

Office of Water Services

Resource Accounts 2005-06

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2005-06

(For the year ended 31 March 2006)

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OFWAT'S RESOURCE ACCOUNTS AND REVIEW OF ACTIVITIES 2005-06

Annual report

Introduction

These accounts cover the operation of Ofwat for the period 1 April 2005 to 31 March 2006. They have been prepared on an accruals basis in accordance with the Government Financial Reporting Manual. The report summarises the main objectives and outputs for the year. This includes the changes arising from the implementation of the Water Act 2003.

Ofwat's aims and objectives

The Director General of Water Services was, until 31 March 2006, the economic regulator of the water and sewerage industry in England and Wales. His duties were laid down in the Water Industry Act 1991 (WIA91) and Water Act 2003 (WA03). A non-executive advisory board was set up by the Director General to provide support and advice. It included four non-executive advisory directors. Its work concluded in March 2006. From 1 April 2006 these responsibilities were assumed by the Water Services Regulation Authority (Ofwat).

In the exercise of most of Ofwat's key functions we are required, by section 2 of WIA91 (as amended by Section 39 WA03), to act in a way that we judge will:

- enable water and sewerage companies properly to carry out their functions;
- enable them to finance their functions, in particular by securing a reasonable rate of return on their capital;
- protect the interests of consumers, wherever appropriate by promoting effective competition;
- have regard to the interests of vulnerable groups;
- promote economy and efficiency on the part of companies; and
- contribute to the achievement of sustainable development.

We also take due account of our general environmental and recreational duties under the Act.

Our main objectives in the period 1 April 2005 to 31 March 2006 were:

Objective 1 – To assess and report on each company's progress towards improving water and environmental quality and security of supply.

Objective 2 – To monitor and report on company efficiency, regulatory accounts and take action as required.

Objective 3 – To commission an independent review of the 2004 price review and consider its recommendations for the future.

Objective 4 – To promote effective competition and to approve tariffs.

Management commentary

Review of Ofwat's activities

Our latest annual report was published on 11 May 2006 (HC1058). The annual report for Ofwat is available on our website www.ofwat.gov.uk, or by contacting The Stationery Office on:

0870 600 5522.

The key outputs achieved included:

- independent steering group report of the periodic review 2004;
- receipt and analysis of the annual information submission from companies (the June return) and taking regulatory action as required;
- publication of five annual performance reports covering levels of service, which includes environmental and water quality standards, leakage and security of supply, tariffs, financial performance and relative efficiency;
- supporting the work of WaterVoice and assisting the set up of the Consumer Council for Water (CCWater) in October 2005;
- working with Defra and other stakeholders on the Water Framework Directive;
- implementing the new competition framework arising from the Water Act 2003; and
- ongoing investigations into the accuracy and reliability of regulatory information prepared by Severn Trent Water Ltd, Southern Water Services Ltd and Thames Water Utilities Ltd.

Statutory Changes

Under the Water Act 2003, CCWater was established in October 2005, which involved the transfer of the assets and liabilities of WaterVoice to the new organisation. WaterVoice operated through nine regional committees based in England and a committee for Wales. They represented the interests of all customers of the water and sewerage companies, allocated to each committee by the Director General.

From 1 April 2006 the duties of the Director General became the responsibility of the Water Services Regulation Authority to be known as Ofwat. The general duties of the regulator remain unchanged and include protecting the interests of consumers, wherever appropriate by promoting effective competition, and contributing to the achievement of sustainable development.

The chairman of the new Ofwat board and interim Accounting Officer is Philip Fletcher, the former Director General of Water Services. The Board includes two executive and four non-executive directors and a chief executive officer, Regina Finn (due to be appointed in October 2006).

Financial commentary

The financial highlights for Ofwat are summarised below:

Operating costs summary	2005-06	Full Year Restated 2004-05
	£000s	£000s
Income		
Deferred income prior year	893	1,533
Licence fees received	10,738	10,547
Other income	281	9
	<u>11,912</u>	<u>12,089</u>
Expenditure		
Administration costs	(10,571)	(11,196)
	<u>1,341</u>	<u>893</u>
Income deferred to following period	(1,341)	(893)
Net operating surplus	<u>–</u>	<u>–</u>

Ofwat began the financial year with an operating budget of £14.7m, including £3.521m for WaterVoice's activities. The assets and liabilities and the balance of the WaterVoice budget was transferred to CCWater with effect from 1 October 2005. The transfer included matching licence fee income and a special fee of £2.45m, charged to water companies, to set up CCWater and cover its increased operating expenditure.

