

INTERNAL AUDITOR'S REPORT TO SOUTH STAFFORDSHIRE WATER PLC

Why was the audit conducted?

In accordance with the Company's Assurance Framework, the Group Internal Audit function (provided by South Staffordshire Plc) was requested by the business to review the reported data contained within certain PR19 Business Plan data tables (the PR19 tables) to provide independent assurance.

The PR19 tables consist of 77 detailed schedules containing both financial and non-financial information. The production and accuracy of the PR19 tables is the responsibility of South Staffordshire Water.

Internal Audit was requested to undertake an audit of specified PR19 tables to provide independent reasonable assurance over the information contained therein. Reasonable assurance is considered to be a detailed review, but is not a guarantee that the audit will detect all misstatements or errors.

What were the audit objectives?

The production of the PR19 tables is a complex process involving a significant number of key staff (including senior management and directors) throughout the business, many information sources and various business models. In view of this, it was not expected by the business that Internal Audit would check the accuracy of all information sources and the workings of the business models.

The objective of the audit work undertaken (using substantive, sampling and analytical techniques) was to review selected supporting documentation and obtain relevant explanations to audit enquiries to support the reliability of the information being reported within the tables.

What was included and not included in the audit?

In accordance with the Company's Assurance Framework, the PR19 tables were risk rated by the business. Tables considered high risk have been independently audited by external professionals Jacobs (UK) Limited and Oxera. These high risk tables are outside the scope of Internal Audit. Internal Audit has not undertaken any audit work on these tables and provides no opinion thereon.

The Company has allocated specific PR19 tables rated below high risk for Internal Audit review. Internal Audit has reviewed 44 tables as set out in the appendix to this report.

Audit Findings and Observations

Internal Audit has utilised substantive, sampling and analytical techniques to perform tests relating to the inputs required for each table.

The PR19 tables were provided to Internal Audit in a spreadsheet format containing links and references to the appropriate electronic supporting information and files. Where input information cells were blank or information was found to be hard coded, the PR19 project team were requested to provide the necessary link or supporting information.

A key audit task was to confirm that the PR19 tables were linking to the appropriate sources of information. Two minor errors were identified and subsequently corrected by the PR19 project team. Based upon substantive testing and explanations received, Internal Audit is satisfied that the PR19 tables (where tested), are linking correctly to supporting documentation.

For financial and operational information for 2017/18 and prior years, Internal Audit has performed audit testing to confirm consistency to published documentation which included, but was not limited to Statutory Accounts, Annual Performance Reviews and Cost Assessment tables.

Where possible, Internal Audit has agreed information for the year ending March 2019 to the internal budgets approved by the Board of Directors and the Executive team.

Information for future years comes from a variety of sources. The majority of the financial information comes from the financial model provided by Ofwat. Internal Audit has sought to confirm that the PR19 tables have been correctly linked to this model. In view of the complexity of this model, Internal Audit has not undertaken any audit work to confirm the accuracy of this model.

Future operational information has been provided based upon both historical trends and the stated business strategy. Internal Audit has reviewed this operational information and where the data supplied has shown significant variation to expectations or previously reported numbers, Senior Management has been requested to provide appropriate explanation.

Internal Audit has also considered the financial and operational information provided against the knowledge and understanding of the business and its future strategy obtained during the course of the audit (sense checking).

The PR19 tables provide a number of links where information can be seen or referenced to two or more tables. Links within the tables have been established by Ofwat and these have not been subject to any audit work. However, Internal Audit has identified further areas where similar information (subject to price bases) is contained in two or more tables for example dividends paid appears in App 8, App 11 and App 18. Internal Audit has performed consistency tests where appropriate.

Internal Audit has identified and raised 167 queries and questions with the PR19 project team and has received satisfactory responses to all of these review points. As a result of these responses Internal Audit noted a small number of errors. These errors have been brought to the attention of the PR19 project team and have subsequently been corrected to the satisfaction of Internal Audit and the amendments have been verified prior to the submission of the PR19 tables.

Independence

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

Audit Opinion

Whilst the audit work undertaken was designed to reveal inconsistencies and errors in data tested, the complexity and volume of information contained within the tables means that Internal Audit can only provide reasonable assurance (not guarantee) that the tables are reliable and accurate.

Based upon the audit work undertaken and appropriate evidence obtained, Internal Audit has evaluated the 44 PR19 tables within its testing scope and these are, in the opinion of Internal Audit consistent with supporting documentation received and explanations provided by the management of the business

Glyn Palmer BA (Hons) FCA
Group Internal Audit Manager
30 August 2018

Appendix:

Tables reviewed by Internal Audit.

1	App4 – Customer metrics
2	App7 - Proposed price limits and average bills
3	App8 - Appointee financing
4	App10 - Financial ratios
5	App11 - Income statement based on the actual company structure
6	App11a - Income statement based on a notional company structure
7	App12 - Balance sheet based on the actual company structure
8	App12a - Balance sheet based on a notional company structure
9	App13 - Trade receivables
10	App14 - Trade and other payables
11	App15 - Cashflow based on the actual company structure
12	App15a - Cashflow based on a notional company structure
13	App16 - Tangible fixed assets
14	App17 - Appointee revenue summary
15	App18 - Share capital and dividends
16	App19 - Debt and interest costs
17	App20 - Cost of debt / analysis of debt
18	App22 - Pensions
19	App24 - Input proportions
20	App29 - Wholesale tax
21	App30 - Void properties
22	App 32 - weighted average cost of capital
23	WS1 - Wholesale water operating and capital expenditure by business unit
24	WS1a - Wholesale water operating and capital expenditure by business unit including operating leases.
25	WS3 - Wholesale water properties and population
26	WS4 - Wholesale water other (explanatory variables)
27	WS5 - Other wholesale water expenditure

28	WS7 - Wholesale water local authority rates
29	WS8 - Third party costs by business unit for the wholesale water service
30	WS18 - Explaining the 2019 Final Determination for the water service
31	Wr1 - Wholesale water resources (explanatory variables)
32	Wr2 - Wholesale water resources opex
33	Wr3 - Wholesale revenue projections for the water resources price control
34	Wr4 - Cost recovery for water resources
35	Wr5 - Weighted average cost of capital for the water resources control
36	Wn1 - Wholesale water treatment (explanatory variables)
37	Wn2 - Wholesale water distribution (explanatory variables)
38	Wn3 - Wholesale revenue projections for the water network plus price control
39	Wn4 - Cost recovery for water network plus
40	Wn5 - Weighted average cost of capital for the water network plus control
41	R1 - Residential retail
42	R3 - Residential retail ~ further information on bad debt and customer services
43	R7 - Revenue and cost recovery for retail
44	R8 - Net retail margins