



Murray Legg
Senior non-executive director

Statement by the Chairman of the Audit Committee

During the year the Audit Committee has been involved with the submission of the Company’s PR19 Business Plan in September 2018, together with the resubmission of the plan (following Ofwat’s initial assessment) in early 2019. The Committee’s focus in this area has been on ensuring that appropriate assurance was provided for these submissions, including agreeing the scope, process and timetable for external assurance where appropriate, together with ensuring that the external parties utilised during the assurance process were appropriately experienced and qualified. In addition, the Audit Committee reviewed key elements of the Business Plan submissions, including performing a satisfactory review of the financeability and long-term financial resilience of the Company’s plans.

However, the above activities have not distracted the Committee from its core activities in 2018/19, including ensuring compliance with statutory and regulatory requirements and that the Company has provided an enhanced long-term viability statement, together with safeguarding the highest standards of integrity, financial reporting, risk management and internal controls within the Company. Further details of these core activities during 2018/19 are provided in this report.

In addition, the Audit Committee has overseen the tender process for the Company’s new external financial auditor, with KPMG – the current external financial auditor – being replaced by PwC for the year ending 31 March 2020, under mandatory auditor rotation rules.

I continue to be impressed by the insight, diligence and seriousness the Company applies to its assurance activities. The Committee has reviewed this Annual Report and accounts. It is able to confirm to the Board that it meets the requirements of the UK Corporate Governance Code by being, when taken as a whole, fair, balanced and understandable. It provides the information necessary for a user to assess the Company’s performance, business model and strategy. I am satisfied moreover that, as a result of the work undertaken during the year, the Committee has acted in accordance with its terms of reference and ensured that good financial practices have continued to operate throughout the Company.

The review of the effectiveness of the Board and its committees, which this year included an externally facilitated review, concluded that the Audit Committee continued to fulfil its objectives appropriately.

Murray Legg
Chairman of the Audit Committee
15 July 2019

Membership

- Murray Legg
- Dave Shemmans
- Jon Woods

Responsibilities

- Reviewing the form and content of the Company’s interim and year-end accounts and results announcements
- Reviewing submissions to Ofwat, including annual performance reports, price control compliance, risk and compliance statements and periodic business plans and resubmissions
- Reviewing the effectiveness of internal controls and risk management systems
- Consideration of the need for an internal audit function within the Company
- Overseeing the relationship with the external auditors, including approval of audit plans and assessment of their objectivity and independence

Attendees:

The Chairman, Managing director, Finance and regulation director, Quality & compliance director and shareholder representatives attend each meeting by invitation. External auditors attend meetings at least twice each year, and meet with the Committee without management present at least once every year. Other members of the financial and general management team attend meetings periodically by invitation, also in attendance were the incoming auditors.

Terms of reference:

The Committee’s full terms of reference as approved by the Board can be found in the corporate governance section of the Company’s website.

Composition and training of the committee

Murray Legg is considered by the Board to have recent and relevant financial experience because he is a chartered accountant who has audited and advised major UK utilities and a variety of listed and unlisted companies in other sectors in a series of increasingly senior roles at PwC for over 35 years. He is also the chairman of the Audit Committee for a UK listed company.

The Committee receives regular accounting and corporate governance updates at least twice each year as well as specific or personal training as required. Members of the committee periodically visit water treatment works, the Bough Beech reservoir, and other sites where operational practices and issues are explained. Advice on regulatory developments is made available to the committee from specialist advisors on regulatory matters.

Main activities of the committee

The Audit Committee met three times during 2018/19, and in June 2019 to consider this Annual Report. At each meeting the committee operates to a formal agenda of items including the minutes and action points of the last meeting. This ensures that an accurate record of its deliberations has been maintained and actions are progressed.

The committee chairman also has preparatory discussions with the Finance and Regulation Director, the external auditors and, where necessary, with other members and senior management prior to committee meetings. He also personally reviews data, processes and assurance measures involved in key regulatory submissions, as well as considering the potential effect of proposed new accounting and regulatory standards.

