

Appendix 4d: Deloitte PR19 Assessment Support

29 August 2018

Yorkshire Water Services Ltd
Western House
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Bradford
BD6 2SZ

For the attention of the Regulation Director

Dear Sir

Price Review 2019 (PR19) Assurance Support

This summary letter provides the background to our PR19 assurance support role, the scope of our work and the summary findings. This letter and our related reports were prepared under the terms of our engagement letter dated 25 April 2018 solely for Yorkshire Water use for the purpose of assessing key elements of Yorkshire Water's development of the PR19 business plan submission.

Introduction

In its final methodology Ofwat sets out the expectation for Boards to *'provide us with an assurance statement that explains, among other things, how it has challenged and satisfied itself that all the elements add up to a plan that is high quality and deliverable'*.

To achieve this, Yorkshire Water has developed a supporting assurance plan (1st, 2nd and 3rd levels) within its PR19 Programme, to assess whether the elements of the plan are of the required quality prior to submission.

As part of this overall assurance plan, Yorkshire Water requested that Deloitte provide assurance support in specific areas (in a 3rd level capacity). This was one element of the 3rd level assurance activities put in place by Yorkshire Water, with other activities undertaken by other third parties. Yorkshire Water remained responsible for overall delivery of the assurance plan, collating the results of individual assurance activities and the assurance statements provided by the Board.

Scope of work

Yorkshire Water engaged Deloitte to carry out seven assessments as part of its overall PR19 assurance approach. A terms of reference was agreed for each of the assessments prior to commencement. The scope of each of the assessments is summarised below:

- **Resilience Framework:** Yorkshire Water has established a framework to measure, monitor and improve the resilience of specific elements of their business. We assessed the design of this framework, with other 3rd line providers then assessing its implementation and use in resilience planning.
- **Financial assumptions and financeability:** the financeability of Yorkshire Water is fundamental to the suitability of the PR19 plan. We assessed the consistency of the financeability documents with Ofwat guidance; the robustness of the evidence base in the documents submitted where Ofwat guidance was not available; whether the relevant financial ratios have been calculated using both the actual and the notional capital structure; and the inputs/key assumptions used to calculate the financeability ratios and their appropriate inclusion.

- **Customer affordability and vulnerability:** this focused on assessing Yorkshire Water's approach to setting bills that are affordable. It covered overall affordability, affordability in the long-term and affordability for those struggling, or at risk of struggling, to pay. Our vulnerability work focused on how Yorkshire Water has identified vulnerable groups and put plans in place to provide efficient and effective support mechanisms.
- **Efficiency and innovation:** Yorkshire Water has identified initiatives to drive efficiencies across its business. We assessed how the overall level of efficiency has been measured against comparators, how efficiencies have been qualified and the extent to which mechanisms to deliver this programme have been put in place. It also has established processes to foster innovation, in terms of efficiency, safety and quality of service. We assessed these processes and the work undertaken to date by Yorkshire Water to establish a culture of innovation.
- **Key financial model and spreadsheet controls:** several key PR19 data tables rely on outputs from the Ofwat final financial model. We assessed how Yorkshire Water managed this model, including spreadsheet controls, how the model was used, and how the outputs of the model were validated by Yorkshire Water.
- **Financial resilience, economic and company scenarios:** we assessed the process to develop and apply a range of scenarios to test the resilience of the plan. We also assessed wider financial resilience topics, for example how financial risks have been evaluated by Yorkshire Water and the company's approach to transparency in key financial transactions, such as taxation and executive pay.
- **Data tables:** we completed defined procedures over the financial elements of Yorkshire Water's data tables, as part of a larger assessment and sign-off process co-ordinated by the company. This was delivered in three separately reported phases. The main assessment phase was performed in August 2018, referred to as **PR19 Business plan, including specified data tables**, and considered 55 data tables. The second phase was the **PR14 performance reconciliation**, which considered nine specific data tables relating to AMP6 performance and formed part of an early submission to Ofwat (13 July 2018). The third phase related specifically to two main **Non Household Data Tables** (which were completed by a separate team in Yorkshire Water). For each of these assignments we completed an initial risk-based assessment of the complexity of the in-scope data tables. The complexity criteria included a 'high', 'medium' and 'low' classification for each in-scope data table which determined the procedures to be undertaken, with additional specific procedures designed for those data tables rated as 'high' complexity. The complexity criteria, defined procedures and additional specific procedures were all set out in a terms of reference and agreed in advance by Yorkshire Water. Any exceptions which were identified through execution of the procedures have been communicated to Yorkshire Water. Following actions undertaken by Yorkshire Water and summary management responses provided to us, exceptions were then closed by Yorkshire Water. We did not perform re-testing on the full data tables affected.

Overall Summary

The nature and extent of our findings have varied across these nine assessments. Several of the financial assessments were dependent on Ofwat's financial model, which has been updated periodically by Ofwat, with the final version published on 18 July 2018. As a result, our work in these areas took place closer to the submission date and we were able to assess more complete documentation.

Other assessments, such as relating to the resilience framework or customer affordability and vulnerability, took place earlier in the process. We were therefore able to provide recommendations to improve these areas with Yorkshire Water teams able to develop the associated documentation in advance of the submission to Ofwat.

Our recommendations focused on the actions Yorkshire Water should take prior to submission, with the exception of efficiency and innovation. This assessment also included recommendations relating to work ongoing, in the run up to, and during, AMP7.

We confirmed our recommendations with management and discussed their plans to address them. The Yorkshire Water PR19 Programme team are now tracking the remaining actions through to closure, prior to submission of the business plan to Ofwat by 3 September 2018. We have not specifically verified each recommendation has been closed, as our work was performed at a point in time. A report with detailed findings and recommendations was prepared for each of the seven assessments listed above.

Out of scope elements and limitations of our work

The scope of our work was limited solely to those procedures in the scope areas we agreed with Yorkshire Water. Accordingly we do not express any opinion or overall conclusion on the procedures we have performed. Yorkshire Water is responsible for determining whether the scope of our work specified is sufficient and we make no representation regarding the sufficiency of these procedures. If we were to perform additional procedures, other matters might come to our attention that would be reported to you. Our reports should not be taken to supplant any other enquiries and procedures that may be necessary to satisfy the requirements of the recipients of the report. The procedures we performed did not constitute a review or an audit of any kind. We did not subject the information given to us by the Directors to checking or verification procedures except to the extent expressly stated above. This is normal practice when carrying out such procedures, but contrasts significantly with, for example, a statutory audit. In regard to the financeability assessment, we did not provide an assessment on the specific financial assumptions or overall financeability of Yorkshire Water's plan. The assessment focused on the process and governance in place to support these assumptions. In regard to the data tables assessment, our procedures involved checking back to the data source but not auditing or verifying the source data.

This letter has been prepared solely for the use of Yorkshire Water in accordance with our Letter of Engagement dated 25 April 2018. Our work has been undertaken solely for the purpose of informing Yorkshire Water's assessment of its plan and scope for the PR19 Programme. Our work was not planned or conducted with any other objective in mind and so cannot be relied upon for any other purposes. Our letter may be provided to the Water Services Regulation Authority (Ofwat) and included within the PR19 documentation published on Yorkshire Water's website in full for information only without any liability on our part. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than Yorkshire Water for this letter or for the work we have performed.

Yours faithfully



Deloitte LLP