The resource accounts for Ofwat for the full year commencing 1 April 2005 and prior year comparative figures exclude operating expenditure, assets and liabilities for WaterVoice. These are included in CCWater's accounts. However, the Director General was the responsible Accounting Officer for income and expenditure relating to WaterVoice and CCWater for the period 1 April 2005 to 30 September 2005. On 1 October 2005, AO responsibilities transferred to Dame Yve Buckland, the CCWater Chair, until the Chief Executive, Tony Smith, took up post on 1 December 2005.

The final HM Treasury approved budget for Ofwat alone for the year was £12.1m, which recognised the transfer of assets, liabilities and resources to CCWater and Ofwat budget pressures arising from the Competition Act 1998 and preparation for the Water Services Regulation Authority (Ofwat).

Our fee income is subject to the constraints set out in Condition N of each water company's licence and negotiation with HM Treasury. Condition N was modified during the year to allow separate recovery of CCWater's expenditure. Fees are based on an estimate of costs at the start of the financial year. In 2005-06, £10.7m of fees covering Ofwat's activities were recovered at the beginning of the financial year. Early in the year we planned to draw down £467k from previous years' accumulated licence fee income. As part of the new competition arrangements Condition N was also modified to recover water supply licence fees.

The outturn net cash requirement (£40k) is lower than the Estimate net cash requirement of £507k due to reductions in planned capital expenditure and changes in working capital arising from a lower than planned use of deferred income.

The underspend against estimate (£1,529k) is related to unused budget for legal consultancy, salary savings and planned expenditure for accommodation improvements being deferred until 2006-07. The project to improve accommodation includes installation of air conditioning, health and safety measures, security upgrade, new switchboard and a reduction in floor area.

As a government department we do not have shareholders. However, we are required by HM Treasury to achieve a cost of capital return of 3.5 per cent. This is assessed on the average value of the assets over the financial year. We have to observe parliamentary control totals for administration costs and our costs are analysed by objectives. These details are provided in the accounting statement and supporting notes to the accounts.

Actual figures for the period compare to the monthly reports made to Management Committee and the Board. Figures for 2004-05 are for the full year and exclude WaterVoice transactions.

Authority for us to incur expenditure is provided by Parliament through the public expenditure process.

Financial instruments

We do not have borrowings and rely primarily on licence fee income and Contingency Fund loans for our cash requirements. We are not, therefore, exposed to liquidity risks. Further details are provided at note 20 to the accounts.

Going concern

Our balance sheet at 31 March 2006 shows negative taxpayers' equity of £3.8m. This reflects the inclusion of liabilities falling due in future years, which are to be financed mainly by drawings from the Consolidated Fund. Such drawings will be from grants of supply approved annually by Parliament, to meet our net cash requirement. Under the Government Resources and Accounts Act 2000, no money may be drawn from the Fund other than that required for the specified year or retained in excess of that need. All unspent monies, including those derived from the department's income, are surrenderable to the Fund.

In common with other government departments, the future financing of our liabilities is met by future grants of Supply and the application of future income, both to be approved annually by Parliament. There is no reason to believe that future approvals will not be forthcoming.

Under the Water Act 2003, the functions of the Director General of Water Services (DGWS) were transferred to the new water regulator, the Water Services Regulation Authority (Ofwat), and the accounts for 2005-06 have been prepared on a going concern basis. The property, rights and liabilities of the DGWS were transferred to Ofwat under a transfer scheme.

Roles and responsibilities

We are a non-ministerial government department with our own resource estimate. The Director General, and in future the Chief Executive carries the responsibilities of the Accounting Officer; supported by the Director of Operations who is the Finance Director. The Director General presented his last annual report to Parliament on the performance of the office on 11 May 2006 (HC1058).

