

Board Assurance Statement

Charging arrangements for new
connection services 2020/2021

Board Assurance Statement

As Directors of South East Water we recognise that it is our responsibility to provide strategic leadership and to promote good corporate governance within a framework of effective controls, enabling compliance with our obligations and the management of risks.

In this statement we describe the systems of internal control we relied on to ensure that we comply with our statutory, regulatory and licence obligations relating to our charges for new connection services and in particular that our charges for new connection services and our charging arrangements for 2020/21 comply with the charging rules for new connection services issued by Ofwat. In making this statement we had also regard to the charges scheme rules as they apply to infrastructure charges for 2020/21 and have included in this statement relevant information on assurance relating to the infrastructure charges and income offset which was carried out together with the assurance of other aspects of our new connection charges.

We have also paid particular attention to the issues related to the transition to a new method of charging which started on 1 April 2018 and the impact of further changes to charging rules from 1 April 2020 requiring us to apply the income offset to infrastructure charges. We considered particularly the impact of these changes on how we can maintain the balance of charges between developers and other customers. We have considered the interplay between the new income offsetting approach and requisition charges, self-lay charges and also bulk supply charges to new appointees. We also had particular regard to the impact of this change on developers and how this could be mitigated taking account of the outcome of our engagement with market participants.

In setting our charges for new connection services we followed the principle that they should reflect fairness and affordability, environmental protection, stability and predictability, and transparency and customer-focused service. We also ensured that no undue preference is shown to, and that there is no undue discrimination against, any class of customers or potential customers.

Our internal controls and Board oversight

Board oversight

We have established a strong governance and management framework ensuring statutory requirements are met and that the data we publish is robust and of a high quality.

A specific governance and assurance process was put in place by the Board for the preparation of our charges supplementing the well-established systems of internal control already in place followed for all regulatory submissions and customer focused publications.

This process incorporated oversight by the Board and a review and approval by Senior Management and the Executive Directors.

In December 2019 the Board approved the final approach for producing the new connection charges for 2020/21, including the external assurance to be undertaken. In doing so the Board had regard in particular to the charges scheme rules. It also prescribed that charges and relevant documents should take due account of external engagement.

In respect of new connection charges, the Board considered the methodology for setting out charges for new connection services for 2020/21, the application of the income offset to the infrastructure charges from 1 April 2020 and the new requirement to include a statement of significant changes where charges for typical developments would increase by more than 10%.

The Asset and Regulation Director was authorised to finalise the new connection charges for 2020/21 and the “charging arrangements for new connection services” and the “infrastructure charges and miscellaneous services charges scheme” for publication in accordance with the relevant charging rules and the Chair of the audit and risk committee and the Executive Directors were jointly authorised to finalise, sign, publish and submit to Ofwat the Board assurance statements relating to charges for new connection services on behalf of the Board in accordance with the relevant charging rules.

Internal control processes

We have relied on comprehensive and transparent controls and assurance mechanisms which set out clear accountability for setting our charges. The data and assumptions used and our charging model have been thoroughly reviewed internally and externally.

Maintaining the balance of charges between developers and other customers

The process we followed to ensure that the balance of charges between developers and other customers was broadly maintained was similar to the process implemented in 2018/19 with the addition of further controls to ensure that the new offsetting methodology would still achieve that balance.

The models and methodology that were developed in 2017/18 to monitor the balance of charges were used again this year with updated data collected during the first

years of operation of our new charges for new connection services and infrastructure charges in order to maintain a consistent approach to the assessment of the balance of charges.

This model had been externally assured by Reckon LLP in 2017/18 and was reviewed by Frontier Economics in 2019 who reviewed our methodology and assumptions and concluded that we had taken the necessary steps to ensure the balance of charges was broadly maintained.

This year's review of the balance of charges was carried out against an update of the initial baseline which had been determined in 2018/19 following a systematic review of developer related expenditure and of the company's expenditure, of contributions relating to requisitions (including on-site and off-site), asset payments, connections and infrastructure charges over a 5 year period.

Assurance of our methodology for calculating the income offset has also been carried out by Frontier Economics in 2019 to ensure the balance of charges is maintained with the offset moving from onsite mains to infrastructure charges.

We ran our models with our new charging methodology over a number of scenarios and used updated assumptions on the forecasted levels of development that were consistent with the levels of development recorded over the past 5 years and that underpinned the current charging balance in order to forecast contributions and expenditure levels moving forward.

We have tested the broad balance of charges for both the larger and smaller developers by running the new charges alongside our previous requisition and connection charges. We did this across a number of schemes for different sizes and types of development. By carrying out this comparison between the methods of charging we ascertained that the new method of charging broadly maintained the balance between developers and other customers.

Infrastructure charges

When setting our infrastructure charges we ensured that they were in accordance with the principle that the amount of infrastructure charges will over a period of five consecutive charging years cover the costs of network reinforcement that we reasonably incur, less any other amounts we may receive for network reinforcement.

For the calculation of the infrastructure charges for 2020/21 we have considered the period to 31 March 2025.

The infrastructure charges for 2020/21 were based on the models designed for the implementation of the new method of charging from April 2018 and were updated using relevant data collected in the first years of operating the new method of

charging and revised assumptions. Internal assurance was provided by data owners for the key inputs to the models.

When determining reinforcement costs used for calculating infrastructure charges, we considered in particular that only relevant costs relating to reinforcement required as a result of new connections and new development sites should be included.

Determination of a new income offset

Previously we applied the income offset to the requisition charge but from 1 April 2020 it will be applied to the infrastructure charge.

We have calculated an income offset per connection for 2020/21 using the average percentage of income offset we applied over the last 5 years.

