

Annual Performance Report 2019-20

Part 5 – Risk and Compliance Statement



RISK AND COMPLIANCE STATEMENT 2019/2020

Scope of the Risk and Compliance Statement

Ofwat expects all water companies to provide a statement setting out how they have complied with their relevant statutory, licence and regulatory obligations for which Ofwat is the relevant enforcement authority (Obligations). The Risk and Compliance Statement is one of Ofwat's key regulatory tools and allows companies to demonstrate their accountability to their customers and demonstrate to Ofwat that they are complying with their obligations.

The Risk and Compliance Statement

We recognise the importance of demonstrating to our customers, stakeholders and regulators that we are meeting the statutory, licence and regulatory obligations that apply to our activities. We have set out in this Statement and our Annual Performance Report our compliance with and performance against certain key performance measures, legal requirements and regulatory outputs. We have also identified the risks that we are facing and the steps we are taking to manage and mitigate those risks.

In preparing this Statement we have considered, in particular, our compliance with those legal, licence and regulatory obligations for which Ofwat is the enforcement authority. In respect of these obligations, subject to the matters set out in this Statement, we confirm that:

- We have a full understanding of, and are meeting, our statutory and regulatory obligations.
- We have taken steps to understand and meet our customers' expectations.
- We are satisfied that we have sufficient processes and internal systems of control fully to meet our obligations.
- We have appropriate systems and processes in place to allow us to identify, manage, mitigate and review our risks.

In this Statement we also:

- explain links between the standards of performance we achieve, and directors' and senior executives' pay (s35A Water Industry Act Statement);
- confirm that the auditors have been made aware of all relevant information (Companies Act 2006);
- explain our dividend policy (Licence Condition F and Regulatory Accounting Guideline 3.11);
- confirm that we have sufficient financial resources and facilities, management resources and systems of planning and internal control available to us for at least the next 12 months to meet our obligations as a water and sewerage undertaker and outline the main factors taken into account when making this statement (Licence Condition I17);
- confirm that a report has been prepared by the companies' auditors and addressed to Ofwat, stating whether they are aware of any inconsistencies between the I17 Statement and the financial statements or any information obtained in the course of their work (Licence Condition I24 & I25);
- confirm we will be able to continue in operation and meet our liabilities as they fall due over the period to March 2030 (UK Corporate Governance Code and Ofwat requirement);
- confirm that we have maintained an issuer credit rating which is classed as an Investor rating (Licence Condition I30);
- confirm that if a special administration order were to be made, we would have available sufficient non-financial resources to enable a special administrator to manage the affairs, business and property of our regulated activities (Licence Condition K3.2 Statement); and
- confirm that transactions with associated companies are at arm's length (except where agreed by Ofwat) with no cross subsidy occurring (Licence Condition I4).

The Individual Statements

Dŵr Cymru fully recognises its accountability to its customers, its regulators and its other stakeholders and is pleased to provide the following Statements to demonstrate that it complies with its Obligations and is managing its risk in an appropriate manner.

1. The Company considers it has a full understanding of, and is meeting, its Obligations.

Our primary obligations and duties as a Water and Sewerage Undertaker are set out in the Water Industry Act 1991, the Water Resources Act 1991 and our Licence.

We keep our assurance processes continually under review to ensure they remain appropriate. A key emphasis is on ensuring the Company has sufficient processes and internal systems to fully meet our obligations. Our Legal Team works with colleagues throughout the business to identify new legal obligations and amendments to existing legislation. Colleagues in the Regulation Team keep abreast of developments or changes to our regulatory and licence obligations. The Compliance Team provides advice, guidance and support to the whole business on understanding the extent of any regulatory or licence obligation and implementing an appropriate internal control framework to ensure compliance with those obligations.

Modernising, or streamlining, the Licence is a long-standing objective for Ofwat. The Licence is a key tool in protecting customers and has done so since privatisation. Ofwat has instigated a programme to simplify the form of the Licence and a working group, of which Dŵr Cymru is a part, has taken forward the work on simplification. During 2019/2020 Ofwat made four modifications to our Licence Conditions. For example, there was a modification to our existing Condition I: Ring Fencing to include an obligation to meet Ofwat's objectives on board leadership, transparency and governance with effect from 1 August 2019. The Compliance Team viewed the introduction of these modifications as an opportunity to enhance the awareness of business units of the obligations they contribute to deliver and to further embed compliance with "business as usual" processes. It is essential that all concerned in ensuring Licence Condition compliance continue to understand their individual responsibilities and appropriate checks and controls are in place to meet our obligations.

However, to achieve this it was important to build upon the existing knowledge of the Licence Owners and to discuss the application of any new modifications with them. Consequently, for each individual Licence Condition covered within the Risk and Compliance Statement we have now:

- Established who the Licence Condition "owner" is;
- Established the relevant Dŵr Cymru Executive (DCE) Member;
- Produced a PowerPoint Guide outlining the purpose of the Condition and our obligations;
- Developed a proforma that:
 - Reviews the Licence Condition in detail to establish all requirements;
 - Establishes how compliance with the individual requirement is achieved;
 - Contains a "compliance statement" which is signed by the Licence Owner; and
 - Contains a "compliance declaration" signed by the relevant DCE Member.

For the 2019/2020 Risk and Compliance Statement we mapped Company processes against our statutory obligations. This was a desk exercise combined with consultation with operational managers. In each case the outcome of the process followed demonstrated that the obligation in question was recognised and that there were processes in place likely to ensure compliance. We continue to use a common reporting format which includes:

- responsible Member of the DCE Team;
- formal description of the obligation, including hyperlinks to the actual legislation referred to;
- description of the obligation in plain English;
- details of policies, procedures and responsible Departments;
- internal governance and assurance arrangements;
- external assurance arrangements; and
- any material performance departures in the report year.

