



Chartered
Institute of
Internal
Auditors

Parliamentary briefing:

Making Internal Audit Mandatory for Water Suppliers - A Regulatory Imperative

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Strengthening Audit, Assurance and Governance Across the UK Water Sector by Mandating Internal Audit Functions

Parliamentarians will be well aware of the stories appearing in the media every day about the failures of privatised water companies. Sewage being pumped into our rivers and seas. Families left for days without clean water to drink, bathe or cook with. Water is a critical part of national infrastructure, and millions of people across the country depend on their water company to deliver safe, clean drinking water every single day. However, what you may not be aware of is that some water suppliers are operating without one of the most fundamental components of good governance: an independent internal audit function. At a time when the water sector faces unprecedented public scrutiny over financial fragility, operational failures and environmental concerns, this gap in oversight should be of serious concern to parliamentarians.

This briefing aims to highlight the pressing need for Ofwat to introduce a regulatory requirement to make it mandatory for all water suppliers to establish and maintain an independent internal audit function. In [2024](#), the Chartered Institute of Internal Auditors (Chartered IIA) identified that several water suppliers facing significant financial and operational challenges did not have an internal audit function, including South East Water. In response, we wrote to the Chief Executive of Ofwat and to DEFRA, outlining our concerns and calling for regulatory action.

Since then, the Government has taken welcome steps to strengthen oversight and governance in the water sector, including establishing the Independent Water Commission and publishing DEFRA's White Paper 'A New Vision for Water'. Any forthcoming Water Bill could potentially be used to deliver stronger legislative requirements to ensure all water suppliers have an appropriately positioned and resourced internal audit function.

Nearly two years on, [the Financial Times](#) has reported that South East Water still has no internal audit function despite these warnings, and is now experiencing the very service and financial failures we cautioned against. Without internal audit, water suppliers may lack the independent oversight needed to identify and act on risks before they escalate, whether those risks relate to financial resilience, operational continuity, regulatory compliance or service delivery to customers.

South East Water: When Governance Gaps Have Real Consequences

The situation at South East Water illustrates exactly why internal audit matters. In 2025 and 2026, households and businesses across Kent and Sussex have endured repeated and prolonged supply failures. Tens of thousands of people have been left without running water, in some cases for extended periods. These failures have disrupted daily life in communities across Kent and Sussex.

Throughout this period, [South East Water has continued to operate without an internal audit function](#), as confirmed in its 2025 Annual Report. It is deeply troubling that nearly two years after we first flagged this governance gap, the company is now experiencing precisely the kind of failures that a robust internal audit function is designed to help prevent. An appropriately positioned and resourced internal audit function could have alerted the board to emerging risks and enabled earlier intervention.

We therefore urge parliamentarians to support our call and advocate for Ofwat to introduce a mandatory regulatory requirement for water suppliers to have an internal audit function. This would align with best practices across other regulated sectors to help ensure the long-term sustainability and resilience of water suppliers.

Research Insights: A Spotlight on Water Sector Audit and Assurance Vulnerabilities

In early 2024, our research revealed that there were three water suppliers operating in the South East of England and serving around 3.7m customers that did not have internal audit. While there has been some progress with water suppliers in this region since then, South East Water continues to operate without internal audit.

South East Water also remains in the "*Action Required*" category in Ofwat's recent Monitoring Financial Resilience Report¹, due to ongoing financial issues. Ofwat's Monitoring Financial Resilience Report describes the importance of water suppliers maintaining financial reserves to navigate short-term fluctuations and fulfil their commitments. In this context, an internal audit function would be a vital source of independent assurance and oversight. Yet measures by Ofwat relating specifically to internal audit remain conspicuously absent.

Given the critical role internal audit plays in underpinning effective governance, risk management and internal control, this omission is significant and must be addressed. The continued issues faced by South East Water underscore the need for an enhanced and robust audit, assurance and risk management framework, underpinned by a strong, competent and appropriately resourced internal audit function.

For water companies that do have an internal audit function, it must be appropriately positioned and resourced to be fully effective. We recommend that internal audit operates in accordance with the Chartered IIA's [Internal Audit Code of Practice](#), with unrestricted scope, access to all areas of the business and a direct reporting line to the Audit Committee.

How can Internal Audit help water companies?

A strong, competent and appropriately resourced internal audit function provides independent assurance and oversight across critical risk areas, including:

- Operational resilience and business continuity
- Corporate reputation and compliance with regulatory standards
- Financial health and economic uncertainties
- Technological vulnerabilities and climate-related risks

Internal audit also supports key processes such as climate risk assessments, economic stress testing and scenario planning — all things internal audit helps to support in other regulated sectors like financial services.

Closing the Regulatory Gap: Alignment with Other Regulated Sectors

Making internal audit mandatory for water suppliers would align with other key regulated sectors. In the financial services sector, regulations set by the Financial Conduct Authority and the Prudential Regulation Authority mandate that companies establish and maintain an internal audit function. Ofgem requires energy suppliers to report on their internal audit capabilities in line with principles similar to the UK Corporate Governance Code. Internal audit is also a regulatory requirement across the public sector and is mandatory for Scottish Water and Northern Ireland Water due to their public

¹ [The Monitoring Financial Resilience Report, Ofwat](#)

ownership. Yet despite the critical nature of water supply, no equivalent requirement applies to water companies in England and Wales.

Key sectors in the economy recognise the value of internal audit in helping organisations safeguard against financial mismanagement, operational inefficiencies, and compliance failures. By drawing lessons from other sectors, the water sector can enhance its audit and assurance framework, helping water suppliers be better equipped to address the myriad risks they face.

Recommendations for Parliamentarians

Given that parliamentarians are likely to share our concerns about the difficulties faced by water suppliers and the issues we have highlighted regarding the lack of internal audit requirements, we would like to work together to address the audit and assurance weaknesses of these suppliers. We want to see an efficient, sustainable, and secure water sector, where constituents, businesses, and suppliers are safeguarded.

We encourage all parliamentarians to consider the following actions:

- **Raise parliamentary questions** calling on the Government to require Ofwat to make internal audit a regulatory requirement for all water companies, or at a minimum, to develop appropriate regulatory guidance.
- **Advocate** for internal audit provisions to be incorporated into future water sector legislation, building on the reforms outlined in DEFRA's White Paper.
- **Call on Ofwat** to work directly with South East Water and other affected suppliers to address this governance deficiency as a matter of urgency.

Contact us: We hope that you find this briefing useful so you can better understand the lack of internal audit presence in the water sector. For any enquiries regarding this briefing or if you would like to set up a meeting to find out more about how we can support your work as a parliamentarian, please contact [Gavin Hayes, Head of Policy and Public Affairs](mailto:gavin.hayes@charterediia.org) at gavin.hayes@charterediia.org