undertake to ensure the PCs [Performance Commitments] will be measured and reported consistently, and the proposed governance and assurance processes. Therefore, we have accepted the company’s proposal."

2.1 Our current assurance framework

All regulatory performance reporting is subject to the same robust system of internal controls and quality assurance. This ensures that the reporting of performance against regulatory performance targets is measured and recorded consistently within a framework of appropriate governance and quality control which includes Board challenge, scrutiny and sign-off.

Our framework uses the best practice “three lines of defence” model, which is illustrated in Figure 1 below.

<table>
<thead>
<tr>
<th>Lines of defence</th>
<th>Activities</th>
<th>Governance</th>
</tr>
</thead>
</table>
| **1st line of defence**  
Business operations |  
Management process and controls  
Controls monitoring and measures |  
• Methodology statements for performance commitment measures  
• Data quality monitoring  
• Ofwat KPI reporting and review |  
• Responsible business directorates and responsible director |
| **2nd line of defence**  
Oversight functions |  
Regulation  
HSE  
Financial control  
Legal  
HR  
IT security  
Risk management |  
• Oversight teams – policy and procedure setting, and ongoing challenge, monitoring and assurance  
• Monthly performance reporting to Executive Management Team and Board for review and challenge |  
• Regulatory compliance function and other oversight functions  
• Our Board and sub-committees |
| **3rd line of defence**  
Independent assurance |  
Internal audit  
External audit |  
• Internal audit review of systems, processes and control monitoring  
• External risk based assurance of financial and regulatory accounts |  
• Third party technical auditor working on behalf of internal audit to assure Ofwat KPIs  
• External financial auditor  
• Our Board and sub-committees |

**Figure 1. Our “three lines of defence” assurance model**

The key features of our three lines of defence framework of internal control and assurance are:

- Documented processes, procedures and systems, which we will continue to use for reporting performance against our targets. These procedures cover the controls on data quality, reporting and review of the information. Confidence grades, which describe the margin of error around particular data, are used to reflect the quality of the information we report.

- Management and director scrutiny with sign-off of data as a key control to ensure the performance we report is complete, accurate and reliable. In the future, this key control will also define accountability for the delivery of the promises in our business plan and will provide a process to escalate issues.

- Reporting procedures and quality assurance processes are subject to an ongoing programme of internal and external reviews and continual improvement, in order that they remain fit for purpose.

A risk and compliance statement signed by the Board continues to form a key part of our Annual Report. The governance and assurance processes which underpin our Board’s ability to make this statement are based on defined.
accountability and escalation processes within the business which comprise:

- Top-level challenge of business performance that allows for action to be taken where improvement is required. This is enabled through our framework of monthly performance reporting to the Board and Executive Management Team (EMT).

- Robust internal compliance processes and procedures - including an obligation on the EMT and senior managers to provide a written declaration that they are fully compliant with company procedures and controls every six months, or otherwise record any areas of non-compliance for areas of the business for which they are accountable. Areas of significant non-compliance are escalated to the Board and require clear action plans to rectify the position.

- All subject matter experts, senior managers, and members of the EMT are required to report any issues with procedures and with information being reported.

- A comprehensive risk framework for the identification, assessment, management and communication of key risks to our business (see Appendix 2 for a fuller description of our corporate risk framework).

- The Board’s Audit and Risk Review Committee (ARRC) monitors assurance activities during the year including through reviews of processes and controls undertaken by internal and external audit teams. These reviews cover the design and operating effectiveness of controls and processes, together with audit trails of reported data.

It is a statutory requirement that annual accounting statements, i.e. our financial information, are audited and an independent auditor’s report is given. We believe customers should see the same principle applied to reporting on the delivery of our non-financial business performance. Following the introduction of risk-based regulation by Ofwat in 2012, Southern Water has continued to use independent external assurance providers to complete reviews of our regulatory compliance-reporting processes and associated data. We see this as important and will continue to use independent experts in customer service, asset management and operations to complete assurance work on our performance reporting.

Our independent external auditor (Deloitte LLP) audits our financial statements annually and, based on its own independent financial materiality assessment, provides a "true and fair view statement" of our annual financial statement.

3. Engagement with stakeholders on our reporting and assurance

In this section we describe the process and result of our engagement with stakeholders on our performance reporting. We also describe how we will address the specific concerns raised by stakeholders in our reporting for 2015–16.

3.1 Stakeholder consultation process and outcomes

In assessing the Risks, Strengths, and Weaknesses of our performance reporting, we have had conversations with our key regulatory stakeholders – Ofwat, the Consumer Council for Water (CCW), Natural England and the Environment Agency (EA).

We also engaged with the Drinking Water Inspectorate (DWI), but it told us that most of the data it uses are statutory returns and it prefers to engage directly on any data assurance issues in that context.

We invited comments from our wider stakeholder group on our performance reporting, but have not received any responses to date. We carried this engagement exercise out during October and the first half of November 2015.

In our discussions with our regulatory stakeholders, we shared details of our current approach to performance reporting, our regulatory assurance framework and our business plan proposals to enhance the reporting and assurance of our data, including how we proposed to work with our independent Customer Advisory Panel (CAP). We then asked for the views of our stakeholders on a set of questions (set out overleaf) relating to (a) the scope of the performance information that we report and (b) the level of assurance we subject that data to.
Scope of information

(i) What performance data do you use currently? To what extent does the data we currently publish meet your requirements? Which performance data do you place most value on?