Ofwat required our Board to provide assurance that the company's PR19 Business Plan would enable it to meet its statutory and licence obligations and that we had taken into account the Welsh Government's Strategic Priorities and Objectives Statement.

In their 2019 price review methodology statement Ofwat specifically mentioned two areas of compliance:

1. The Environment Agency and Natural England's water industry strategic environmental requirements (WISER) document; and
2. Natural Resources Wales's "PR19 expectations and obligations" document.

The Compliance Team assisted colleagues on this aspect of the PR19 process and reviewed both documents in detail and listed all the statutory obligations mentioned. These obligations were then mapped against the statutory obligations already identified in the Company's Risk and Compliance Statement to reinforce the assurance that we have a full understanding of, and are meeting, our statutory obligations.

Each individual legal obligation has always had a nominated 'Owner' and DCE Member. We have now developed a Compliance Proforma that evidences how compliance is achieved. The Compliance Proforma:

- Reviews the Legal Obligation in detail to establish all requirements;
- Establishes how compliance with the individual requirement is achieved;
- Contains a "compliance statement" which is signed by the Legal Obligation Owner; and
- Contains a "compliance declaration" signed by the relevant DCE Member.

We will continue our efforts to improve the awareness of business units of the obligations they contribute to deliver and to further embed compliance within "business as usual" processes.

For the 2019/2020 Risk and Compliance Statement we have developed a 'Risk Based Compliance Programme'. This involved assessing each of our individual Legal Obligations. We have also developed a 'Third Line Independent Assurance Matrix'. This will enable us to establish which of our Legal Obligations are subject to independent third line assurance. It will also enable us to review the adequacy of this independent assurance and allow resources to be targeted at those Legal Obligations not subject to independent third line assurance.

2. The Company has taken steps to understand and meet customer expectations.

Our Customer-led Success approach places the needs of our customers at the heart of everything we do. We take a lot of pride in shaping our services around the needs of our customers - and delivering the best service possible is our top priority.

Our vision is to "earn the trust of our customers every day". This vision is fundamental to the way we work and enshrines our commitment that everything we do should be geared towards the benefit of our customers, not just our responses to high-profile events or campaigns.

Being customer-led means we can focus solely on providing the best service possible and supporting those who need it most. In the Autumn of 2018, our Board established a Technology Committee to allow detailed consideration of the development and subsequent implementation of the Group's technology and digital strategy. This is part of our determination to provide better customer service at lower cost.

When we plan for the future, whether it is over decades or over the next few years, working together with our customers forms a central part of our way of working. We appreciate fully that we need to develop new and innovative methods to talk to our customers, to ensure that we continue to meet our customers' service expectations.

Looking ahead to 2025

Our business plan for 2020-2025 sets out our vision for improving services to benefit customers and how we intend to pay for it through increasing efficiency while reducing customer bills. To gauge what our customers thought of these plans we worked with and listened to our customers about our plans for the future. As a result, 40,000 customers had had a direct say on how we run their water and wastewater services.

What did we do?

We interacted with our customers across all the areas we serve because as a not-for-shareholder company, our customers' views are at the heart of everything we do. To get a better idea of what customers want to see in our business plan we:

- Attended major events across Wales and Herefordshire to help customers “have their say” on our priorities for the future;
- Developed innovative technological solutions to offer a wide choice to customers to have their say, including a world-first bilingual English-Welsh Facebook chatbot and a permanent “online community” customer focus group;
- Carried out intensive focus groups and customer interviews to gain detailed insight into what customers value most; and
- Worked with our customers of the future – reaching more than 65,000 children a year through our education programmes – either through school outreach or through visits to one of our Discovery Centres.

What are our plans?

Our business plan for 2020-2025 maps out our proposals to meet customer priorities, including investing a record £2.3 billion over that period to supply customers with the best quality water, provide a safe and reliable wastewater service, and to protect the environment around us. This will go hand in hand with making sure bills are fair and affordable.

In January 2019, we launched the Retail 2025 Strategy, which sets out how we will deliver the process and technology change for 2020-2025, particularly how we will transform our digital experience for our customers.

Welsh Water 2050

One of the key pillars underpinning customers' trust is their faith that we are planning and preparing to meet those challenges in future. The Welsh Water 2050 vision sets out 18 “strategic responses” to trends which we, our key stakeholders, and our customers believe will help us meet those challenges head on. The plan responds to the feedback and concerns that we have heard from customers and stakeholders. We are building flexibility into our plans to respond to shifts in customer priorities, as well as future events - with reviews every five years to ensure it is delivering the best outcomes for our customers. It also aims to be consistent with the wellbeing goals set out in the Wellbeing of Future Generations (Wales) Act 2015.

This long-term plan sits alongside our five-year investment for 2020-2025, which sets out what we intend to do as first steps towards realising this vision.

Customer Challenge Group

We worked with our independent Customer Challenge Group (CCG) throughout the development of our business planning process to ensure the key elements of our plan – bill levels, service levels, and outcome delivery incentives – were based on our customers' priorities. The CCG has been critical to the success of our approach. Their role is to provide assurance that the research we have undertaken is of high quality, and the results of that research are reflected appropriately in the Company's plans. Our CCG also has an additional role concerning the way in which customers' views are best ascertained to inform ongoing business decisions such as how any financial surpluses are reinvested or returned for customers' benefit, in line with their priorities.