Non-executive advisory directors

The Director General was supported by the Ofwat advisory board which included four non-executive advisory directors (NEADs). The NEADs' responsibilities included chairing and membership of the Audit Committee, DG Remuneration Committee and membership of the Senior Civil Service and Staff Remuneration Committees. The NEADs for the period were:

John Baker CBE

Chairman of Globeleq, Renewable Energy Holdings plc and the Maersk Company. Chairman of the Senior Salaries Review Body and the Associated Board of the Royal Schools of Music. Chief Executive (1989-95) and Chairman (1995-97) of National Power plc.

Jane May

Non-executive board member of the Office of Rail Regulation; non-executive director of the Public Guardianship Office and SITA Trust. Formerly Customer Service Director, Thames Water (1994-2000) and Freeman's Customer Relations Director (1992-94).

Roger Munson OBE

Formerly member of the Competition Commission (1996-2003); previously partner, Coopers & Lybrand.

Martin Cave

Professor and Director, Centre for Management under Regulation, Warwick Business School, University of Warwick; formerly Professor of Economics and Vice-Principal, Brunel University.

These appointments ended 31 March 2006, with the exception of Jane May who was appointed on 1 April 2006 as a member of Water Services Regulation Authority.

Audit Committee

Our financial and risk management systems and reports are scrutinised by the Audit Committee. Members of the committee in 2005-06 were John Baker (Chairman) and Roger Munson, both non-executive advisory directors. The NAO, internal audit (KPMG Audit PLC), the Director General and senior finance staff attend the committee. The committee met three times during the year.

The members of the Audit Committee in 2006-07 will be Peter Bucks (Chairman) and Lord Whitty (non executive directors).

Equal opportunities policy

We recruit staff on merit through fair and open competition. This ensures equal opportunity for employment, regardless of race, colour, nationality or ethnic or national origin, sex, sexual orientation, age, marital status, disability, religion or working pattern. All recruitment activity is subject to audit by the Civil Service Commissioners to ensure that we comply with the guidance set out in its recruitment code.

Employee involvement

We attach great importance to managing, developing and training our staff in accordance with best practice. We have a staff committee, which is consulted on a range of issues including our forward programme. Ofwat is an accredited Investor in People organisation.

Payment of suppliers

We achieved 99.1 per cent against the Government target for paying agreed invoices within 30 days of receipt during 2005-06. We are committed to achieving the 100 per cent target. The corresponding figure for 2004-05 was 99.4 per cent.

Internal audit

KPMG provide our internal audit service. The service provides an independent appraisal service for management by measuring and auditing the adequacy, reliability and effectiveness of management and financial control systems. KPMG make recommendations based on the appraisal of each system reviewed.

External audit

Our external auditor is the Comptroller and Auditor General (C&AG) who is required to audit the financial statements under the Government Resources and Accounts Act 2000 and HM Treasury directions and report to Parliament on his examination. So far as the Accounting Officer is aware, there is no relevant audit information of which the auditors are unaware. The Accounting Officer has taken all the steps that he ought to have taken to make himself aware of any relevant audit information and to establish that the auditors are aware of that information.

The notional cost of this service is £32,000, which has been met by a non-cash adjustment to the General Fund.

There was no non-audit work completed for the period 1 April 2005 to 31 March 2006.

The future

The Ofwat forward programme 2006-07 to 2008-09 was approved by the new board in June 2006. The forward programme aims to maintain stability and consistency of approach through the period of organisational change. The forward programme set out a broad range of objectives covering emerging strategic issues, protecting customers, company finance, market competition and corporate governance.

Philip Fletcher
Accounting Officer

17 July 2006

Remuneration Report

Senior management team

The composition of the senior management team in the reporting period was as follows:

Philip Fletcher*	Director General
Bill Emery* (Left 18 September 05)	Director of Costs and Performance and Chief Engineer
Roger Dunshea*	Director of Operations
Melinda Acutt* (Appointed 3 January 06)	Director of Network Regulation
Tony Smith* (Left 30 November 05)	Director of Competition and Consumer Affairs
Keith Mason*	Director of Regulatory Finance and Competition
Huw Brooker	Legal Adviser
Fiona Pethick	Head of Corporate Affairs
Sue Cox (Appointed 1 December 05)	Acting Head of Consumer Affairs

*denotes Advisory Board member.

