

2019

Risk and Compliance Statement



Bournemouth
Water



South West
Water

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Introduction to our Risk and Compliance statement

Introduction to our Risk and Compliance Statement

On an annual basis South West Water are required to publish a Risk and Compliance Statement which sets out how we have complied with the relevant statutory, licence and regulatory obligations.

It lays out how we have complied with these obligations and how we are taking appropriate steps to manage and/or mitigate the risks we face.

The statement is important in the process of demonstrating that customers and other stakeholders can place confidence that the Board:

- understands and has taken appropriate steps to meet our obligations and customer expectations
- is satisfied that the processes and systems of internal control are sufficient to fully meet our obligations
- is satisfied that the Company has appropriate systems and processes in place to allow it to identify, manage and review its risks and has in place adequate mitigations for those risks.

THE RISK REPORT (CONTAINED WITHIN THE ANNUAL PERFORMANCE REPORT AND REGULATORY REPORTING)

Within the Annual Performance Report and Regulatory Reporting, the Risk and Compliance Statement is published alongside our Risk Report which sets out in more detail the Company's risk management framework and internal control as well as for each Principal Risk facing the company; the strategic impact of the risk

- a description of the controls in place to mitigate the risk
- an assessment of the current level of risk faced by the Company after controls and mitigations currently in place.

The Risk Report also more fully details the risk management framework and system of internal controls (see pages 104 to 106 of the Annual Performance Report and Regulatory Reporting).

Therefore this document should be read in conjunction with the Risk Report (pages 104 to 116 of the Annual Performance Report and Regulatory Reporting) for a full understanding of the actual risks identified and mitigations in place.

ASSURANCE OVER THE RISK AND COMPLIANCE STATEMENT

In signing the Board Assurance Statement within the Risk and Compliance Statement the Board has confirmed that they have the appropriate systems, procedures and management frameworks in place to be able to compile the statement.

As part of Jacobs' assurance work as South West Water's Technical Assurance Partner, the Board has also engaged Jacobs to review the Risk and Compliance Statement and provide an independent opinion on "the risks, processes and controls in place to enable it to compile the statement in which stakeholders can have trust."



Document map



RISKS, STRENGTHS AND WEAKNESSES STATEMENT

This statement sets out our risks, strengths and weaknesses to the information that we publish following consultation with customers and other stakeholders.



DRAFT ASSURANCE PLAN

The draft assurance plan lays out areas we have identified as key areas for assurance (including as a result of the risks, strengths and weaknesses consultation).



FINAL ASSURANCE PLAN

Following consultation with customers, employees and other stakeholders the final assurance plan updates the draft assurance plan to address feedback received.



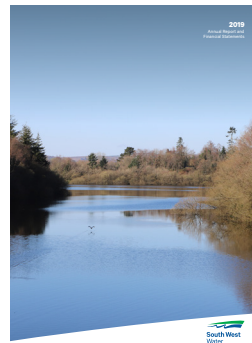
ANNUAL PERFORMANCE REPORT AND REGULATORY REPORTING

The annual performance report lays out our performance against the regulatory targets we have committed to achieve. Our regulatory reporting lays out key financial and non financial performance for the year.



SUMMARY PERFORMANCE REPORTS

We publish summary performance reports for each of the South West Water and Bournemouth Water operational areas; these provide a shorter summary of performance against each of our regulatory targets.



ANNUAL REPORT AND FINANCIAL STATEMENTS

Our annual report and financial statements are published in line with Companies Act requirements and as well as reporting on overall performance, provide a more detailed review of our financial performance during the year.



Document map continued



SUMMARY ASSURANCE REPORT

Our summary assurance report (incorporating our 'Data Assurance Summary') provides an update on the assurance which we have performed in line with this plan.



OUR WEBSITES

The documents listed here are published on our websites (southwestwater.co.uk and bournemouthwater.co.uk) alongside other useful documents – such as our charges to customers for the year.



BUSINESS PLAN 2020-25

In September 2018 we published our business plan for 2020-25 'The New Deal', which was given fast-track status by Ofwat. For further information on South West Water's New Deal visit southwestwater.co.uk/newdeal.



RISK AND COMPLIANCE STATEMENT

This report sets out how we have complied with the relevant statutory, legal and regulatory obligations.