In calculating the average percentage of offset, we had regard to the need to maintain the balance of charges between developers and other customers. During the relevant period of five years, the income offset was calculated using both the methodology that was applied before 1 April 2018 (where the cost of any network reinforcement was included in the total cost of the scheme to which the income offset was applied) and the methodology that has been applied since 1 April 2018 (where the cost of any network reinforcement was not included in the total cost of the scheme to which the income offset was applied).

In order to determine the average percentage of income offset that best ensured we could maintain the balance of charges between developers and other customers, and after considering different methods of calculating it over the relevant period, the percentage of income offset in respect of pre-April 2018 development was calculated as a proportion of the costs of the site specific works (rather than the total costs inclusive of any network reinforcement). Having normalised the data between the pre-April 2018 schemes and the post-April 2018 schemes, we calculated the average percentage of income offset over the relevant five year period.

We have then applied this average percentage to our forecasted total cost of onsite mains in 2020/21 and divided the result by the forecasted number of new connections in 2020/21 to obtain an income offset per plot.

To ensure we are maintaining the accuracy of the data we use to calculate the income offset and to maintain the balance of charges between developers and other customers, from 1 April 2020 we will continue to calculate the income offset (and equivalent asset value for self-lay) using the pre-April 2020 methodology for each development scheme (alongside applying the new methodology for offsetting) to maintain comparability with historic data used for calculating the income offset and maintain the balance of charges.

Our external assurance

In addition to the internal assurance undertaken, the Board has also obtained assurance from Frontier Economics in respect of our charging methodology.

Frontier Economics was commissioned to review our infrastructure charges and new connections charges to comment on the extent to which our approach satisfies the guidance set out by Ofwat and Defra.

They produced a detailed assurance statement, which concluded:

We have been commissioned by SEW to review its developer services charging methodology and to comment on the extent to which we believe its approach satisfies the guidance published by Ofwat and Defra. This is to provide assurance to SEW's board that SEW has been compliant with the relevant guidance, and also that the risk of competition complaints with respect to any individual charges has been effectively managed.

The scope of this project was to focus on SEW's methodology in setting charges, and whether SEW has reflected all of the relevant guidance when setting them. We have not reviewed SEW's final charging arrangements documents, nor have we reviewed the accuracy of the input data that feeds into the analysis or the precise calculations which have been made to produce the final numbers.

In summary, we believe that SEW's developer charges are designed in line with Ofwat's guidance. SEW has made effort to ensure that the charges are designed in a cost-reflective way with fixed up-front charges provided where possible.

The current balance of charges between developers and other customers is broadly maintained compared to how it was prior to the introduction of Ofwat's new rules.

We have considered the extent to which SEW's approach to setting charges for contestable services is compliant with the economic principles of competition law. We consider this approach to be reasonable and that SEW has taken reasonable steps to ensure compliance with competition requirements. In particular, charges are clearly split-out, and the charges are cost-reflective. SEW is no longer required to make asset payments to SLPs or any discount to NAV bulk supply agreements, due to the income offset now being subtracted from infrastructure charges, rather than requisition charges.

Our external engagement

Engagement with market participants

We have engaged extensively with developers to explain the new charges and discuss any of their concerns or ideas. There has been considerable focus on the change in the application and calculation of the income offset. We have carried out a number of road shows for developer, SLP's and NAVs as well as telephone surveys, online surveys and one to one meetings with stakeholders who were not able to make any of our road shows. We believe that our developers, SLP's and NAV's have

a good understanding of how our new charges will work and that they will be able to see that we have taken on board some of their concerns, and put in place mitigations, particularly around payment terms for requisition charges and the potential for the offset to be significantly different to their current level in certain cases.

Mitigation of the impact on the new offsetting on developers

In order to mitigate the potential disproportionate impact on certain types of developments of applying the income offset to infrastructure charges, we will be capping the income offset to within 10% of what the income offset would have been using the offsetting method that applied until 1 April 2020.

We have also introduced new instalments plans for the payment of requisition charges to address concerns raised by developers that with the transfer of the income offsetting to the infrastructure charges, requisition charges would mechanically increase and the application of the income offset to infrastructure charges would necessarily only be applied at a later stage of the development process which would affect their cash flow.

Engagement with CCW

We also provided the Consumer Council for Water with information on the revisions to our infrastructure charges and other new connection charges and discussed our methodology with them.

Bill impact assessment

We have carried out an assessment of the costs of new connection through worked examples for typical developments following the methodology defined by Ofwat to ensure that charges did not increase by more than 10%. The statement of significant changes is set out in our charging arrangements for new connection services.

Board statement

For the preparation of this statement we have considered compliance with our statutory, regulatory and licence obligations relating to setting our charges for new connections, the requirements of the charging rules for new connection services and also those of the charges scheme rules relating to the infrastructure charges.

Our governance and oversight processes have not identified any material deviation from or non-compliance with these obligations and to the best of the Board's knowledge after reasonable enquiries the company has complied in all material respects with these obligations and the company is taking appropriate steps to ensure compliance and manage and/or mitigate the relevant risks.

This enables us to have a high degree of confidence in the information presented in this statement and in our charges for new connection services and in our charging arrangements for 2020/21.

Based on the scope and outcome of the process review detailed in this statement the Board is able to confirm that:

- i The company complies with its obligations relating to the charging rules for new connection services;
- ii The company has appropriate systems and processes in place to make sure that the information contained in the charging arrangements and the additional information relating to our charges for new connection services is accurate.

We have provided in the previous sections of this statement explanations on how the company has ensured that the balance of charges between developers and other customers is broadly maintained.

Signed on behalf of the Board by:



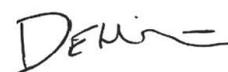
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