The Director General was appointed on 1 August 2000 by the Secretary of State for the Environment, Transport and the Regions under section 1 of the Water Industry Act 1991. The Director General's remuneration was agreed as part of his employment contract. Annual increases were decided by the DG Remuneration Committee based on performance assessment analogous to that of Permanent Secretaries. His contract finished on 31 March 2006. The contracts of other members of the senior management team can be terminated by the standard process as set out in the Civil Service Management Code.

Members of the senior management team are members of the Senior Civil Service (SCS) and are appraised and remunerated, including performance pay in line with SCS requirements. Details of remuneration are included in the tables below. Senior managers are employed by Ofwat, of these two have been appointed to the WSRA.

Senior managers and board members have declared that they held no company directorships or other significant interests that might have caused a conflict with their Ofwat responsibilities.

Tony Smith, former Director of Competition and Consumer Affairs, was appointed as Chief Executive of CCWater from 1 December 2005.

Philip Fletcher (Chairman), Keith Mason and Melinda Acutt (executive directors) have been appointed to the Ofwat Board from 1 April 2006. The other appointments as non executive directors are Peter Bucks, Lord Whitty, Penny Boys and Jane May. Regina Finn, the new Chief Executive will join in October.

Staff remuneration

A performance related pay (PRP) system applies to all other staff. NEADs provide independent scrutiny covering the overall performance of the office and the consistency and fairness of the PRP process.

The total PRP available is the agreed percentage of the sum of the salaries of staff in post at 31 July. PRP is determined by the appraisal system. It is awarded as a percentage increase in basic salary.

Staff salaries are set on the basis of recruiting and retaining high calibre staff within the framework of controlling public expenditure set by the Government. Members of the SCS receive increases in line with Senior Salaries Review Body guidance agreed by the SCS Remuneration Committee. The Staff Remuneration Committee determines pay awards for the rest of the office.

Remuneration committee members**Staff remuneration Committee**

During the year members of the SCS and staff remuneration committees were:

Philip Fletcher CBE (Chair)
Jane May
Roger Munson OBE

DG remuneration Committee

During the year members of the DG remuneration committee were:

John Baker CBE (Chair)
Jane May
Roger Munson OBE
Martin Cave

Pension liabilities

The main pension scheme for Ofwat staff is the Principal Civil Service Pension Scheme (PCSPS). This is a defined benefit, unfunded scheme. The payment of benefits from the scheme are borne by the Civil Service Superannuation Vote. The pension liabilities arising from Ofwat's employees' membership of the PCSPS are not provided for in these accounts in accordance with HM Treasury's instructions and as described below.

Full provision has been made in the accounts for by-analogy pension schemes for both the former Directors General pensions as required by HM Treasury. Claims are made on the Exchequer to cover the pension costs that relate to employment other than with Ofwat.

Exgratia Payments

A gross payment of £40,428 was made to Philip Fletcher, the former Director General in recognition of tax benefits lost because of delays by Defra in approving his by-analogy pension scheme.

In accordance with the agreement with Defra and HM Treasury this sum and resulting employers national insurance has been reimbursed to Ofwat by Defra and the payment to Philip Fletcher, the former Director General has been invested in his pension scheme.

Senior Managers' Remuneration

	2005-06		2004-05	
	Salary £000	Benefits in kind (to nearest £100)	Salary £000	Benefits in kind (to nearest £100)
Philip Fletcher CBE <i>Director General of Water Services</i>	175-180	–	160-165	–
Bill Emery <i>Director of Costs and Performance</i> <i>(Left 18 September 2005)</i>	50-55 (full year equivalent 105-110)	–	100-105	–
Roger Dunshea <i>Director of Operations</i>	95-100	–	90-95	–
Melinda Acutt <i>Director of Network Regulation</i> <i>(Appointed 3 January 2006)</i>	20-25 (full year equivalent 85-90)	–	–	–
Tony Smith <i>Director of Competition and Consumer Affairs</i> <i>(Left 30 November 2005)</i>	65-70 (full year equivalent 95-100)	–	90-95	–
Keith Mason <i>Director of Regulatory Finance and Competition</i>	95-100	–	85-90	–
Huw Brooker <i>Legal Adviser</i>	80-85	–	65-70	–
Julia Havard <i>Head of External Relations</i> <i>(Left 7 January 2005)</i>	0-5	–	45-50 (full year equivalent 60-65)	–
Fiona Pethick <i>Head of Corporate Affairs</i>	75-80	–	10-15 (full year equivalent 75-80)	–
Sue Cox <i>Acting Head of Consumer Affairs</i> <i>(Appointed 1 December 2005)</i>	20-25 (full year equivalent 65-70)	–	–	–