In addition, our Board provided leadership in developing our plan from beginning to end, devoting considerable time to understanding the views of customers and challenging the plan as it evolved.

The Wellbeing of our Customers and our Communities

We see ourselves as more than just a water company – we want to be at the heart of our communities and bring long-lasting benefits to the areas we serve. In areas where our investment in assets is having a considerable impact on local communities, we are challenging ourselves to involve customers in a way we have not done before. This is illustrated by the work we have carried out in the Rhondda Fach area over

the last eighteen months and we are working to establish two more “Water Resilient Communities” in Rhyl and Rhymney-Bargoed, with plans for three more before 2025.

In December 2019, the Members of the Company approved a new Statement of Corporate Purpose to be included in the Articles of Glas Cymru, to ensure that we always remain focussed on trying to improve the wellbeing of the customers and communities we serve, both now and for generations to come. Following on from that, we published in March 2020 a set of Wellbeing Commitments, which set out clear and measurable targets and objectives for the next five years, which will contribute to the seven wellbeing goals set out in the Wellbeing of Future Generations (Wales) Act 2015.

Our Wellbeing Commitments are a blueprint for how we intend to benefit the communities we serve over the long-term.

Business Customers

Dŵr Cymru serves around 110,000 business customers which range from water intensive manufacturers to small shops and hairdressers’ salons. We know that the services we provide to businesses are essential - and we work to ensure we can help businesses make the most efficient and cost effective use of water and wastewater services. Business customers are supported to reduce their water usage, drive down energy costs, and reduce their carbon footprint. For 2019/2020 we were ranked first amongst all providers of customer service in MOSL’s Market Performance Standards, for business customers in the competitive retail market. We also achieved a 90% customer satisfaction rating for those business customers who have to remain with us and the same level of satisfaction was reported by CCWater in their report ‘Testing the Waters’ where we were ranked in 1st place compared to other retailers in England on measures including satisfaction and value for money.

Developer Customers

Dŵr Cymru provides services to housing, commercial and industrial developments, including major projects within our supply area, via our dedicated Developer Services team. In 2019/2020, the Dŵr Cymru Developer Services team continued to be best industry performer in the Water UK Developer Services Levels of Service scheme and has done since April 2015. This is the most consistent performance across the sector in England and Wales. We were also the first company to voluntarily implement a Developer Customer Services Commitment which has now extended to include our NaV (New Entrant & Variations) customers, We also have a “Surface Water Incentive Scheme” specifically for developer customers which has been expanded to include our business customers who are not in the retail market.

Vulnerable Customers

In November 2018, we launched our strategy for vulnerable customers - setting out what we intend to do to support customers who are most in need of help and support. Maintaining and increasing the number of customers in need of extra support to pay their bills is of great importance to us with an industry-leading 130,000 already supported through our measures. We are also working with Welsh Government, the Emergency Responder Services and other utilities to explore opportunities for sharing information to support vulnerable customers.

The Water Resilient Communities project challenges us to work with and involve customers in a way that we haven’t done before, by working with customers to co-create and co-deliver more resilient services. As part of our second project in Rhyl, we started a partnership with the Department for Work and Pensions at Rhyl Job Centre, to signpost their users to support they could have with paying their bills, like HelpU, and reducing debt they had on their accounts.

3. We have satisfied ourselves that we have sufficient processes and internal systems of control fully to meet our Obligations.

The Board has overall responsibility for the operation and effectiveness of the Group’s system of internal controls and risk management. The system of controls is designed to manage the risk of failure to achieve business objectives, and comprises audited policies and procedures aimed at identifying and managing the most significant risks faced by the business.

A detailed review of risk is set out below. In considering the development of the system of controls, the Executive team reviewed the materiality and the relative cost benefit associated with each identified

significant risk. The internal control systems are designed to provide reasonable assurance against misstatements, loss or failure. The key features of our system are typical for a business of our scale and complexity. They include:

- identification of key strategic risks and opportunities facing the business;
- reviewing emerging and current issues at meetings of the Executive and the Quality and Environment Committee;
- clear management accountability for risk management, supported by regular risk reporting to the Board, the Quality and Environment Committee and the Audit Committee;
- acceptable risk parameters set by the Board, particularly in the context of the business planning process for the purposes of the next five year period;
- implementing controls that recognise that the nature and balance of risk changes and evolves;
- implementing procedures that govern the approval and control of major items of capital expenditure, the acquisition and disposal of material assets, and commitment to any arrangement that could give rise to a material liability;
- ensuring that financial systems and procedures are fit for purpose for preparing management and financial accounts; and
- an appropriate design of management processes to ensure the effective direction and review of the business' operations supported by accurate and timely key performance indicators.

The Board receives assurance from independent work by Dŵr Cymru's technical adviser on regulatory reporting issues (Jacobs Engineering Group) and from the programme of internal audit, the major findings from which are reviewed at the Audit Committee and the Quality and Environment Committee.

Risk is reviewed and considered at each meeting of the Board and a strategic review of risk is considered twice a year under a process chaired by the Chief Executive, who submits an update to the Board of the Executive team's view of the key strategic risks facing the business so that this can be considered by the Board as a whole. The process to review the effectiveness of internal control includes discussion with management on significant risk issues and a review of plans for, and results from, internal and external audit. The Audit Committee reports the results of its review to the Board which then draws its collective conclusion on the effectiveness of the system of internal controls.

