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### **PR24: Consultation Response**

The Chartered Institute of Internal Auditors (Chartered IIA) represents over 10,000 internal audit professionals across the UK and Ireland, including those within the water industry. We advocate for good corporate governance, strong risk management and a rigorous control environment, leading to the long-term success of organisations and the contribution internal audit makes to these aims.

We welcome the opportunity to respond to Ofwat's PR24 consultation, recognising the importance of robust regulatory frameworks that ensure water companies deliver high-quality services and outcomes for customers and the environment. Our response focuses on the critical role of internal audit in providing independent assurance of performance data, financial resilience, and the delivery of enhancement schemes.

We continue to believe that Ofwat should make it a regulatory requirement for the boards of all regulated water suppliers to establish and maintain an independent internal audit function as an integral part of their governance structure. To be independent and appropriately positioned, this typically requires the board audit committee to be responsible for the internal audit function with a primary reporting line into the Audit Committee Chair. This requirement is especially important for the water sector given the vital role that internal audit can play in providing valuable independent assurance, including supporting the PR24 assurance requirements.

The Chartered IIA is happy to discuss any of the comments included in the response. We are also happy for our response to be published and made publicly available on the Ofwat website.

### **Response to the PR24 Draft Determinations: Our Approach Document**

We appreciate Ofwat's commitment to enhancing monitoring and assurance measures for the 2025-30 period, particularly the introduction of independent third-party assurance for the delivery of water suppliers' enhancement schemes. However, we emphasise the critical role that appropriately resourced, competent, and independent internal audit functions can play in providing assurance. When appropriately positioned, internal audit could support continuous oversight and provide independent assurance on the delivery of enhancement schemes, ensuring data accuracy, completeness and reliability, while complementing the assurance provided by external parties. We suggest that Ofwat consider internal audit a valuable source of independent assurance, particularly in financial resilience and performance reporting.

Regarding the proposal for additional board assurance and financial resilience plans, internal audit functions, where they exist, should be recognised as vital contributors to the assurance process. Internal audit can provide independent assurance and critical insights, strengthening the robustness of financial resilience plans. This is especially important for companies like South East Water, which currently lack an internal audit function, underscoring the need to establish one. Our concerns are further validated by our findings published in the [Financial Times](#), which highlighted the absence of internal audit functions in three water companies as a 'significant weakness' in their audit and corporate governance frameworks.



The introduction of a turnaround oversight regime for persistently poor performers is a necessary step towards improving company performance. Internal audit functions can play a supportive role in this regime by assisting with root cause analysis, reporting on transformation plans, and monitoring corrective actions. This approach aligns with best practices in the financial services sector, where internal audit functions are often tasked with providing independent assurance to regulators such as the Financial Conduct Authority and the Prudential Regulation Authority and could be leveraged similarly to support Ofwat's objectives.

In terms of the proposals for independent monitoring and the appointment of an Independent Monitor for companies with significant performance issues, internal audit functions could potentially support this role. As the only internal independent assurance provider within a company, internal audit teams if positioned properly with a reporting line to the board audit committee, should have full and unrestricted access to company information. Like the turnaround oversight regime, they could provide ongoing monitoring and report on progress against transformation plans. This would enable Ofwat to benefit from the continuous, internal insights that an independent internal audit function can provide while retaining the option to appoint external monitors where necessary.

### **Response to the PR24 Quality and Ambition Assessment (QAA)**

In this document, Ofwat identified that 10 companies' business plans met the minimum quality expectations. However, two of these companies, SES Water and Portsmouth Water, do not have internal audit functions, raising concerns about the robustness of their internal assurance processes regarding their business plans. We recommend that where internal audit functions exist, they should be leveraged to provide independent assurance on the quality of business plans, thereby strengthening governance and reliability. Furthermore, South East Water, which required significant intervention to meet the minimum quality expectations, also lacks an internal audit function. This underscores the need for the company to establish and maintain an independent internal audit function to enhance the assurance and broadly bolster internal controls, risk management, and governance.