	2005-06		2004-05	
	Salary £000	Benefits in kind (to nearest £100)	Salary £000	Benefits in kind (to nearest £100)
Non executive advisory directors (NEADs)				
John Baker CBE	10-15	–	10-15	–
Martin Cave	10-15	–	10-15	–
Jane May	10-15	–	10-15	–
Roger Munson OBE	10-15	–	10-15	–

Salary

"Salary" covers both pensionable and non-pensionable amounts and includes gross salary; performance pay or bonuses; overtime; recruitment and retention allowances; private office allowances and any other allowance to the extent that it is subject to UK taxation.

Benefits in kind

The monetary value of benefits in kind covers any benefits provided by the employer and treated by the HM Revenue and Customs as a taxable emolument.

Senior Managers' Pension Benefits

Officials

	Real increase in pension and related lump sum at age 60	Accrued pension at age 60 at 31 March 2006 and related lump sum	CETV at 31 March 2006	CETV at 31 March 2005	Real increase in CETV	Employer contribution to partnership pension account
	£000	£000	£000	£000	£000	Nearest £100
Philip Fletcher CBE Director General of Water Services (see Note 14)	n/a	n/a	n/a	n/a	n/a	–
Bill Emery Director of Costs and Performance (Left 18 September 2005)	0-5: lump sum 0-5	35-40: lump sum 115-120	820	649	24	–
Roger Dunshea Director of Operations	0-5: lump sum 0-5	25-30: lump sum 80-85	494	375	26	–
Melinda Acutt Director of Network Regulation (Appointed 3 January 2006)	0-5	0-5	4	-	3	–
Tony Smith Director of Competition and Consumer Affairs (Left 30 November 2005)	0-5	0-5	57	31	13	–
Keith Mason Director of Regulatory Finance	0-5: lump sum 5-10	10-15: lump sum 40-45	240	165	30	–
Huw Brooker Legal Adviser	0-5	5-10	79	43	18	–
Fiona Pethick Head of Corporate Affairs	0-5: lump sum 5-10	20-25: lump sum 60-65	350	250	31	–
Sue Cox Acting Head of Consumer Affairs (Appointed 1 December 2005)	0-5: lump sum 0-5	15-20: lump sum 35-40	223	190	25	–

The factors used to calculate the Cash Equivalent Transfer Value (CETV) were revised on 1 April 2005 on the advice of the Scheme Actuary. The CETV figure for 31 March 2005 has been restated using the factors so that it is calculated on the same basis as the CETV figure for 31 March 2006.

Civil Service Pensions

Pension benefits are provided through the CSP arrangements. From 1 October 2002, civil servants may be in one of three statutory based 'final salary' defined benefit schemes (classic, premium, and classic plus). The Schemes are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under classic, premium, and classic plus are increased annually in line with changes in the Retail Prices Index. New entrants after 1 October 2002 may choose between membership of premium or joining a good quality 'money purchase' stakeholder arrangement with a significant employer contribution (partnership pension account).

Employee contributions are set at the rate of 1.5 per cent of pensionable earnings for classic and 3.5 per cent for premium and classic plus. Benefits in classic accrue at the rate of 1/80th of pensionable salary for each year of service. In addition, a lump sum equivalent to three years' pension is payable on retirement. For premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike classic, there is no automatic lump sum (but members may give up (commute) some of their pension to provide a lump sum). Classic plus is essentially a variation of premium, but with benefits in respect of service before 1 October 2002 calculated broadly as per classic.