Risk and Compliance Statement

Governance

The 2018/19 South West Water Annual Performance Report and Regulatory Reporting highlights Company performance for the fourth year of the five-year 'K6' regulatory period (2015 to 2020).

The Outcome Delivery Incentives (ODIs), which are South West Water's Key Performance Indicators, incorporate the metrics used by the South West Water Board and Ofwat, our economic regulator, to monitor performance.

In line with Ofwat's Regulatory Reporting requirements, this risk and compliance statement details the South West Water Board's approach to governance, and compliance with its obligations to stakeholders.

The South West Water Board has in place a well established and effective set of policies and processes covering corporate governance, internal control and risk management.

STATUTORY OBLIGATIONS

The Company has a number of statutory obligations including those detailed within the Water Industry Act, the Companies Act, the South West Water Licence, and the Competition Act.

Since privatisation, the Company has developed and established processes and procedures for ensuring obligations are adhered to in all material aspects. Compliance with obligations and performance against targets are outlined through Regulatory Reporting. This year's performance is again summarised in the Company's Annual Performance Report and Regulatory Reporting.

The South West Water Board has received reports from the business detailing the applicable statutory licence and regulatory obligations (for which Ofwat is the relevant enforcement authority) and the means by which compliance in all material aspects with those obligations is assured within South West Water for 2018/19.

CUSTOMER EXPECTATIONS

The Company has developed approaches and appropriate processes for engaging with customers to ascertain priorities and expectations.

The Company continually gathers customer feedback and engages with customers in order to understand their expectations.

South West Water has considered how communications adhere to Ofwat's information principles with the aim of ensuring information is accurate, transparent, clear, accessible and timely.

Our Codes of Practice meet licence conditions G, H and I, providing information to customers describing the nature of the services to domestic customers, giving guidance to domestic customers who have difficulty paying their bills and advising customers of their options and rights about the help available when they have a leaking supply pipe.

Our approach for producing and reviewing customer information is consistent with Ofwat's information principles. Customer research and feedback is acquired through our quarterly tracking survey and on specific topic areas to support the quality of our communications.

Company performance

The South West Water Board monitors and controls the performance of the Company against the targets and expectations within the Final Determination and statutory obligations by:

- Setting targets and reviewing performance against key levels of performance indicators and financial measures on a monthly basis at Board and Executive Management level
- Implementing Investment Planning & Control procedures to ensure that the principles of proper financial control are applied throughout the inception, evaluation, implementation and handover of capital investment
- Encouraging a culture of openness, where issues can be openly discussed, continuing to support a 'Whistleblowing' policy.

Performance against targets is measured and reported using key performance indicators which are aligned with those highlighted in this Annual Performance Report.

There are appropriate systems and processes in place to identify, manage and review any potential material exceptions to the delivery of outputs or changes in circumstances to that assumed within our 2014 Final Determination. These include those which might lead to an adjustment to price limits through the revenue price caps or performance measures.

South West Water has not identified any circumstances that have resulted in a material variance to the Final Determination expectations.

Risk and Compliance Statement continued

Board transparency and governance

The South West Water Board is dedicated to developing and improving the governance structures and activities in accordance with best practice and Ofwat's Board Transparency and Governance requirements.

For 2018/19 South West Water had a fully functioning and standalone Board and Committees. The business of the Board with associated Audit, Sustainability, Remuneration and Nomination Committees covers a full range of corporate issues including strategy, performance, delivery, compliance and governance.

In accordance with the governance framework, and as approved by Ofwat, the South West Water Board convenes before each Pennon Group Board meeting to consider South West Water strategy, performance and regulatory planning.

The governance framework is set out in the governance section on pages 62 to 66 (of the Annual Performance Report and Regulatory Reporting). The regulatory ring-fence around the South West Water business is protected through efficient and transparent decision making.

The Board has a 'matters reserved' schedule setting out its responsibilities. Each Committee has detailed terms of reference setting out its responsibilities and accountabilities. Further details of the responsibilities of each of the Committees are set out in the report of each Committee on pages 72 to 89 of the Annual Report and Financial Statements. These, together with the risk management and internal controls frameworks form an effective and robust governance structure.

We will continue to review our governance structures regularly in accordance with Ofwat's Board Transparency and Governance guidelines, ensuring we continue to carry out our business in a transparent way, designed to secure the Company's long-term success and profitability.