When reviewing the risks faced by the Company – and the mitigations already in place – the committee has this year given particular attention to certain key matters – namely cyber security and Brexit.

The committee's consideration of the threat to assets, controls and personal data (of both employees and customers) posed by malicious activity over the internet has been performed in conjunction this year with the Company's Cyber Assessment Framework (CAF) submission to the DWI under the Network and Information Systems Regulations (NIS). The latter focused on the threat to the Company's operational technology and – while the effectiveness of the Company's existing protective measures has been noted – the committee continues to work with management to enhance further plans for handling threats to water quality and operations.

The committee, together with the Board, also considered the potential effects of Brexit on the Company during the year, with particular regard to potential chemical inventories and labour constraints, and satisfied itself that the mitigation activities proposed by management were sufficient given the information available.

In addition to the other matters covered under separate headings below, during the year the committee has also considered:

- The Company's preparation for PR19 Business Plan (and resubmission) assurance, including agreeing the scope, process and timetable for external assurance of the plan, together with ensuring that the external parties to be utilised during the assurance process were appropriately qualified and experienced
- Key elements of the Business Plan submissions, including performing a satisfactory review of the financeability and long-term financial resilience of the Company's plans
- Documents required by Ofwat to be published by the Company, including the Annual Report (incorporating regulatory accounts, performance against PR14 Final Determination performance measures, and financial resilience measures); targeted assurance plans; and the Company's wholesale, developer services and retail charges schemes
- The Company's risk register, including reviewing and challenging at six-monthly intervals management's assessment of the key risks faced by the business, the probability of their occurrence and the impact of mitigation measures in place. The key risks from the Company's latest risk register are illustrated on pages 28 and 29 of this report
- The Company's long-term viability statement, going concern assumption, tax policy statement and certificates of compliance with its Instrument of Appointment
- The Company's compliance with covenants associated with its £100 million index-linked bond, including the maintenance of appropriate financial ratios and the funding of ring-fenced reserve accounts
- The operation of internal controls within the business and progress with management responses on detailed control points identified by external audits
- The operation of the Company's compliance and assurance function and the associated programme of internal audits
- The Company's adoption of new accounting standards in the year (IFRS 15 'Revenue from Contracts with Customers' and IFRS 9 'Financial Instruments'), together with the Company's consideration of the effect of new accounting standards to be adopted in 2019/20 (IFRS 16 'Leases')
- The tender process to replace KPMG as the Company's external auditors, as required under the audit reforms effective from June 2016
- Review of compliance of the Company on Service Level Agreements with SES Business Water and other associated companies, ensuring services provided are on an arms-length basis and no cross-subsidy from the appointed business is occurring.

Significant accounting judgements

In recommending the Annual Report and accounts to the Board for approval, the Committee reviewed significant issues, judgements and estimates reflected in the financial statements to ensure that appropriate rigour had been applied as part of the year-end process.

The committee considers that the key estimates and judgements are:

- The appropriateness of the estimates and provisions for doubtful debts – the Committee supported management's approach to provisioning, which remained the same as in the prior year, noting that collection performance for debt over one year old remained consistent with the basis of the provision made. The Committee did note the weaknesses in the design and operation of systems in relation to aged debt reporting for unmeasured debtors, and the increased level of judgement that this brings to the unmeasured debt provision.

- The appropriateness of the accounting estimates and disclosures for the benefits provided to employees through the Company's Section of the Water Companies' Pension Scheme (WCPS) - the committee concluded that the estimates applied by the Company's actuarial advisors in calculating the annual cost and valuing the assets and liabilities associated with the defined benefit obligation were within the range typically adopted for prudent provisions in the current economic environment. In addition, the committee concluded that the effect of the recent Guaranteed Minimum Pension matters had been appropriately accounted for and reported in the Company's financial statements, together with the closure of the Company's Section of the WCPS
- The appropriateness of the Company's policy for capitalising expenditure as fixed assets under FRS 101 and the consistent application of the policy in the year - the committee noted that the policy and practice was consistent with that adopted under previous accounting standards, continued to be applied in detail and was subjected to significant management and audit scrutiny
- The need for provisions for outstanding claims - the committee agreed that the basis of provisions made was prudent and realistic.