In fulfilling this responsibility, the Board considers periodic reports from the Audit Committee, Quality and Environment Committee and from management, and relies on its routine monitoring of key performance indicators and monthly reports of financial and operational performance. This enables the Board to review the effectiveness of the internal control system throughout the course of the year.

Our culture is also a cornerstone of the internal control framework and is based on shared values and beliefs. It helps shape the way we conduct our everyday business and ensures we strive to "do the right thing". Because of its importance, company culture is sometimes described as a layer of control even preceding the first line of defence against inaccurate information. Maintaining a positive culture is important to us because other controls might be occasional or periodic, but culture is ongoing and permanent.

The culture of our Company is defined by the values we adopt and the knowledge, skills and attitudes of our employees. We have made it our Vision to earn the trust of our customers every day. It is vitally important that we act responsibly as individuals and as a company at all times - not only when we are required to do so by law, but also generally, in our working lives.

We are committed to ensuring that we give our employees the tools to do their job, which is why we invest in developing our people. We take pride in being Investors in People accredited, which was granted in June 2018 (gold status), for our work in creating a culture that encourages our people to flourish and realise their potential.

Our governance processes are based on transparency and fairness, underpinning the values of the Group and the Company purpose. Dŵr Cymru is committed to comply with reporting requirements under the UK Corporate Governance Code, and the UKLA's Disclosure Guidance, Transparency Rules and Listing Rules and we continue to adhere to the principles set out in Ofwat's governance principles. We will continue to review our governance arrangements to ensure that we remain compliant with future changes to the UK Corporate Governance Code and our Licence Conditions. We were also supportive of Ofwat's decision to

introduce a licence obligation to require companies to meet the four overarching objectives which comprise the revised board leadership, transparency and governance framework.

4. We have appropriate systems and processes in place to allow us to identify, manage, mitigate and review our risks.

All colleagues play a part in ensuring effective risk management, which is essential to underpinning decision making at all levels of the organisation, and ultimately to ensure the long-term success of the business.

Our Process

- Our systems of internal control are designed to identify, evaluate and manage risks affecting the business and these systems or internal control are regularly considered and monitored by the Audit Committee. Action plans with agreed timescales are adopted and tracked.
- Having risks identified and changes in the assessment of risks highlighted means that the Board is able to undertake its own informed assessment of the principal risks facing the Company and to work with the Executive to agree the Group's tolerance of risk in these key areas on a regular basis.
- This assessment is used on a day-to-day basis to inform decision making including decisions concerning our investment programme. Every strategic update paper presented to the Board and its Committees includes a risk report and where risks identify the need for further mitigation, will include action plans with agreed timescales to enable progress to be tracked.

Our Approach to Risk Management

- Individual teams within the business take responsibility for managing risks within their areas of responsibility.
- Each business unit feeds into a "bottom up" risk management system, escalating risks through our governance structure of committees and team meetings. Risks recorded through that process are discussed during a more "top down" discussion of risk every month at a meeting of the Executive team.
- The Executive team's update on strategic risks affecting the business is reviewed at every Board Meeting and the Board carries out an in-depth review of strategic risks twice every year. The Board assesses both the current and target level of each risk.
- The Audit Committee has accountability for overseeing the risk management processes and procedures and reports to the Board on the adequacy of internal controls.
- This bottom up and top down approach to risk management provides assurance that risks are being effectively managed by the business and identifies those areas where further mitigation steps are needed.
- The Board and its Committees review a summary of strategic risks facing the business at every meeting.

Three Lines of Defence

We continue to use the 'Three Lines of Defence' model to mitigate risk of non-compliance with our processes and policies:

1. First line of defence is ownership and management of risk.
This is fulfilled by our operational teams and managers.
2. Second line of defence is risk management and risk control.
This is fulfilled by our Compliance team and internal committees.
3. Third line of defence is independent review and oversight.
This is fulfilled by Internal and External Auditors, including our technical adviser on regulatory reporting issues (Jacobs Engineering Group).

Our customers need to know they can rely on the services we provide over the long term. The Board's consideration of the Group's long-term viability is embedded in our business planning process. This includes robust risk management controls, financial forecasting and sensitivity analysis, as well as regular budget review. Risks are identified and assessed through a continuous cycle of bottom-up reporting and review and top-down feedback and horizon scanning. The Board has analysed the efficacy and robustness of its internal control framework in managing the likely causes and consequences of each risk. We have stress-tested our business plan forecasts to 2030 against a variety of financial scenarios.

Our vision is to earn the trust of our customers every day. This commitment aligns closely to Ofwat's shared vision 'where customers, investors and wider society have trust and confidence in vital public water and wastewater services'. Consistent with the Company Monitoring Framework (CMF) we have considered the risk to customer 'trust and confidence' in the context of provision of accurate data and our ability to demonstrate we are listening to their needs and delivering the services they want and can afford.

We support Ofwat's approach to the CMF - we cannot expect to build and maintain the trust of our customers and stakeholders if we do not first understand if they have any concerns, and then seek to address them. Key to our CMF is the assurance we undertake at each stage of the process and how we engage with stakeholders to ensure that the information we provide is useful and relevant for their needs.

Dŵr Cymru was the only company to be promoted in 2019 to the self-assurance category for CMF, and was one of only two companies to achieve this status last year. Ofwat stated that "Dŵr Cymru has demonstrated the consistently high standards required for a "self-assurance" company and met the criteria to be promoted to the self-assurance category. We have looked at how well the company has performed against the expectations we have set for each of our assessments."

Ofwat has concluded that we are able to deliver accurate and reliable information that gives stakeholders trust and confidence.