The South West Water Board of Directors comprised the Chairman (Non-Executive), two Executive Directors, five further Independent Non-Executive Directors (including a Senior Independent Director), two of whom are also Non-Executive Directors of the Pennon Group plc and Chris Loughlin, Pennon Group Chief Executive Officer as a non-independent Non-Executive Director. Since May 2019, Chris Loughlin has temporarily been appointed as Managing Director. The Board considers that the Chairman and each of the Independent Non-Executive Directors were independent throughout the year.

Susan Davy, Pennon Group Chief Financial Officer and Iain Evans a Pennon Group Non-Executive Director also attend the South West Water Board.

They are considered by the Board to have the appropriate skills, experience in their respective disciplines and personality to bring independent and objective judgement to the Board's deliberations and to represent customers' interests.

The Company has complied with the UK Corporate Governance Code 2016 subject to a number of exceptions which relate to certain responsibilities being reserved by the Board and Committees of Pennon Group plc (the parent company), which itself fully complies with the UK Corporate Governance Code. The exceptions are explained in the South West Water Annual Report page 71.

Risk management

The Company has robust systems and processes in place to identify, manage, mitigate and review its risks.

The system for profiling and monitoring key risks is embedded in our normal business practices. We regularly review how we have sustained specific risk control measures, to decide if the probability and consequence of certain risks has changed, and if necessary to recommend further actions or investment to ensure the effectiveness of our corporate governance.

For the purposes of assessing and managing risk within South West Water, the individual departments review risks to the business associated with their accountabilities and responsibilities within the Company strategy. An overall risk register is updated on an ongoing basis as a result of any changes in the nature and extent of risks.

Through the year, Risk and Assurance Forums (attended by members of the Executive Management and Senior Management) formally review and update the risk register on a quarterly basis, with a particular emphasis on assessing and challenging, where necessary, the controls and mitigating factors recorded on the risk register. Risks are also formally reviewed as part of the quarterly forecasting and annual business planning processes.

Executive Directors and Senior Managers are required to complete an annual 'Certificate of Effective Internal Control' prior to the finalisation of the financial statements and before publishing any annual performance data. The South West Water Audit Committee considers the resources for carrying out internal audits in key Company specific areas – this activity is carried out by the Independent Pennon Internal Audit team.

The South West Water Audit Committee endorses and acts on audit findings from these audits carried out within the Company. There is also a programme of internal audits coordinated by the Risk and Compliance team as part of the Company's ISO certifications. South West Water currently holds the following accreditations/certifications:

- ISO 9001:2015 (quality management)
- ISO 14001:2015 (environmental management)
- ISO 50001:2011 (energy management)
- ISO 27001:2013 (information security)
- ISO 17025:2005 (laboratories and sampling).

Risk and Compliance Statement continued

South West Water Board statement

The South West Water Board confirms that in its opinion sufficient processes and systems of internal control were in place to meet the Company's obligations for the 12 month period to 31 March 2019 for ensuring that the Company complied in all material respects with its legal and regulatory obligations as a water and sewerage undertaker.

It also confirms that in its opinion the Annual Performance Report covers the issues it considers to be material to the Company, gives a fair, balanced and understandable view of the Company's performance and compliance with the relevant obligations.

Statement of Directors' responsibilities for regulatory information

Further to the requirements of company law, the Directors are required to prepare accounting statements which comply with the requirements of Condition F of the Instrument of Appointment of the Company as a water and sewerage undertaker under the Water Industry Act 1991 and Regulatory Accounting Guidelines issued by Ofwat. This additionally requires the Directors to:

- Confirm that, in their opinion, the Company has sufficient financial resources and facilities, management resources and methods of planning and internal control for the next 12 months
- Confirm that, in their opinion, the Company has sufficient rights and assets which would enable a special administrator to manage the affairs, business and property of the Company
- Confirm that, in their opinion, the Company has contracts with any associate company with the necessary provisions and requirements concerning the standard of service to be supplied to ensure compliance with the Company's obligations as a water and sewerage undertaker
- Report to Ofwat changes in the Company's activities which may be material in relation to the Company's ability to finance its regulated activities, undertake transactions entered into by the appointed business, with or for the benefit of associated companies or other businesses or activities of the appointed business, at arm's length
- Keep proper accounting records which comply with Condition F.

These responsibilities are additional to those already set out in the statutory financial statements.