(ii) Is information about our performance readily accessible and easy to understand?

(iii) Is there other information that we should be including in our annual performance report?

(iv) Is our Annual Report the right place for reporting to customers and stakeholders or is there a better model?

Assurance

(i) What are your expectations in terms of the reliability and accuracy of data that is published?

(ii) Do you have any concerns about the quality of annual performance data currently published? Are there areas we should be focusing our assurance work on?

(iii) Is the level of assurance proposed appropriate for the reporting of data to our customers and stakeholders? Are there any specific concerns about our approach?

(iv) Are there lessons we can learn from elsewhere to improve our assurance?

(v) Do you have any views on the role of our Customer Advisory Panel in reporting and assuring our performance data?

3.2 Summary of our stakeholders’ feedback

In terms of the scope of the performance information that we publish, our regulatory stakeholders all noted that they receive information directly from water companies and, in some cases, had statutory powers to require the provision of performance information. In general, most stakeholders felt the scope of the information we publish was appropriate.

They did highlight a few areas where they felt there was a shortfall in our current reporting or we could improve our reporting. These included:

- Setting some of the environmental improvements we are delivering under the National Environment Plan in the context of wider national and international environmental goals. For example, how some of this work is contributing to delivery of the Government’s Biodiversity 2020 commitments.

  - Ensuring we meet our statutory obligations to report on the condition of Sites of Special Scientific Interest under our management and our obligations to report annually on delivery of our Water Resources Management Plan.

  - Giving greater focus to the work we are doing to help customers who are struggling to pay their water bills.

  - Improving clarity around the service received by those customers with a different water supplier, to whom we provide only wastewater services.

Stakeholders noted and welcomed the work that we have done to improve the accessibility of our publications, including our Annual Report, with one noting in particular that the use of pictograms was very good. While recognising that few customers and stakeholders were likely to read the Annual Performance Report in its entirety, stakeholders agreed that there was value in having a single source of performance data. The challenge is to make this accessible in a way that allows customers and stakeholders to ‘dip in’ to particular areas of interest.

CCWater did not believe there was significant customer appetite for performance reporting on a more than annual basis. It felt that reporting on a regional basis might have value if it was at a level that customers could relate to, such as their county, but would be less meaningful at catchment or water resources zone level.

Providing comparative performance information for other companies in the sector was felt to be most useful for customer service performance, such as customer complaints, but less useful for data relating to our infrastructure. The exceptions noted were leakage, customer consumption, pollution incidents and water quality.

In terms of assurance, with the exception of Ofwat, regulatory stakeholders noted that they would expect to carry out their own verification of key performance data supplied to them by companies. The overarching expectation of all stakeholders is that all the performance information we publish should
be reliable, accurate and timely. None of the stakeholders we spoke to had particular concerns about any of the current performance data we publish.

Stakeholders did not identify any additional criteria for assessing the level of assurance, but agreed the existence of financial rewards and penalties for some performance targets should be reflected in our overall assessment of the appropriate level of assurance.

One aspect that stakeholders highlighted was the importance of ensuring the narrative description of our performance is fair and balanced and that data is presented in context. This is relevant to both the presentation of performance in our Annual Report and where we summarise performance data in other forms (for example in customer billing literature).

Finally, stakeholders welcomed the role of our independent Customer Advisory Panel in challenging the company to deliver the commitments set out in our business plan. However, they did not feel that independent reporting of our performance by the CAP would mean a great deal to customers. CCWater noted that customers’ recognition of statutory bodies such as Ofwat and CCWater was very low and so very few were likely to understand the role of the CAP or regard them as independent of the company.

3.3 Our response

While stakeholders did not identify any specific areas of concern, and acknowledged the work that we have done to improve the accessibility of our Annual Report, they did identify a few specific areas where we could improve our reporting and assurance. We summarise these areas below, together with our proposed approach to addressing each of them.

(i) Setting the environmental improvements we are delivering under the National Environment Plan in the context of wider national and international environmental goals.

We agree that this is important context for our performance reporting. We will ensure that we highlight, under our ‘Looking after the Environment’ outcome, how we are contributing to the delivery of key national and international goals, such as the Biodiversity 2020 targets.

(ii) Ensuring we meet our statutory obligations to report on the condition of Sites of Special Scientific Interest (SSSIs) under our management and our obligations to report annually on delivery of our Water Resources Management Plan (WRMP).

We will ensure that our annual reporting meets all our statutory and regulatory requirements and will ask our statutory auditors and third party assurers to confirm this.

We will report on our management of SSSIs and delivery of our WRMP in the ‘Looking after the Environment’ section of our Annual Report.

(iii) Greater focus on the work that we are doing to help customers who are struggling to pay their water bills.

One of our key business plan promises for the period 2015–20 is to ensure bills are affordable and to increase the number of customers receiving help from one of our assistance schemes. As we report on delivery against this promise we will highlight the work that we have done, including case studies where appropriate. We will also provide clear signposting for customers who may be in need of help.

(iv) Improved clarity around the service received by those customers with a different water supplier, to whom we provide wastewater only services.