The partnership pension account is a stakeholder pension arrangement. The employer makes a basic contribution of between 3 per cent and 12.5 per cent (depending on the age of the member) into a stakeholder pension product chosen by the employee. The employee does not have to contribute but where they do make contributions, the employer will match these up to a limit of 3 per cent of pensionable salary (in addition to the employer's basic contribution). Employers also contribute a further 0.8 per cent of pensionable salary to cover the cost of centrally-provided risk benefit cover (death in service and ill health retirement).

Further details about the CSP arrangements can be found at the website www.civilservice-pensions.gov.uk

Cash Equivalent Transfer Values (CETV)

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies. The CETV figures, and from 2003-04 the other pension details, include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the CSP arrangements and for which the CS Vote has received a transfer payment commensurate to the additional pension liabilities being assumed. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost. CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries.

Real increase in CETV

This reflects the increase in CETV effectively funded by the employer. It takes account of the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

Philip Fletcher
Accounting Officer

17 July 2006

Statement of Accounting Officer's responsibilities

Under the Government Resources and Accounts Act 2000, HM Treasury has directed Ofwat to prepare for each financial year resource accounts detailing the resources acquired, held, or disposed of during the year and the use of resources by the department during the year. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of Ofwat and its net resource outturn, resources applied to objectives, recognised gains and losses, and cash flows for the financial year.

In preparing the accounts, the Accounting Officer is required to comply with the Government Financial Reporting Manual, and in particular to:

- observe the Accounts Direction issued by HM Treasury including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards, as set out in the *Government Financial Reporting Manual* have been followed, and disclose and explain any material departures in the accounts; and
- prepare the accounts on a going-concern basis.

HM Treasury appointed Philip Fletcher Accounting Officer of Ofwat under his capacity of Director General of Water Services. On the formation of the Water Services Regulation Authority he has remained as Accounting Officer in his capacity as Chairman and acting Chief Executive. These responsibilities will transfer to the permanent Chief Executive once she takes up post.

The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding Ofwat's assets, are set out in the Accounting Officers' Memorandum issued by HM Treasury and published in *Government Accounting*.

Philip Fletcher
Accounting Officer

17 July 2006

Statement on internal control 2005-06

1. Scope of responsibility

I was the Accounting Officer during 2005-06 and I am the interim Accounting Officer for the new organisation until the appointment of the Chief Executive.

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of Ofwat's policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in *Government Accounting*. My Accounting Officer responsibilities will be transferred to the permanent Chief Executive of Ofwat, when she takes up post.

We have over the past year further developed our risk management procedures with regular reports to our Audit Committee and Board. The Audit Committee members were drawn from the non-executive advisory directors of the Board. The Audit Committee of the Water Services Regulation Authority is also drawn from its non-executive membership.

The duties and governance of Ofwat is laid down by legislation, in particular the Water Industry Act 1991 and the Water Act 2003. Any future changes require an act of Parliament. Currently there is no further legislation under consideration that could affect its longer term position.

2. The purpose of the system of internal control

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness.

The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of departmental policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place in Ofwat for the year ended 31 March 2006 and up to the date of approval of the annual report and accounts, and accords with HM Treasury guidance.

3. Capacity to handle risk

Risk management is a shared responsibility across all Ofwat's senior managers. During the period, we revised and updated the risk registers. The Ofwat Advisory Board, Management Committee and Audit Committee received reports summarising key messages from the risk registers and commentaries on our assurance activities. Risk assessment is embedded into the work of the office. Senior managers, and their staff, are committed to managing risk. Our approach is reviewed in regular reports to the Ofwat Board, Management Committee and Audit Committee.

Our policy consultation documents include as required, regulatory impact assessments. These routinely include reference to the need to minimise risk and uncertainty to water companies, investors and customers.

4. The risk and control framework

The Ofwat Board reviewed the risk framework in November 2005 with a view to providing a concise explanation of the key risks faced by Ofwat, how they are managed and who is responsible. The framework is based on HM Treasury standard guidance in the Orange book. The key elements are:

- Risk ownership responsibilities have been clearly allocated from the Accounting Officer and board to all members of staff;

- Risk appetite is balanced proportionately between threats, opportunities and resources and factors such as desired outcomes and maintenance of reputation;
- Potential risk areas have been identified with mitigating actions for areas such as decision taking, failure in quality assurance, inability to recruit the right staff, failure in business continuity, breaches of security, financial procedures and corporate governance;
- Annual risk management workshops are held within each division;
- Risk registers are updated regularly and at least every six months and reports prepared for Management and Audit Committees; and
- Actions are followed up from internal audit studies.