In the case of each of the persons who are Directors at the time when the report is approved under Section 418 of the Companies Act 2006 the following applies:

- So far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware
- He/she has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Licence of Appointment – statement relating to Condition P

The Board of Directors of South West Water Limited has resolved that a Certificate be issued to the Water Services Regulation Authority confirming:

- That the Appointed activities are conducted as if it is substantially the Company's sole business and it is separate from any other business activities carried out by the Company
- The Company retains sufficient rights and assets and has in place adequate financial resources and facilities, management resources and systems of planning and internal controls
- Any transfers or transactions entered into by the Company do not adversely affect the Company's ability to carry out the regulated activities
- That in the opinion of the Board, South West Water would be able to maintain an Issuer Credit Rating which is investment grade.

In making this declaration, the Board has received external independent assurance over this assessment and has taken into account the following main factors in giving its opinion:

- Key financial metrics including: adjusted interest cover; net debt / RCV; FFO / net debt and RCV / net debt
- Ownership and availability of assets where assets are held outright in perpetuity
- The capital programme over the current and future regulatory period as a proportion of the regulated asset base
- Financial policies, including dividend policy.

South West Water performed a synthetic rating analysis utilising all relevant financial ratios aligned to specific credit rating guidelines.

Robust, independent external assurance was undertaken by a rating agency to support the Board's view which gave comments on both the current and future assessment of South West Water's credit rating.

This supported the internal assessments made and the opinions of the Board.

Risk and Compliance Statement continued

Long-term resilience and viability statement

South West Water is a long-term business characterised by a multi-year investment programme, with the associated revenue stream.

The Board has assessed the Company's financial viability and confirms that it has a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due up to the end of 2030. The assessment has been made with reference to the Company's current position and prospects, its longer-term strategy, the Board's risk appetite and the Company's principal risks and how these are managed through our risk management framework, as detailed on pages 104 to 107 of the Risk Report (within the Annual Performance Report and Regulatory Reporting).

The Company's long-term strategic business plan and associated principal risks are the foundation of the scenario testing. This assessment has considered the potential impact of arising risks on the business model, future performance, solvency and liquidity over the period in question. In making their assessment, the Directors reviewed the principal risks and considered which risks might threaten viability.

Over the course of the year the Audit Committee has reviewed the risk assessments for all of the 16 principal risks and considered a deep-dive review of the following principal risks to enable a thorough assessment of the impact of these risks on ongoing viability:

PRINCIPAL RISK	MATTERS CONSIDERED BY THE AUDIT COMMITTEE
Capital projects	Review of the performance of large capital projects
Operational challenges	Ability of South West Water to maintain network resilience in extreme scenarios
Business resilience	A review of business continuity

All principal risks, including the net risk assessment and mitigations and alongside the risk appetite are reported on pages 110 to 116 (of the Annual Performance Report and Regulatory Reporting). The risk level is set based on a number of factors including financial and reputational impacts as well as the level of management resources and intervention needed to mitigate these risks. Historical impacts as well as future estimates are considered when making the financial assessment (for example the level of actual costs associated with non-recovery of customer debt in recent years as well as future assessments of cash collections performance). The risk trends are considered when reflecting the likelihood of this risk arising.

In stress testing the Company's business plan it was determined that none of the individual risks would in isolation compromise the Company's viability. In performing this stress testing all risks have been monetised with reference to risk weighting, factoring in the likelihood of occurrence and financial impact. In addition, further factors were considered to reverse engineer a scenario that could possibly compromise South West Water's viability, these included:

- All the principal risks occurring in all of the years up to 2030
- Lower retail price index (RPI) projections in each of the years up to 2030
- Significant one-off costs
- A deterioration in the credit quality of amounts owed to the Company.

The four factors above have been monetised as absolute financial costs with the principal risks weighted on the likelihood of occurrence.

The Board considered the monetary impact of these scenarios on the Company's viability up to the end of 2030, concluding the reversed engineering scenario remote. The period assessed reflect the longer-term nature of South West Water's business and greater visibility of future cashflows, to include the next two regulatory periods 2020-25 and 2025-30.

As part of the Board's considerations additional scenarios concerning viability were reviewed.