During our discussions, stakeholders were clear that having all performance information in one place was helpful, even though few customers or stakeholders would be expected to read our Annual Report in its entirety. What they did emphasise was that the information needs to be accessible to customers with a specific interest. We think the challenge around ensuring customers can access information that is relevant to them is best addressed through the presentation of our performance reporting on our website (which will be based on our Annual Performance Report).

We intend to carry out further engagement with our customers next spring to ensure the way we report is accessible and useful (see Section 5). As part of this we will
consider how we signpost wastewater-only customers to relevant information for them.

(v) Reporting performance on a regional basis
CCWater emphasised that more local reporting is helpful only where it is based on areas customers can naturally relate to, such as counties. We do not routinely collect data at this level for most performance measures and so will not be in a position to report performance at this level for 2015–16. We will examine the feasibility of providing key performance measures such as water consumption and water quality on a county basis for 2016–17.

(vi) Showing comparative performance for key areas
Stakeholders agreed that showing comparative performance was most meaningful in the areas of customer service and key operational measures. We will show comparative information (based on published data from the previous year) for the following performance measures:
- Service Incentive Mechanism
- Customer complaints
- Total leakage
- Pollution incidents
- Water consumption
- Drinking water quality

(vii) Taking account of the existence of financial rewards and penalties in our assurance assessment.
As part of Ofwat’s new framework we are required to report the value of any rewards or penalties accrued each year in our Annual Performance Report. Where performance targets are associated with significant financial rewards and penalties we will always ensure we have third party assurance over both the underlying data and the calculation of any associated rewards and penalties.

(viii) Ensuring that the narrative description of our performance (including where this is summarised) is reliable and accurate as well as the data itself.
This is a particularly challenging area to address because unlike data it is inherently subjective. However, we agree that how we describe performance can be as important as the data. We will discuss with our third party assurance providers and statutory auditors how we can best tackle this challenge through an independent review.

4. Risks, Strengths, and Weaknesses

In this section we summarise the findings of our Risks, Strengths, and Weaknesses assessment. We also set out our draft assurance plan for 2015–16 and our proposals to enhance our assurance framework to reflect the results of the assessment and the commitments that we made in our business plan to independent scrutiny and challenge of our performance against our targets.

4.1 Risks, Strengths, and Weaknesses

We believe we have put in place a robust framework for reporting and assuring regulatory performance data. This was confirmed by Ofwat in its review of our 2015–20 business plan, where it accepted we had provided sufficient evidence to ensure performance against our targets was measured and reported consistently.

Our engagement with stakeholders did not identify any specific areas of weakness with our reporting, but they expressed a clear view that the performance data we publish should be reliable, accurate and timely. However, stakeholders did identify two areas where we could enhance our assurance further. These were ensuring the narrative description of our performance is appropriately balanced and ensuring we take account of the existence of rewards and penalties for certain performance targets. We set out (in Section 3) above how we will address these two areas.

Stakeholders also provided a number of helpful suggestions for enhancing the accessibility of our performance reporting, which we will take account of as we develop further our proposals for the look and feel of our reporting (see Section 5 on page 11).

A substantial majority of our performance targets for 2015–20 are based on well-established measures, with detailed procedures and controls associated with them. These include, for example, leakage, per capita consumption, sewer flooding and pollution incidents. However, we have also set performance targets in a number of new areas, such as customer awareness of how to manage...
hard water, customer perception of value for money and first time call resolution. These new measures are inherently more risky because they will be reported for the first time in 2015–16. To address this, we will be embedding them within our existing control framework and will ensure that all new measures will be externally assured for 2015–16.

4.2 Draft assurance plan for 2015–16

Our stakeholders did not identify any specific weaknesses with our performance reporting and Ofwat has acknowledged that our business plan proposals for reporting and assurance were robust. We will therefore retain the core aspects of our current assurance framework (described in Section 2) for the period 2015–20. This is illustrated in Figure 2 below.

All financial and non-financial performance data in the 2015–16 Annual Performance Report will be subject to rigorous internal and independent external assurance to ensure the information we report to our customers and stakeholders is reliable and accurate.

For all our customer promises and Ofwat performance commitments we will adopt the following year-end assurance process:

- All data reviewed and signed-off by process owners and their senior manager
- All data submissions reviewed by the Business Plan Performance Team, including reviewing the controls self-assessment (based on the methodology statement) together with supporting evidence, audit trails and reconciliations
- Data review and sign-off by the relevant Executive Management Team member.

<table>
<thead>
<tr>
<th>Annual Performance Report (APR)</th>
<th>1st line of defence Business operations</th>
<th>2nd line of defence Oversight functions</th>
<th>3rd line of defence Independent assurance</th>
<th>Final APR challenge and approval to publish</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Section 1</strong> Regulatory financial reporting</td>
<td>Process owner and line management</td>
<td>Finance</td>
<td>Executive management review</td>
<td>Corporate auditors (Deloitte LLP)</td>
</tr>
<tr>
<td><strong>Section 2</strong> Price control and additional segmental reporting</td>
<td>Process owner and line management</td>
<td>Finance</td>
<td>Executive management review</td>
<td>Corporate auditors (Deloitte LLP)</td>
</tr>
<tr>
<td><strong>Section 3</strong> Performance summary</td>
<td>Process owner and line management (Regulatory Compliance Framework)</td>
<td>Regulation</td>
<td>Executive management review</td>
<td>Third party certifier (Halcrow Management Sciences)</td>
</tr>
<tr>
<td><strong>Section 4</strong> Additional regulatory information</td>
<td>Process owner and line management</td>
<td>Finance/Regulation</td>
<td>Executive management review</td>
<td>Corporate auditors (Deloitte LLP) and third party certifier (Halcrow Management Sciences)</td>
</tr>
</tbody>
</table>

Figure 2. Our draft assurance plan for 2015–16
• Our independent technical auditors Halcrow Management Services (HMS) will audit all data submissions through to our Annual Performance Report to provide assurance that the information is reliable and accurate.