In Table 2, under 'Data, Information and Assurance', internal audit should be recognised as a key provider of independent assurance. Internal audit functions are well-positioned to assess the accuracy, completeness, and reliability of the data in business plans, ensuring alignment with the company's long-term strategy. Leveraging internal audit in this way could enhance the quality of business plan submissions, leading to better regulatory and customer outcomes.

Regarding the assessment of financial resilience, we support Ofwat's focus on the need for additional assurance in this area. However, internal audit functions, where established, can provide valuable independent assurance on financial resilience plans, evaluating the robustness of financial strategies and ensuring companies are prepared to maintain resilience throughout the regulatory period and beyond.

### **Response to the PR24: Delivering Outcomes for Customers and the Environment**

We commend Ofwat's emphasis on high-quality performance data and rigorous assurance processes. However, the assurance framework should explicitly recognise and reference internal audit as a key component of the organisation's audit and assurance framework, highlighting the need for an independent third-line assurance provider. Internal audit provides independent and objective assurance, assessing and verifying the validity of first and second-line assurance functions such as legal and compliance or risk management teams, to ensure data robustness and the reliability of any assurance provided. By verifying the assurance work of first and second-line functions, internal audit can help ensure that performance data meets



Ofwat's rigorous standards.

While we understand the focus on external third-party assurance, it is important to recognise that independent assurance does not always need to be externally sourced. Appropriately resourced, competent and well-positioned internal audit functions could provide such assurance, offering an internal perspective deeply knowledgeable about the company's operations. Internal audit can also operate in a co-sourced model, leveraging external expertise where necessary while maintaining internal oversight. This approach enables internal audit to incorporate external skills and knowledge on specialist technical subjects while ensuring a thorough, independent examination of performance commitments and data metrics.

We agree that companies should provide detailed assurance reports outlining the scope and findings of assurance activities. However, Ofwat should recognise the important role of internal audit in this process. Internal audit can provide a comprehensive view of how performance commitments are met, scrutinising the data and metrics behind performance reporting with the same level of independence and rigour expected from external third-party assurers. Including internal audit in this process would enhance the overall audit and assurance framework by utilising existing internal resources, ensuring more continuous and informed oversight.

### **Response to Expenditure Allowances – Assurance Requirements for Delivery of Enhancement Schemes Appendix**

We strongly recommend that condition 2 related to Price Control Deliverables (PCDs) in each company's license include the requirement for the board audit committee to establish and maintain an independent internal audit function. An internal audit function would provide ongoing, independent assurance regarding the achievement of PCDs, ensuring that necessary controls and processes are in place and operating effectively throughout the regulatory period. This inclusion would enhance assurance requirements along with the overall governance and accountability within water companies.

We believe it is a missed opportunity that the proposed assurance requirements for enhancement schemes do not specifically reference internal audit as a key provider of independent assurance. The assurance requirements should encompass the role of internal assurance providers, not just external ones. Recognising the role of internal audit would significantly strengthen the assurance framework for enhancement schemes.

While we acknowledge the need for independent external third-party assurance, independent assurance can also be effectively provided by internal audit functions that report to the board audit committee. Internal audit can ensure the accuracy, completeness, and reliability of the data that supports the company's reporting, offering a level of independence comparable to external assurance providers. Companies and their boards should be encouraged to leverage their internal audit capabilities to help meet the need for enhanced assurance requirements.

### **Conclusion**

In conclusion, while we fully support Ofwat's proposed enhancements to the regulatory framework, as part of PR24, we strongly advocate for the explicit inclusion of internal audit functions as key providers of independent assurance. Internal audit functions can complement external third-party assurance efforts, particularly in the areas of financial resilience, performance reporting, and enhancement scheme delivery, thereby contributing to more effective regulation and better outcomes for customers and the environment. We believe that recognising the important role of internal audit within these frameworks will enhance assurance and strengthen the overall governance and accountability within the water sector.