This additional assessment considered South West Water's regulatory financial ring fence through the following scenarios that are recommended to be tested by Ofwat as part of the business planning process:

- totex underperformance (15% of totex) → →
- ODI penalty (3% of RoRE) in one year
- inflation sensitivities (+/-3%)
- increase in the level of bad debt (20%)
- new debt financed at 2% above forward projections
- financial penalty – equivalent to 3% of turnover
- any relevant inter-company financing scenarios.

These scenarios were considered in isolation and in the following combination:

- 10% totex underperformance in each of the years to the end of 2030
- ODI penalty of 1.5% in each of the years to the end of 2030
- One-off financial penalty of 1% of revenue.

South West Water has considered the impact of each scenario (and the combined scenario) upon key ratios used for South West Water's covenant compliance of gearing (net debt / RCV) and EBITDA interest cover. For all scenarios, including the extreme and implausible combined scenario above, these covenants are not exceeded in any year and would, therefore, not challenge the long-term viability.

In addition, we have assessed the impact of scenarios which do consider potential risk mitigations we would take including, efficiency programmes to reduce operating expenditure and innovations within the capital programme, opportunities for refinancing reducing interest costs and the option of deferring dividend payments into subsequent years or regulatory periods. Over the period to 2030 the key ratios below used in assessing financial resilience for credit ratings have been assessed:

- Gearing
- Adjusted interest cover
- FFO / net debt
- RCF / net debt

Based on our assessment these metrics would remain at an investment grade level in all but the extreme case where these impacts occur in every year to 2030 without any mitigation, which is considered implausible.

Ofwat's optimal notional gearing for 2020-25 is 60% and a maximum of 70% is set, above which further sharing of outperformance with customers would be required. In each of the scenarios (including in respect of the combined extreme scenario) the Company remains within that maximum as well as the range for investment grade credit ratings of 55-70%.

Risk and Compliance Statement continued

STRATEGIC PLAN

South West Water maintains a ten-year strategic plan, which is updated every six months and reviewed by the Board. This is maintained alongside updated long-term interest rates and inflation forecasts. During the year a full update of the capital plan to 2030 was also prepared and the Company has assessed that this is financeable and that there are no significant doubts over this period concerning the Company's viability.

Macro economic cycles are also considered by the Group Risk Forum and Company Risk and Assurance Forum in respect of the Company's risk assessments.

Other considerations

In making the assessment, the Directors have taken account of the Company's robust capital solvency position, its ability to raise new finance and key potential mitigating actions on other payments.

In assessing the prospects of the Company, the Directors note that as the Company operates in a regulated industry which potentially can be subject to non-market influences, such assessment is subject to uncertainty, the level of which depends on the proximity of the time horizon. Accordingly the future outcomes cannot be guaranteed or predicted with certainty.

South West Water does not have any intercompany financing arrangements outside of those directly with its wholly owned subsidiary South West Water Finance Plc. The two bonds raised are back-to-back as if they were held directly. There are no Group financing arrangements except for £100m facility available from Pennon which can be drawn on a short-term basis. Therefore we have not included any intercompany financing scenarios.

Summary of long-term resilience and viability

From the assessments undertaken above, whilst the scenarios which have a significant one-off impact may challenge the financial ratios in one individual year, these are deemed to be remote in terms of likelihood and therefore do not challenge the overall viability or long-term financial resilience of South West Water.

A number of the scenarios do not take account of mitigations which the Company would implement if such scenarios arose (for example continued totex underperformance would not be accepted and additional efficiency plans would be targeted to mitigate cost risks). This further strengthens the expectations of financial resilience over the period.

The Board have not identified any other significant plausible scenarios relating to the long term viability of other companies within the group (including of the parent company), which would preclude its assessment of the long term viability of the ring fenced South West Water Appointee business.

In addition, in extreme circumstances South West Water would be able to defer dividend payments to support its long-term viability if required. The Directors have therefore concluded these scenarios in isolation and the combination noted above did not compromise the viability of South West Water over the five-year assessment period.

Mitigations which would be applied if the remote combined scenario occurred include continued totex underperformance not being accepted and additional efficiency plans which would be targeted to mitigate cost risks.

Licence of Appointment – statement relating to Condition F

In addition to internal assurance performed over the viability statement and external assurance in line with EY's role as statutory external auditor of the financial statements, the Audit Committee has provided extensive oversight and review of South West Water's long-term financial resilience (see pages 24 to 30 of the Annual Report and Financial Statements) and we commissioned further specific 'Agreed Upon Procedures' to be performed by EY covering the calculations and assessments made as well as challenge of the underlying assumptions and judgements.