The scope of our financial assurance work for 2015–16, which will be provided by our independent external auditor, Deloitte LLP, includes the following key components:

• Statutory audit of the Southern Water financial statements for reporting in accordance with UK legal requirements under the Reduced Disclosure Framework (‘FRS101’).

• Audit of specific regulatory reporting, including the Annual Performance Report, the Statement of Adequacy of Financial Resources and other agreed-upon procedures.

Our financial auditors will also be asked to agree that the non-financial figures presented in Section 3 of the Annual Performance Report agree to supporting documentation from HMS. They will read the narrative associated with Section 3 and be asked to confirm that no inconsistencies are identified between the narrative and the financial data presented.

While not part of the Annual Performance Report itself, our auditors will continue to provide independent assurance of the setting of our charges for the charging year 2016–17. This is based on a set of agreed-upon procedures to assure the accuracy and reliability of our charges. This provides the Board with independent assurance in addition to the internal control sign-off process by the Executive Management Team.

4.3 Enhancing our assurance framework
While we will maintain the core aspects of our current assurance framework for 2015–16, we have identified a number of enhancements to the way we assure our performance information, which we will be putting in place this year. The specific areas where we are making improvements are:

(i) Extending our compliance framework to include new performance commitments
As noted above, we have introduced a number of new measures for 2015–20, which have not previously been reported on. We will incorporate these new measures within our Regulatory Compliance Framework. This means we will ensure that each of the new measures has fully documented processes and that we have identified and are operating key controls around the reporting of this information. This work will be completed and in operation before the end of the 2015–16 report year

(ii) Development of a new monthly Board performance dashboard
We have updated the way we report performance to our Executive Management Team and our Board. We have developed a new dashboard report based on our customer promises and performance commitments for the period 2015–20. This enables the executive and the Board to understand and challenge performance on a monthly basis and ensure the appropriate corrective action is taken in a timely manner. By showing monthly progress against targets, the dashboard also provides the Board with confidence that the year-end data reported in our annual performance report is reliable and accurate

(iii) Strengthening the Regulatory Compliance Framework
To ensure that the processes and methodologies set out in our Regulatory Compliance Framework remain fit for purpose, we have engaged external advisers to review the framework and make recommendations for improvements to the processes, controls and documentation which comprise the framework. This review and any corrective actions will be completed by the end of 2015–16
(iv) Scrutiny and challenge by our independent Customer Advisory Panel

We have established an independent Customer Advisory Panel (CAP) to monitor and report on delivery of our business plan promises and performance commitments. The CAP is chaired by Anna Bradley, an expert in consumer advocacy, and includes members from Age UK, the British Youth Council, Sussex Chamber of Commerce, Waterwise, East Sussex County Council, the South Downs National Park and Ofgem. The role of the CAP is to:

• advise the Board on delivery of customers’ priorities and to ensure they remain at the heart of the business
• provide assurance and challenge around the delivery of the promises
• provide scrutiny of Southern Water’s customer and stakeholder engagement programme
• provide insight on best practice in customer and stakeholder engagement developments.

(v) Appointing an independent certifier

We will appoint a certifier, who has a professional background in technical, operational and regulatory aspects of the water industry, to lead the external assurance work on our performance report. The certifier is independent from Southern Water and will be engaged by the Audit and Risk Review Committee.

(vi) Extending our assurance to include narrative as well as numerical reporting

One of the key areas of feedback from stakeholders was the importance of ensuring that the narrative reporting of our performance is appropriately balanced. While this is inherently more subjective and more challenging than assuring numerical data, we intend to explore with our third party assurance providers and statutory auditors how we can best tackle this challenge through an independent review.

5. Enhancing our reporting

As well as engaging with stakeholders on the assurance of our performance data, we also discussed the scope and presentation of our annual performance reporting. We set out in Section 3 how we propose to address some of their specific comments. In this section we describe our current, sector-leading approach to annual performance reporting through our Annual Report and the work that we propose to do to improve the way we report.

5.1 Annual Report

Our Annual Report and Accounts currently represent the main vehicle for reporting of performance to our customers and stakeholders. As well as our financial accounts, in our Annual Report we show key statistics about our business, details on how we spend customers’ money, and a set of key performance indicators. The report also includes details of our corporate ownership structure, the profits we make and who are Board members are.

Since 2013–14, we have been working on making the presentation of this information more accessible for our customers and stakeholders through the use of web-based technology, video and innovative graphical presentation. This work was recognised at the CIPR 2014 PRide Awards (South of England and Channel Islands) the Gold Award for Best External Publication.