The Ofwat CMF states that companies in the self-assurance category are not required to publish assurance plans. However, we see assurance as part of our continuous improvement programme and is an important part of our day-to-day activities and we therefore plan to continue to consult with stakeholders and publish a final assurance plan as we have done in previous years.

DISCLOSURE OF DEPARTURES FROM THE STATEMENT OF COMPLIANCE WITH OUR OBLIGATIONS

Our vision is to earn the trust of our customers every day. Strong governance and leadership, with the correct focus on customers at the heart of everything we do, together with properly transparent reporting, can play an important part in helping us achieve this vision.

The Board notes that the following have been identified. In all instances a thorough review was undertaken to identify the root cause and to obtain assurance that there were no significant risks to future compliance with the particular obligation. Further details on our performance can be found in our Annual Performance Report for 2019/2020 available at www.dwrcymru.com.

Environmental Permitting Regulations 2010

On 13 February 2020, at Llandudno Magistrates' Court, Dŵr Cymru was fined £40,000 for polluting a stream with sewage in June and July 2018. The district judge imposed costs of £12,480 and a £170 surcharge for the incident in a tributary of the Emral Brook, near Wrexham, part of the River Dee catchment.

This was a prosecution instigated by Natural Resources Wales for an offence under the Environmental Permitting Regulations 2010 and was due to extremely dry soil causing a crack in a rising main, where sewage is pumped to a higher level. It burst on 23 June 2018, affecting the watercourse for two or three kilometres in private woodland.

A full review was undertaken to identify lessons learnt and any improvement actions required.

Our performance in this area is monitored by our Quality and Environment Committee.

Water Quality

Under Section 68 of the Water Industry Act 1991, water companies are under a statutory duty to supply wholesome water. Regulation 4 of the Water Supply (Water Quality) Regulations 2018 in Wales provides that water is wholesome if it contains concentrations or values in respect of various properties, elements, organisms and substances that do not contravene the prescribed maximum, and in some cases, minimum concentrations or value.

Each year we carry out sampling at water treatment works, service reservoirs and customer taps to ensure our water meets the European and National Standards. During the 2019 calendar year we carried out 243,127 tests and found 60 had failed the required Standard (0.02%).

An investigation report is completed for each failure and this is shared with the Drinking Water Inspectorate (DWI). Any recommendations or suggestions made by DWI are recorded in action plans with agreed timescales to enable progress to be tracked. Our Quality and Environment Committee review the findings of investigations into all water quality failures and receive regular reports on action plan progress.

Drinking Water Safety Plans

A continuous supply of safe clean drinking water is vital to maintain public health. Ensuring the quality of that drinking water is fundamental to the service we provide to our customers. We do this by ensuring that the risks to drinking water quality are identified and managed. A Drinking Water Safety Plan (DWSP) is the most effective way of ensuring that a water supply is safe for human consumption and that it meets the health based standards and other regulatory requirements. It is based on a comprehensive risk assessment and risk management approach to all the steps in a water supply chain from catchment to consumer.

All water quality failures trigger a review of the asset specific DWSP to enable the capture of new risks and the review of existing risk scores. If any of our DWSPs identify a potential danger to human health we inform DWI immediately. The DWI may consequently issue a legal Notice requiring the company to complete a programme of remedial actions.

We currently have 27 Improvement Programmes in place and the last Notice received from DWI was in March 2020. We hold quarterly meetings with DWI to discuss progress. In addition, our Quality and Environment Committee also monitor progress against agreed timescales. Regular reports are provided to our Board.

Abstracting Water

During 2019-2020 we self-reported twelve abstraction licence non-compliances to Natural Resources Wales. Five of these have been classified as a Category 3 incident (“non-compliance which could have a minor environmental effect”) and four have been classified as a Category 4 incident (“no potential environmental impact”). We are currently awaiting the classification of the remaining three non-compliances.

Our performance is influenced by the non-compliances at Prioress Mill and Llantrisant. These are a function of the significant capital works that are taking place to construct a new pumping station at Prioress Mill. Construction of the new station will enable us to meet the stringent new abstraction licence conditions set by Natural Resources Wales at this site, to achieve the requirements of the EU Habitats Directive for the River Usk Special Area of Conservation.

Treating Wastewater

The Urban Waste Water Treatment Regulations and the Environmental Permitting Regulations set standards for sewage treatment. For each of our wastewater treatment works there is a permit which regulates the quality of wastewater we are allowed to discharge into rivers and coastal waters.

During the 2019 calendar year we achieved our fourth best-ever wastewater treatment works compliance with just six non-compliant discharges out of the 564 permitted waste water treatment works discharges (98.94%).

We remain committed to achieving 100% compliance with an annual target of maintaining a downward trend of overall sample exceedances. A Compliance Steering Group (CSG) meets every month and we continue to focus on improving the use of our operational and maintenance data to identify deteriorating trends and use statistical analysis to forecast potential sample exceedances. This has resulted in specific interventions to prevent LookUp Table compliance. Our focus for the coming year is to try and predict and prevent Upper Tier consent failures. We have also introduced a Compliance Quarterly Workshop to supplement the CSG where operational teams, process science and support, and asset management teams come together to review operational incidents, share lessons learnt and identify best practice and improvement actions for roll out across all areas.

Our performance in this area is monitored by our Quality and Environment Committee.

Water Treatment Works discharge limits for environmental permits

Water Treatment Works (WTW) discharge effluent from a range of activities associated with the production of drinking water. These discharges may be continuous or intermittent. The Environment Agency/Natural Resources Wales sets numeric limits on the effluent discharges.