The Board of Directors of South West Water Limited has resolved that a Certificate be issued to the Water Services Regulation Authority confirming:

1. That in the opinion of the Directors, the Company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the Regulated Activities (including the investment programme necessary to fulfil the Company's obligations under the Appointment)
2. That in the opinion of the Directors, the Company will, for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out those functions.

In making this declaration, the Directors have taken into account:

- The net worth of the Company and the strength of key performance indicators as shown in the Company Annual Performance Report for the year ended 31 March 2019 and the Company's business plan for the remaining K period
- Borrowing facilities which include significant committed undrawn bank facilities
- Parental support provided by the holding company which will provide financial support to the Company to enable it to meet its liabilities as they fall due
- The Company's formal risk management process which reviews, monitors and reports on the Company's risks and mitigating controls and considers potential impact in terms of service, compliance, value, people, society and partners
- The Company's employment policies and strategy.

The Directors also declare that in their opinion all contracts entered into with any associated company, include all necessary provisions and requirements concerning the standard of service to be supplied to the Company to ensure that it is able to meet all its obligations as a water and sewerage undertaker, as required in Section 6A.2A(3) of Condition F of the Instrument of Appointment. This opinion has been formed following examination of the documents in question.

Licence of Appointment – statement relating to Condition R and Market Codes in respect of the non-household market

At 31 March 2019 the Company had in place an Access Code compliant with paragraphs 2 to 4 of Condition R of the Licence from the Secretary of State for the Environment, and South West Water has complied with this Code.

Risk and Compliance Statement continued

South West Water has also ensured that every transaction between itself and a related licensed water supplier is at arm's length and does not preferentially make available to the related licensed water supplier any of its other assets.

South West Water has complied with other aspects of Condition R and Market Codes in respect of the non-household retail market.

In making this assessment, the Directors have taken into account:

- South West Water's Compliance Code (available on southwestwater.co.uk)
- Internal processes for monitoring compliance against South West Water's Code
- Internal and external assurance provided as part of the Company's preparations for the opening of the non-household retail market (prior to its opening on 1 April 2017).

Delivering for everybody who depends on South West Water's services

South West Water's targets are ambitious and include both:

- our performance commitments in respect of the outcomes laid out in our 2015-20 and 2020-25 business plans, which were set following extensive customer and other stakeholder engagement to reflect the priorities of our stakeholders
- a limited number of additional KPIs which have been included to provide performance information in respect of South West Water's performance in other areas deemed important to stakeholders (such as our community scorecard).

The targets are reviewed and monitored on a monthly basis with the Executive Management level 'Outcome Delivery Incentive (ODI) Group' preparing performance updates and plans to ensure targets are delivered. This group reports to the Executive and the Board.

Our performance is challenged by the WaterShare Panel and Customer View Group as described on pages 96 to 97 (of the Annual Performance Report and Regulatory Reporting).

This Report includes performance against all of the performance commitments as well as our additional KPIs. All performance data has been externally assured (as summarised on page 90 to 97 of the Annual Performance Report and Regulatory Reporting). It also demonstrates the linkage between our purpose and values, our business outcomes, our business model and the risks to achieving these.

The majority of South West Water's outcomes have annual committed performance levels which are designed to achieve year-on-year improvements in performance.

Executive Director remuneration is linked to Company performance via the performance related bonus arrangements. This linkage is summarised on page 78 (of the Annual Performance Report and Regulatory Reporting) and comprehensive disclosures of Director remuneration are provided in the South West Water Annual Report and Financial Statements (pages 97 to 104), including the specific performance targets used in the bonus calculations on page 86 (of the Annual Performance Report and Regulatory Reporting). These targets used are either in line or more stretching than South West Water's regulatory performance commitments.

NAME & POSITION	SIGNED
Sir John Parker Chairman	
Louise Rowe Finance Director	
Lord Taylor of Goss Moor Non-Executive Director	
Jon Butterworth Non-Executive Director	
Martin Hagen Non-Executive Director	
Neil Cooper Non-Executive Director	
Gill Rider Non-Executive Director	
Chris Loughlin ¹ Non-Independent, Non-Executive Director	
Susan Davy Pennon Group Chief Financial Officer	
Iain Evans Pennon Group Non-Executive Director	

¹ Since May 2019, Chris Loughlin, has temporarily assumed the role of South West Water Managing Director.