Figure 3. Our 2014–15 Annual Report
5.2 Further enhancing our annual performance reporting

The engagement with stakeholders, described in Section 3, gave us some very helpful insights into what stakeholders wanted from our annual performance reporting and how we could improve this. To build on this we intend, working with our Customer Advisory Panel, to carry out engagement with customers next spring to understand how they would like to receive information about our performance.

Our initial thinking is that we will retain the Annual Performance Report both to meet Ofwat’s regulatory requirements and as a comprehensive one-stop shop for performance information, but that we will produce a suite of tailored reports based on the specific needs of different customers and stakeholders. These would reflect the same underlying performance data, tailored to meet the interests of different stakeholders. We would welcome any comments from customers and stakeholders on how we might best do this.

6. How to respond to this document

We are grateful for the feedback we have received from stakeholders to date. This has informed our assessment of our Risks, Strengths, and Weaknesses (set out in Section 5) as well as providing useful insights into how we can better report our performance.

We have developed a draft assurance plan for 2015–16, which builds on the robust Regulatory Compliance Framework we currently have in place, enhanced in a number of areas to meet the new challenges. We have also set out our plans for consulting further with customers on the way we report our performance.

We would welcome comments on both this draft assurance plan and our proposals for improving the way we report our performance. We will finalise and re-publish our draft assurance plan, taking account of comments received from stakeholders, by the end of January 2016. We will publish our first Annual Performance Report for 2015–16 in July 2016.

We invite responses to this document by 31 December 2015. You should send any comments to: regcorrespondence@southernwater.co.uk.
Appendix 1: Our promises

Responsive customer service
- Quick and effective resolution of your queries - 90 per cent resolved first time by 2020
- Improved service to you and your community - increase the number of customers who feel our service meets their individual needs and those of their community
- Improved ranking in our regulator’s league table for customer satisfaction - be among the best by 2020
- Direct compensation paid if we let you down – this will be linked to the service standards set out in our updated Customer Charter

Looking after the environment
- No ‘serious pollution incidents’ affecting local rivers, streams and beaches caused by our operations by 2020
- Aim for 100 per cent compliance by our wastewater treatment works with required standards - at least maintain performance at 98.6 per cent (2014-15 target level)
- Increase by seven the number of customers who feel our services provide value for money
- Reduce the amount of water we take from the environment by 1.4 per cent, despite predicted population growth of four per cent

A constant supply of high-quality drinking water
- No restrictions on water use, such as hosepipe bans, unless there are at least two dry winters in a row
- Reduce leakage by 2020 – target of 86 million litres a day by 2020, equating to a reduction of almost two million litres a day
- No increase in the average time you are without water, for example because of a burst water main
- Aim for 100 per cent compliance with drinking water quality standards – at least maintain performance of 99.93 per cent then 99.95 per cent from 2017-18
- No increase in the number of households suffering from persistent low water pressure
- Help reduce the effect of hard water in homes and businesses – increased customer understanding through better information and advice

Better information and advice
- Ten per cent reduction (15 litres per person, per day) in average water use by 2020 with better advice on saving water, energy and money - we will reduce average water use from 148 litres (2012-13) to 133 litres per person, per day*
- Improved advice on how to prevent blocked drains to help reduce blockages – increase the number of customers who know how to help prevent blockages in drains and sewers
- A 50 per cent reduction in bill queries by 2020
- Customers provided with better information about what we do, why we do it and what it costs – increase the number of customers who understand how we use the money they pay us

Removing wastewater effectively
- No increase in the number of blockages in our sewer network
- Significant reduction of 25 per cent in sewer flooding inside your homes and businesses by 2020
- No increase in the number of incidents of sewer flooding affecting outside areas
- Reduction of five per cent in complaints about smells from our wastewater treatment works and pumping stations by 2020

Affordable bills
- Efficiency savings made during 2015-20 to help keep bills as low as possible
- Ten per cent reduction (15 litres per person, per day) in average water use by 2020 with better advice on saving water, energy and money – this will reduce average water use from 148 litres (2012-13) to 133 litres per person, per day*
- Customers in genuine financial hardship provided with improved support – increase the proportion of customers who take up the support we offer around bills
- Customers provided with better information on how we are providing value for money – increase the number of customers who feel our services provide value for money

* Note this promise contributes to both better information and advice and affordable bills
Appendix 2: Governance and risk management

1.1 Governance

To successfully embed risk and performance management across Southern Water, the risk management process is supported by a governance structure that defines roles and responsibilities, and key control activities at each level of the company, outlined above.

1.1.1 Company Board

The Board is ultimately accountable for ensuring risks are managed effectively across Southern Water and for maintaining robust systems of risk management and internal control. Key responsibilities include:

- Agreeing the company’s risk management strategy and risk appetite.
- Providing oversight, challenge and approval of the management of Southern Water’s principal risks, and defining the monitoring process required for the on-going scrutiny of the risk management and internal control systems.
- Reviewing, challenging and approval of outputs of the EMT’s twice-yearly strategic risk assessment exercise, and integrating these into strategic planning activities.
- Signing-off revisions to the risk management framework.
1.1.2 Audit & Risk Review Committee

The Audit & Risk Review Committee (ARRC) is responsible for overseeing and challenging the effectiveness of Southern Water’s approach to risk management. Key responsibilities include:

- Ensuring the Board receives appropriate assurance that the systems of risk management and internal control are operating effectively, and that all significant failings, weaknesses and principal risks have suitable management activities in place to rectify and/or remain within the defined risk appetite.
- Endorsing an internal audit plan that is informed by principal risk exposures, including overseeing targeted reviews of key risk and control areas.
- Maintaining an assurance landscape that has integrity, independence and reliability.