During the year there were five non-compliant discharges out of 41 WTWs. The Natural Resources Wales findings for all non-compliant discharges, together with any required actions and timescales, are captured on an internal Register. This Register is closely monitored and also discussed at monthly performance meetings to ensure that all actions are implemented within agreed timescales.

We have a number of plans in place to improve on our performance including training of key colleagues, updating procedures and better use of technology to improve reporting and provide better warning signs for early intervention. A key strategy has been recycling discharge water so that we don't discharge at all.

Our performance in this area is monitored by our Quality and Environment Committee.

Pollution

The number of pollution incidents for 2019 is 122. During 2019, two serious incidents occurred, both of which were classified as Category 2 (high-significant impact) incidents from Water Treatment Works (WTWs). This is an improvement compared to the five reported in 2018. Our aim is to achieve zero serious pollution incidents. All serious incidents are followed up by a Serious Incident Review. The purpose of the Incident Review is to gather information that in turn may reduce the potential for future incidents. During the reviews the incident is analysed and lessons learnt disseminated, with recommendations, information and process changes instigated. We are also investing in new technology to reduce this risk of serious

pollution incidents from burst rising mains. Pressure monitoring and analysis of this data provides early warnings of bursts that would previously have taken time to identify, reducing the volume and duration of any escape of sewage. In addition, we have begun a review of the drainage plans for our high risk WTWs in order to ensure that any spillages are contained and do not enter surface water drainage.

Incidents of pollution are among the most serious incidents we deal with. Our Pollution Reduction Strategy provides a sustainable approach to long term pollution performance improvement. Based around the themes of Asset Understanding, People, and Data and Systems, the objectives included in the Strategy drive a planned approach to achieving zero serious pollution incidents. We continue to participate in the Environment Agency's Joint Workshop On (Pollution) Incidents, to ensure that we are implementing national industry best practices to improve understanding of asset bases in order to drive future improvements in pollution performance.

Our performance in this area is monitored by our Quality and Environment Committee.

Sites of Special Scientific Interest

Between 3 and 5 July 2019, we undertook emergency works to repair the Llygwy raw water main, which is located in a SSSI. Whilst we had a good reason to undertake the works, as it was an emergency, we failed to inform Natural Resources Wales (NRW) as soon as practicable. NRW sent us a formal caution in April 2020 regarding the incident, which we have accepted.

On 20 September 2019 our contractor undertook works to repair a leaking communication pipe close to Marshfield. The works were undertaken within the boundary of a SSSI and we failed to notify NRW of the works or obtain the requisite assent. The evidence we hold suggests there was no damage to the SSSI.

We will attend a lessons learnt session with NRW to ensure issues like these are avoided in future. We will also be holding similar sessions with our main contractors.

General Data Protection Regulation

In the run up to the implementation of the General Data Protection Regulation (GDPR) under the Data Protection Act 2018, we implemented a programme of compliance across the business. We have significant numbers of interactions with our customers and we have experienced a number of technical breaches of the data protection rules.

Out of the breaches notified internally, we have deemed two to be serious and therefore notifiable to the ICO. Of the two serious breaches we have notified to the ICO, where we received feedback from the ICO with recommended steps, we had already taken those steps, and the ICO confirmed that they were taking no action. In each case of a reported suspected breach, we ensure that any lessons learnt are taken into account, that the individual's training on data protection is up to date, and that the specific circumstances which led to the breach or "near miss" have been addressed with their manager.

STATEMENT OF DIRECTORS' RESPONSIBILITIES FOR REGULATORY INFORMATION

The following confirmations from our Directors are provided to comply with the requirements of Condition F of our Licence, which requires that accounting statements are prepared in accordance with the Regulatory Accounting Guidelines issued by Ofwat and Condition I (Ring Fencing). In particular, Regulatory Accounting Guideline 3.11 issued in January 2019 requires the following Statements to be made by our Directors:

- Statement of Directors' remuneration and standards of performance.
- Statement on disclosure of information to auditors.
- Statement on Dividend Policy.
- Statement on sufficiency of financial resources and facilities.
- Statement on Long Term Viability.
- Statement on sufficiency of non-financial resources.

Statement on Directors' Remuneration and Standards of Performance

The Company is required under s35A of the Water Industry Act 1991 to provide a Statement that the remuneration paid to Executive Directors is linked to standards of performance. This Statement is provided within the Report from the Chair of the Remuneration Committee which can be found in our Annual Performance Report for 2019/2020 available at www.dwrcymru.com.

Statement on disclosure of information to auditors

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

- a) so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- b) 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 the information.

Statement on Dividend Policy

Licence Condition F and Section 3.4 of Regulatory Accounting Guideline 3.11 requires companies to report on the value of any dividend paid and provide a comprehensive explanation of the basis of the dividend.

Dŵr Cymru's ultimate parent undertaking is Glas Cymru Holdings Cyfyngedig, a company formed with the single purpose to manage Dŵr Cymru. As a company limited by guarantee, and having no shareholders, all financial surpluses are reinvested for the benefit of customers. The reserves built up from retained profits help to insulate Dŵr Cymru and its customers from any unexpected costs and also to improve credit quality to keep the cost of finance as low as possible.

Our Dividend Policy was approved by Ofwat in December 2015 and formally adopted by the Board in the June 2016 Board meeting. No monies are transferred out of the Glas Cymru group of companies under this Policy and all financial surpluses are retained for the benefit of customers. Our Dividend Policy expressly provides that dividends will not be paid unless the Directors are satisfied that this would not impair Dŵr Cymru's ability to finance its regulatory activities.