Jacobs Assurance Memo

JACOBS®

SUBJECT Annual Performance Report 2018/19
Risk & Compliance statement

ATTENTION South West Water Limited

FROM Graham Hindley – Assurance Director, Jacobs

DATE 15 July 2019

COPIES TO N/A



As part of our assurance work for South West Water's (SWW) 2018/19 Annual Performance Report for the South West Water and Bournemouth Water regions, we have reviewed the Company's Risk and Compliance Statement. We are pleased to provide our independent opinion on the risks, processes and controls that SWW has in place to enable it to compile the Statement in which stakeholders can have trust. Ofwat requires companies' statements to confirm compliance with all relevant statutory, licence and regulatory obligations and to demonstrate they have appropriate controls to identify, manage and mitigate risks.

Since being appointed as the Company's Technical Assurance Partner in 2017, we have had visibility of SWW's risk framework and how this is linked to the parent company Pennon Group's risk framework. SWW's integrated assurance framework is embedded within the organisation and uses a risk based approach to ensure risks are regularly identified, updated and appropriate mitigations are in place.

The assurance framework uses three lines of defence which are well established to ensure an appropriate level of assurance is provided depending on the assessed level of risk. Our reviews have confirmed the top down and bottom up risk processes to be robust. We have seen evidence of the bottom up process where risks are identified, reviewed and owned by the departments' senior managers (e.g. Drinking Water Services). SWW's Risk Management Policy requires Certificates of Effective Internal Control to be completed and signed off annually by each senior manager, and director, to confirm responsibility for risks and controls within the relevant team.

SWW's Risk & Assurance Forums comprise the Company's directors and senior management with a role to review and challenge the risks from a top down perspective. Minutes of these meetings evidence strong governance and understanding of the business.

We have observed a further improvement in data governance between data production, where an additional layer of review and sign off by responsible managers has been performed. This process generally operated well for the 2018/19 Annual Performance Report and is considered to be good practice.

Responsibility for internal audit, risk management, and assurance activities across the Pennon Group sits with Pennon Group's Director of Risk & Assurance. Responsibility for co-ordinating the production of the Annual Performance Report (APR) sits with SWW's Finance and Regulation Directorates. An improvement has been made during the 2018/19 year where the APR reporting and audit and assurance programme were overseen by the Group Risk and Compliance Manager who reports to the Group Director of Risk & Assurance. This provides an additional level of independence and enhances SWW's link into Pennon Group's Risk Forum. At Group level, the Pennon Board sets the top down strategic direction and governance requirements through the Pennon Audit Committee for implementation by the Pennon Group Risk Forum. The SWW and Pennon Audit Committee challenges how robust and confident the Company is in its assessed risks and has a process to launch deep dive reviews where risk owners can be asked to present demonstrating how risks are identified and effectively managed.

With the new independent supervision of SWW's risk management by the Group Risk & Compliance Manager we have seen evidence of continued improvement in SWW's risk management activities and improved governance of data reporting.

We found evidence of SWW's horizon scanning of emerging risks through SWW's Risk & Assurance Forums which feed into the Pennon Group Risk Forum.

We conclude that SWW's risk management processes are well established and embedded in the organisation with direction provided by SWW's Board, Executive Management cascading into the Risk & Assurance Forums as the top down process. Risk owners, senior managers and directors are responsible for the bottom up identification and ownership of risks. We have seen continuous improvement in risk management and governance during the year where SWW has appropriate levels of involvement across the business with the additional independent support and supervision provided by Pennon Group.

In 2017/18 we noted that that SWW's internal data assurance and sign off processes had improved during the year with central co-ordination and review. In a small number of areas we recommended an additional internal compliance review from all responsible managers. Our assurance activities for the 2018/19 Annual Performance Report confirmed this has been successfully implemented, for example a Regulatory review of property and population data identified the need for a minor data amendment prior to external audit.

Through our discussions in relation to assurance of internal and external annual reporting assurance we are satisfied that SWW:

- Fully understands the Company's relevant statutory obligations
- Has appropriate systems and processes to identify, review, mitigate and manage risks and has sight of emerging risks to the business; and
- Has articulated its risk processes and governance, and those of the wider Pennon Group, in the Annual Performance Report and Risk & Compliance Statement.