1.1.3 Executive Management Team

The Executive Management Team (EMT) is responsible for ensuring the Corporate risk management system is effective and embedded in the business, and operates in accordance with the Southern Water risk management policy. Key responsibilities include:

- Leading a strategic ‘top-down’ risk assessment exercise on a biannual basis, aligned to Southern Water’s strategic planning and budgeting cycle.
- Monthly review, challenge and approval of all significant ‘bottom-up’ risks that have been escalated to the EMT.
- Individual ownership of principal risks and proposal of principal risk list to the Board.
- Actively sponsoring and supporting the practice of risk management and policy compliance by promoting the right ‘Tone from the Top’.
- Defining desired appetite levels for key risk areas for Board review and acceptance.
- Challenging Directorate management during performance reviews as to the effectiveness of their risk management performance.
- Performing monthly ‘deep dives’ on principal risks.

1.1.4 Directorate Management

Responsible for implementing accurate and reliable risk and performance management in their Directorate and ensuring that appropriate risk and performance management governance structures, processes and activities are in place. Key responsibilities include:

- Responsibility for the effective management of risk and performance within their Directorate.
- Reviewing and challenging the scope, quality, completeness and validity of risk and performance information reported by their area.
- Escalating risks in accordance with the defined Board Risk Escalation Thresholds.

1.1.5 Risk Owner

A named individual is allocated as the Risk Owner for each risk identified, who is the single point of accountability and responsible for its effective management. The Risk owner is:

- Familiar with the risk and has the required authority to ensure its effective management.
- Responsible for assessing and agreeing the severity of the risk.
- Accountable for monitoring the risk to identify any material changes or issues.
- Ensuring that all escalations e.g. where defined thresholds are breached, are made as required.

1.1.6 Action Owner

Action Owners have delegated responsibility from Risk Owners, and are responsible for the implementation of specific risk response activities.
1.2 Risk management approach

Risk management is a core component of Southern Water’s wider governance and internal control framework, which provides the overarching structure through which the company is managed to achieve its objectives.

Southern Water’s effective system of risk management provides the company with many benefits, including:

- Informed risk decision making to help deliver consistent and improved business performance by avoidance of unwanted surprises and realisation of opportunities.
- Identification and mitigation of key risks that could have a material impact on the achievement of business objectives.
- Consistency and clarity in accountability and ownership for managing risks, enhancing governance.
- An improved view of key controls, their effectiveness and gaps in the control environment, enabling optimisation.
- A clear path to raise significant risks to senior management and the Board.
- A proactive, risk aware culture across the company.
- Assurance to the Board and Audit & Risk Review Committee that processes and behaviours are embedded that ensure significant risks are routinely and consistently identified, understood and effectively managed.

The Southern Water strategy for risk management is that all significant risks to the achievement of our objectives are identified, assessed and managed to within acceptable levels. To achieve this, the Board and management promote a culture that encourages routine consideration of risk in key decisions and supports integration of risk management with our critical processes and ways of working.
1.3 Risk management process

The four main stages of Southern Water’s risk management process are set out in the diagram below.

Figure 6. Risk Management Process

1.3.1 Risk identification

The first stage in the risk management process involves the identification and description of all risks that could affect business objectives, and includes establishing the context and environment of the business area under review, and agreeing appropriate risk ownership and categorisation.

To ensure that Southern Water’s risk profile is complete, the EMT conducts a “top down” (looking across and down from the top of the company) strategic risk identification exercise on a biannual basis. This supplements the Directorates’ “bottom up” (identifying risks at operational levels of the company and working up) risk evaluation that is performed quarterly. In addition, consideration of risk is also embedded into key processes including budgeting, business planning and performance management.

All identified risks are captured in the corporate risk systems, with all descriptions detailing the risk’s cause, event and consequence.

1.3.2 Risk assessment

Once risks have been identified, an estimation of their potential likelihood and business impact is needed to determine whether they are of concern and require a management response with, for example, implementation of controls and mitigation; this is called risk assessment.

All risks are assessed from three perspectives, a Residual basis, assuming controls and mitigating activities already in place work as intended, an Inherent basis, assuming the controls and mitigating activities do not exist or do not work as intended, and a Target basis, capturing the desired level of risk exposure. Assessing risks in this way supports understanding of the reliance placed on existing controls and mitigation, the worst case scenario for the risk, and how acceptable current levels of exposure are compared to Target positions. This helps to inform the focus of management oversight and challenge as well as prioritisation of responses.

The impact and likelihood values of risks are assessed over an annual time horizon, using the ‘Southern Water Group Risk Assessment Criteria’, which consist of five point severity scales. This allows reliable and consistent measurement and comparison of risks on a like-for-like basis.

The Risk Owner is responsible for agreeing the assessed size of each risk to a clearly defined methodology.