During the year to 31 March 2020 no dividends were paid or received by the Company.

Statement on sufficiency of financial resources and facilities

Information Notice 20/01 published by the Water Services Regulation Authority in February 2020 sets out guidance for water and wastewater companies in England and Wales in preparing their Ring-fencing Certificate. The regulatory ring-fencing framework provides an important protection for companies and their customers. The Directors have resolved that a Certificate required under Condition I17 of our Licence and prepared in accordance with the latest guidance be issued to the Water Services Regulation Authority confirming that in the opinion of the Directors:

- a) the Company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next twelve months, the Regulated Activities (including the investment programme necessary to fulfil the Company's obligations under the Appointment); and
- b) the Company will, for at least the next twelve months, have available to it management resources and systems of planning and control which are sufficient to enable it to carry out those functions.

In providing this Certificate, the Directors have also made a statement of the main factors that have led to the conclusion that resources are sufficient. This can be found at Appendix 1 of the Certificate.

A copy of the Directors' Certificate together with the supporting main factors can be found in our 2019/2020 Annual Performance Report available at www.dwrcymru.com.

This Directors' Certificate also confirms that in the opinion of the Directors all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to the Company, to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

Sections I24 and I25 of Licence Condition I requires our independent auditors to produce a report that sets out:

- whether they are aware of any inconsistencies between the Director's Certificate and any of the accounting records; and
- the extent to which the Company has during the preceding 12 months complied with its obligations under Licence Condition I13.3 and I14.

A copy of the auditor's report can be found in our 2019/2020 Annual Performance Report available at www.dwrcymru.com.

Long-Term Viability Statement

Our customers need to know they can rely on the services we provide over the long term. Ensuring the long-term resilience of our business, including financial resilience, is therefore a key area of focus for us. The Board's consideration of the Group's long-term viability is embedded in our business planning process. This includes robust risk management controls, financial forecasting and sensitivity analysis, as well as regular budget review. Risks are identified and assessed through a continuous cycle of bottom-up reporting and review and top down feedback and horizon scanning. The Board has analysed the efficacy and robustness of its internal control framework in managing the likely causes and consequences of each risk. We have stress-tested our business plan forecasts to 2030 against a variety of financial scenarios.

Ofwat expects companies to confirm that they are financially viable over the longer term. Our approach to doing this complies fully with Ofwat's latest guidance contained within Information Notice 19/07 published in April 2008 as well as Provision 31 of the UK Corporate Governance Code.

As a result of their assessment, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period to March 2030. The Long-Term Viability Statement is provided within our Annual Report and Accounts for 2019/2020 which is available at www.dwrcymru.com.

Statement on sufficient non-financial resources

Under paragraph 3.1 of Condition K of the Licence, the Company is at all times required to ensure, so far as is reasonably practicable, that if a special administration order were made, the Company would have available to it sufficient rights and assets (other than financial resources) to enable the special administrator to manage the affairs, business and property of the Company.

The Directors are satisfied that the business has adequate resources to continue in business for the foreseeable future. Accordingly, the Financial Statements for the year ended 31 March 2020 have been prepared on a going concern basis.

Licence Condition I30 – Maintaining an Investment Grade Rating

The Directors confirm that throughout 2019/2020 the Company, or an Associated Company as issuer of debt on its behalf, has ensured that it has maintained at all times an issuer credit rating which is an

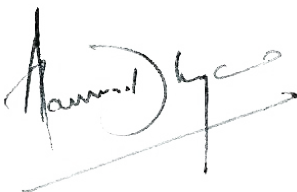
Investment grade rating. Dŵr Cymru has the strongest credit ratings in the water sector, reflecting the Company's high level of creditworthiness. All three credit rating agencies have issued rating updates following Ofwat's publication in December 2019 of the challenging Final Determination for the AMP7 price control. On 30 January 2020 Fitch confirmed the rating of our bonds as A and amended the outlook from negative to stable; on 7 February 2020 Moody's announced that they were downgrading our corporate family rating and class B senior secured debt from A2 to A3 (with stable outlook); and also on 7 February 2020, Standard & Poor downgraded the class B senior secured debt from A to A- and revised the outlook to stable.

Licence Condition I4 – Trading with Associate Companies at Arm's Length

We have an Obligation to ensure that every transaction between the Appointed Business and any Associated Company is at arm's length so neither gives to nor receives from the other any cross-subsidy. There were no transactions with any associated companies except for:

- the Directors of Dŵr Cymru Cyfyngedig (DCC) are also directors of other companies within the Glas Cymru Group. However, the emoluments of the Directors are paid in full by Dŵr Cymru Cyfyngedig as their activities are predominantly related to the regulated water and sewerage business. During the year the Directors' emoluments amounted to £2,320,031 (2019: £2,511,210) (including pensions accruals);
- no dividends were paid or received by the Company during the year (2019: none);
- intercompany interest payable to Dŵr Cymru (Financing) Limited ("DCF"), another member of the Glas Cymru Holdings Cyfyngedig group, was £141,867,000 during the year (2019: £144,820,000). As at 31 March 2020 the balance outstanding on the intercompany loan from DCF stood at £3,075,771,000 (2019: £2,577,311,000);
- all borrowings raised by DCF are immediately on-lent to the company on an arm's length basis. The intercompany loan is subject to the terms and conditions of the whole business securitisation structure of Glas Cymru Anghyfyngedig and its subsidiaries. DCC, in its capacity as debtor, repays such principal and interest as is due on each borrowing on the due date plus 0.01%;
- an intercompany loan to Glas Cymru Anghyfyngedig of £1,971,000 (2019: £1,971,000) remains outstanding as at 31 March 2020;
- during the year an intercompany loan was received from Dŵr Cymru Holdings Limited totalling £2,812,458; and
- as at 31 March 2020 intercompany trading balances owing to the Company were: Welsh Water Infrastructure Limited £2,400 (2019: £312,542), Welsh Water Organic Energy (Cardiff) Limited £149,259 (2019: £4,874), Cambrian Limited £4,265, Glas Cymru Anghyfyngedig £8,481 (2019: £8,481), Glas Cymru Holdings Limited £18,901 (2019: £3,759), Welsh Water Organic Waste Limited £277,127 and Welsh Water Organic Energy Limited £9,675 (2019: £7,509).