Having considered a paper from management on the Company's liquidity and forecast obligations for the immediate future and for the period to 31 March 2030 and having made appropriate enquiries of management, the committee supported the directors' assessment that the Company should adopt a going concern assumption for the preparation of the annual financial statements and should provide a long-term viability statement (which considers Ofwat's recent guidance in this area as detailed in Information Notice 19/07) as set out on page 48.

Fair, balanced and understandable report

The April 2016 edition of the UK Corporate Governance Code requires the Board to consider whether the Annual Report is, when taken as a whole, fair, balanced and understandable and provides the information necessary for users to assess the Company's performance, business model and strategy. The Board has asked the Audit Committee to advise on compliance with this important requirement.

In considering the advice to be given to the Board, we have reviewed the Company's processes for ensuring the accuracy of information within this Annual Report, noting the continuous updates to the well-established processes for assurance of key performance measures (including those required for regulatory purposes) and underpinning the Company's Risk and Compliance Statement to the Water Services Regulatory Authority (which can be found on page 95), as well as the financial controls and audit procedures for ensuring the integrity of the accounts.

The Committee has drawn further assurance from the close personal involvement of executive directors and senior staff in the preparation and review of the Annual Report, reflecting the detailed involvement that senior employees can have in the day-to-day operations and control of a business of the size and nature of SES Water. Having reviewed drafts of the Annual Report, enquiries answered satisfactorily, and noted enhancements made to initial drafts, the Committee is pleased to confirm to the Board that it considers the Annual Report meets the high standards required by the UK Corporate Governance Code.

External auditors

The committee approved KPMG's proposed approach for the year-end statutory audit at their meeting in March 2019. The Audit Committee approved the management representations to the external auditor and also requested feedback from both management and the external audit team about the effectiveness of the audit carried out.

The Committee noted that KPMG had conducted an annual review of its independence, identifying all services provided to the Company and its associates and assessing whether the content and scale of such work was a threat to their independence.

Note 3 to the statutory accounts (page 79) shows that the fees due to KPMG all related to audit or other assurance procedures on the Company's statutory and regulatory obligations. The Committee concurred with the auditors' assessment that there are no factors which would impair their objectivity and independence. The committee is satisfied that there are adequate safeguards in place to protect the independence and objectivity of the service provided by the external auditors, including a requirement for all non-audit work likely to exceed £10,000 to be approved by the chairman of the Audit Committee.

External audit tender

During 2018/19, the Audit Committee conducted a tender process for a new external financial auditor given that the Company's incumbent auditor - KPMG - is required to rotate off after completion of the audit for the year ended 31 March 2019. The Audit Committee, led by the Audit Committee chair, conducted a thorough and open process to appoint a new external financial auditor, with the option to tender being advertised for all parties on the Company's website (although only one party ultimately tendered), and the Company's procurement department ensuring compliance with European Union procurement requirements. In addition, the Committee utilised the FRC's Audit Tender - Notes on Best Practice, when conducting the tender process.

The Audit Committee therefore, after interviewing and being satisfied on their suitability, provided the Board with the recommendation to appoint PwC, which the Board subsequently approved. A detailed evaluation process was performed by the Audit Committee prior to recommending appointment of PwC to the Board. An overall evaluation comparison based on 'confidence to deliver' and 'commercial' criteria was performed, and the assessment itself comprised (a) evaluation of the submitted tender proposal from suppliers to demonstrate their capability and experience within the water utility industry (b) a presentation to the Audit Committee chair and management and (c) client references.

The Audit Committee therefore conducted a thorough appointment process and was satisfied - with the Board - regarding PwC's proposed appointment. The Company's two shareholders were consulted throughout the tender process and are also content with the Board's decision.