1.3.3 Risk response

Where the Residual severity of a risk exceeds acceptable levels (i.e. is not aligned with Target levels) then appropriate actions may need to be selected and implemented to bring the Residual risk position in line with the Target risk position.

Options to respond to a risk can typically include:

- Reduction, with controls and mitigation;
- Transfer, with insurance and contracts;
- Avoidance, by stopping or changing the activity that gives rise to the risk; and
- Acceptance, if the benefit of taking the risk justifies the potential downside exposure or further responses are not feasible or cost-effective.
The Risk Owner retains overall accountability for the management of the risk, though Action Owners can be assigned that have responsibility for the implementation of specific response activities.

Details of all planned activities and delivery milestones shall be detailed in Risk Response Plans and recorded in the corporate risk system(s).

### 1.3.4 Risk monitoring, reporting and escalation

Risk monitoring and reporting involves the timely tracking, capture and sharing of risk information to enable review and notification of changes in risk exposure by management. It supports understanding and decisions on risk responses to be made, including potential management interventions to avoid a risk occurring or reduce its impact should it occur.

In addition to monitoring of individual risks, the ARRC, on behalf of the Board, also undertakes on-going performance monitoring of the systems of risk management and internal control to assure they are effective and performing as expected.

Directorate risks that exceed the ‘Southern Water Risk Escalation Thresholds’ are reported to, and reviewed by, the Board and EMT on a monthly basis via the monthly tier one and tier two dashboards. The EMT also conducts a monthly “deep dive” review of risks each month.

A Risk Update Report is issued to, and reviewed by, the ARRC three times a year, and the Committee holds a dedicated risk workshop once a year.

The thresholds for risk escalation, based on the ‘Group Risk Assessment Criteria’ where a risk rating of 25 is the most severe and 1 is the least, are:

- Risks with Residual impact score of 15 or greater, and
- Risks that have an inherent and residual impact score of 5 that have been separately identified as a ‘HILL’ (High Impact Low Likelihood).

The list of the most significant risks facing the organisation is referred to as ‘the principal risks’. These are risks that are considered by the EMT and Board to have the greatest potential to affect the achievement of strategic objectives, based on outputs from the “top down” and “bottom up” risk assessment exercises and their ongoing review and monitoring. The principal risks we face are disclosed in Southern Water’s Annual Report.

Outside of monthly risk reporting, any new risks that are identified from ongoing business activities and analysis, or risks that have been detected via monitoring to have changed in severity that meet the escalation criteria, are escalated to the EMT and Board in line with the agreed escalation process.

### 1.3.5 Communication & consultation and target risk

Communication and consultation is a key factor in all stages of the risk management process, ensuring appropriate individuals are engaged that, for example, contributes to better understanding of the nature and details of a risk, as well as those who are specifically affected by it. It is also critical to ensuring that accountable decision makers and management receive the right types of information at the right time and are engaged to provide their views and share their experiences.

Risk appetite, which is a Board’s expression of the types and amounts of risk it is willing to take or accept in pursuit of its objectives, is also a key consideration throughout the risk management process, helping inform the business’ understanding of the levels of risk that is deemed to produce required returns, and those risks that are not acceptable and require management responses, escalation and reporting.

The determination of a target risk is, in practice, a reflection of risk appetite at a granular level. For example, where the Residual risk is higher than the Target risk, the risk may be considered to be unacceptable and a risk reduction plan is required. Once the Residual risk aligns with the Target risk level, the risk would be then be considered to be acceptable and within appetite. The setting of target risk levels is informed by the Board’s Group risk appetite, policies and procedures, and management plans and objectives.
1.4 How we assess risks

Summary
A. Understand the size/significance of the risk
B. Impact and Likelihood risk assessment criteria
C. How to assess Inherent, Residual and Target risk
D. Worked example of assessment of a risk

A. Understand the size/significance of the risk
Risk assessment determines the significance of a risk by considering two factors: the potential impact(s) of the risk if it were to occur and the likelihood of the risk occurring. Both factors can be expressed in qualitative or quantitative terms and are based on the risk’s full description of cause, event and consequence.

Impact
The impact of a risk is established by considering its potential effects on the achievement of company objectives. As objectives can vary widely in their nature and importance, a standard scale that measures a risk’s effects on common company assets such as finances or reputation is used as a proxy.

Likelihood
The likelihood of a risk occurring is determined by estimating the probability or expected frequency of the risk occurring in a given timeframe.

B. Impact and Likelihood risk assessment criteria
A defined set of risk assessment criteria, the Southern Water Group Risk Assessment Criteria, are used to support consistent assessment of risk size/significance to allow comparison of risks across the Group. The criteria measure risk impact and likelihood against five levels of severity using the following criteria:

Impact
Financial, Reputation, Health & Safety, Legal, Regulatory & Environmental, and Security of Supply

Likelihood
Probability of occurrence (in percentages), expected frequency of occurrence, and qualitative descriptors.

C. How to assess inherent, residual and target risk
Understanding of the potential significance of a risk exposure is enhanced by assessing its Inherent, Residual and Target risk positions, taking into account the effects of controls and mitigations.

Southern Water defines controls as activities and measures that reduce the likelihood of a risk occurring and mitigations as activities and measures that reduce the impact of a risk, should it occur.