Approved on behalf of the Board of Dŵr Cymru Cyfyngedig,



Alastair Lyons

Chair, Dŵr Cymru Cyfyngedig

2nd July 2020

Letter of Assurance

For the attention of The Board, Dŵr Cymru Welsh Water

Subject: 2019/20 Risk and compliance statement - assurance letter, 12th June 2020

To the Board

As set out in IN 20/03, Ofwat requires companies to publish an annual risk and compliance statement, appropriately signed off, in which the Board clearly confirms that the company:

- considers that it has full understanding of, and is meeting, all its relevant statutory, licence and regulatory obligations and has taken steps to understand and meet customer expectations;
- has satisfied itself that it has sufficient processes and internal systems of control to fully meet its obligations; and
- has appropriate systems and processes in place to allow it to identify, manage, mitigate and review its risks.

Where the company considers it is unable to provide such a statement IN 20/03 states that it should explain why it is unable to do so.

As with other company information, it is important that stakeholders can have trust and confidence in your risk and compliance statement and to support this you have asked us to provide assurance in this area. Building on our approach over the last four years, we have reviewed the processes that support the declarations in your risk and compliance statement.

Approach

Our review focused on the approach and processes you follow to assess your compliance with your obligations. You interpret the scope of the risk and compliance statement to be those obligations for which Ofwat is the relevant enforcement authority. This is consistent with your approach in prior years. We are aware that you have processes to manage compliance with other obligations and duties, but that they are not explicitly covered as part of your risk and compliance statement (e.g. compliance with health and safety legislation and requirements).

We held a meeting on 20/05/2020 with your Compliance Team, including Nicola Williams, Paul Marsh and Debbi Parfitt. The meeting was held remotely using MS Teams. Your team had provided some information prior to the audit and we reviewed further documentation off-line following the meeting. Our review entailed a review of the steps taken to prepare the risk and compliance statement as documented in the strategy document. We inspected a sample of the compliance proforma and other evidence that demonstrated completion and sign-off of the various tasks.

We did not review the processes used to assess compliance directly with any owners or nominated individuals associated with each obligation. However, we note that as part of our assurance of the information you are submitting in your Annual Performance Report (APR) and your annual scheme of charges, we have directly examined a number of the processes and controls you have in place to support your obligations in relation to reporting information and compliance with specific licence obligations.

We did not review the proposed risk and compliance statement.

Observations

We recognise the considerable work done by the Compliance Team and the progress made since last year in improving the approach and addressing our recommendations. From our audit and our overall assurance activities we continue to observe elements of good practice and note the team has plans to make further improvements in 2020/21.

Our main observations are as follows:

- Through our work assuring your APR and annual scheme of charges and submissions in 2019/20, we have continued to see evidence of appropriate systems and controls;
- We observed significant improvements to the process for preparing the risk and compliance statement and the evidence available to demonstrate compliance. In particular we welcome the introduction of the Compliance Proforma which evidences how compliance has been achieved and is signed off by the business owner and the member of the Executive Team responsible for the Obligation. At the time of the audit all proforma had been signed off by the owners and most by the responsible Executive Team member. We reviewed a sample of the completed compliance proforma and identified no issues;
- You described your approach to horizon-scanning and we note that a formal requirement for the business owner to consider horizon scanning is included in the Compliance Proforma. We saw evidence of horizon scanning in our sample checks.
- You propose to include in your 2019/20 risk and compliance statement a section noting exceptions and areas for improvement. Where areas of exception and potential compliance risks have been identified they are noted and addressed in your assurance plan;
- You confirmed that your strategy for the preparation of the 2020 risk and compliance statement was approved by the Welsh Water Executive Team;
- Over the past year you have reviewed the scope of your existing external assurance to understand whether for some obligations assurance is already being completed for other purposes, and to understand the adequacy of that assurance. The results of this review will allow you to focus your internal and external resources on areas not already covered by adequate independent third-line assurance. We understand that this has highlighted a number of areas for improvement;

Recommendations

We recognise that your team have made considerable improvements over the past year to your processes and are intending to make further improvements over the coming months. In particular they intend to work with the Integrated Management System Team to fully document the approach to preparing the Risk and Compliance Statement as a formal procedure.

We recommend that, once you have documented the process and in advance of the year-end audits in 2021, we review the process and documentation using our standard process assessment methodology. This would confirm that the process is robust and would identify any issues and areas for improvement in sufficient time to make changes for 2020/21 reporting. It also allows the final audit in May to be focused on demonstrating compliance with the process.

Conclusions

We consider that, other than where indicated otherwise in this letter and/or the feedback we provided:

- you have a full understanding of the Company's relevant obligations (as you have interpreted the scope required for this exercise); and
- you have appropriate systems and processes in place to run your business and identify and manage risks in a way that meets the relevant obligations (as you have interpreted the scope of these).

Yours sincerely



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