Note: there are several different types of controls that can be designed and implemented, including detective, preventative, directive and monitoring – further guidance is available in Section 4. Similarly, mitigation can take a wide range of forms. Consideration should be given to the most appropriate types and combinations of controls and mitigations to best manage a risk.

Inherent Risk Assessment
The assessment of risk on an Inherent basis involves the assessment of the impact and likelihood of the risk based on the assumption that controls and mitigations that are currently in place (and that have a specific and significant effect on management of the risk) do not exist or do not function as intended. This assessment determines the credible and foreseeable worst case scenario for the risk described.
Why assess inherent risk?
Assessing risk on an inherent basis provides a view of how bad a risk could be if the existing controls and mitigations in place did not exist or do not work as intended. This is important as, when compared to the Residual risk exposure, it provides an understanding of the amount of reliance being placed on current response activities, focusing scrutiny and challenge by management on their effectiveness and adequacy in light of potential worst case consequences. Where there is significant reliance on the existing controls and mitigations, their operation and effectiveness should be tested on a regular basis.

Residual Risk Assessment
The assessment of risk on a Residual basis involves the assessment of the impact and likelihood of the risk based on how it is currently being managed. It assumes that the specific and significant controls and mitigations that are currently in place to manage the risk are working as intended.

Why assess residual risk?
Residual risk assessment tells us the current size of a risk’s exposure if existing responses to manage it are in place and working as intended. In addition to helping direct the focus and ownership of management towards those that are most significant (after taking response activities into account), the difference in size between Inherent and Residual positions (the delta) also helps inform the oversight and assurance focus on key controls and mitigations.

Target Risk Assessment
The assessment of risk on a Target basis involves the determination of the desired impact and likelihood levels for the risk, based on the amount of exposure Southern Water is comfortable in accepting for the benefits it derives from taking the risk, and the feasibility and cost of any further response activities. Target risk determination will be informed by the Group and Directorate’s risk appetite, where relevant and available. Of note is that it is not always desirable or possible to try to avoid or reduce some types of risk; the objective of risk management is to ensure that the right level of reward is achieved in return for taking/accepting certain types of risks.

Why assess Target risk?
Determination of Target risk positions allows understanding of whether current Residual risk positions are acceptable or require further management action to align with risk appetite.

How to assess a risk
Once a risk has been identified and appropriately described in terms of cause, event and consequence(s), the following steps to assess the severity of the risk are carried out.

The illustration below shows the three different risk positions (Inherent, Residual and Target) and the effect of associated controls and mitigations.
**Step 1 - Establish the controls and mitigations currently in place**
Detail all significant controls and mitigations that are specifically applied to actively manage the risk at present and consider their effectiveness:

- What component(s) of the risk do they affect, how and by how much e.g. do they fully prevent a cause leading to an event?
- Are they independent or rely on other processes or activities to work?
- How reliable are they - could they fail or not be available when needed? If so, how often could this be the case?
- What are their limitations - will they only work up to a certain threshold of risk severity?
- Is there redundancy - if one fails is there back up?

The focus should be on the identification of controls and mitigations that are specifically in place to manage the risk and have a significant effect on its management. Generic informal activities e.g. calling the fire brigade if there is a fire should not be considered.

Note that where a new risk is identified, there may not be any specific controls or mitigations in place.

**Step 2 - Assess the residual position**
Taking account of controls and mitigations, estimate the Residual risk size. What are the likelihood and impact values of the described risk occurring based on the effectiveness of the controls and mitigations considered in the previous step? Consider:

- How often does the risk cause occur that could lead to the described event and consequence? E.g. is it always in the background or periodic?
- The reliability of the controls working as intended; are they always in place and effective?
- The effectiveness and reliability of mitigations e.g. an alternative supplier may take time to ramp up, insurance may not pay out etc.

**Step 3 - Assess the inherent position**
What would the likelihood and impact of the described risk be if all current controls and mitigations did not exist? Consider:

- All the controls and mitigations already captured in step 1, the effect they would have on the risk (step 2) and imagine that none of them were in place:
  - What could happen?
  - How severe could the impact be i.e. what is the credible and foreseeable worst case scenario for the risk?
- How likely is it that the risk would occur? Is the likelihood the same as the cause? I.e. is it constant or intermittent? Would it occur if a control failed, such as a safety valve, and therefore face a likelihood equivalent to the failure rate of the control?

**Step 4 - Assess the target risk position**
Is the current Residual risk position acceptable or are the desired impact and likelihood values different? When establishing the Target risk position, the following should be considered:

- What are the benefits and opportunities presented by being exposed to or taking the risk? Do they justify the size of the exposure?
- Is the current risk position 'unacceptable'? Given the feasibility and cost of actions to reduce the position, what is an acceptable size for this risk?
- Has risk appetite been defined that relates to this risk?
- How important is the objective that the risk could affect?
- Do the Southern Water values and culture help indicate what an acceptable level would be?
- Are there internal rules and policies related to the risk area? Consider, for example, the Southern Water Code of Conduct and the Health and Safety and Environment Manual.
- Are there external regulatory and legal requirements that Southern Water must comply with?
We invite responses to this document by 31 December 2015.

You should send any comments to:
regcorrespondence@southernwater.co.uk