Particular risks were addressed during the year in respect of organisational change in respect of the establishment of CCWater on 1 October 2005 and the formation of the Water Services Regulation Authority from 1 April 2006. Both were project managed with clear milestones, budgets and deliverables.

The CCWater project was led by the Chair Designate and membership included the Ofwat Director of Finance. Similar arrangements were made for the formation of the Water Services Regulation Authority with activities including the review of governance procedures, ensuring a smooth transition and providing information to stakeholders.

5. Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within Ofwat who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Board, the Audit Committee and a plan to address weaknesses and ensure continuous improvement of the system is in place.

Annually, we consult on and publish our forward programme. This sets out our high level objectives for the coming financial year plus a look forward to the following two years. The forward programme drives divisional plans and ultimately each member of staff's objectives. On a monthly basis the Management Committee reviews progress against key outputs and projects. There is also a quarterly assessment of achievement of the forward programme objectives. In addition to this, I carry out annual divisional performance reviews. We have in place a process of individual performance review for staff. On a regular basis, the resource requirements for Ofwat are assessed against the forward programme and developing priorities. The non-executive advisory directors also provide an independent view to me on our performance. In May 2006 Ofwat laid its annual report for 2005-06 before Parliament.

The Ofwat Board, Management Committee and Audit Committee regularly assess and monitor our performance and related systems of internal control. Our internal auditors, KPMG, review and advise on our risk management processes and internal controls and have reviewed systems and procedures in respect of finance, human resources and IT systems.

KPMG operate to standards defined in the Government's Internal Audit Standards and submit regular reports, which include an independent opinion by the Head of Internal Audit on the adequacy and effectiveness of our system of internal control together with recommendations for improvement.

Philip Fletcher
Accounting Officer

17 July 2006

The Certificate and Report of the Comptroller and Auditor General to the House of Commons

I certify that I have audited the financial statements of the Office of Water Services for the year ended 31 March 2006 under the Government Resources and Accounts Act 2000. These comprise the Statement of Parliamentary Supply, the Operating Cost Statement and Statement of Recognised Gains and Losses, the Balance Sheet, the Cashflow Statement and the Statement of Operating Costs by Departmental Aim and Objectives and the related notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Accounting Officer and auditor

The Accounting Officer is responsible for preparing the Annual Report and the financial statements in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions made thereunder and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's Responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited has been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I also report to you if, in my opinion, the Annual Report is not consistent with the financial statements, if the Department has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by HM Treasury regarding remuneration and other transactions is not disclosed.

I review whether the statement on pages 15 to 16 reflects the Department's compliance with HM Treasury's guidance on the Statement on Internal Control, and I report if it does not. I am not required to consider whether the Accounting Officer's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Department's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Introduction and Aims and Objectives, Management Commentary and the unaudited part of the Remuneration Report. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Department's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error and that in all material respects the

expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

Opinion

In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by HM Treasury, of the state of the Department's affairs as at 31 March 2006 and the net cash requirement, net resource outturn, resources applied to objectives, recognised gains and losses and cashflows for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000; and
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.

John Bourn
Comptroller and Auditor General

National Audit Office
157-197 Buckingham Palace Road
Victoria
London SW1W 9SP

18 July 2006

Statement of Parliamentary Supply*Summary of Resource Outturn 2005-06*

	2005-06						Net total outturn compared with estimated saving/ (excess) £000	2004-05 Outturn (Restated) Net Total £000
	Estimate			Outturn				
	Gross expenditure £000	A in A £000	Net Total £000	Gross expenditure £000	A in A £000	Net Total £000		
Request for resources 1: Regulation of the Water Industry	12,101	(12,098)	3	10,571	10,571	-	3	-
Total resources	12,101	(12,098)	3	10,571	10,571	-	3	-
Non operating cost A in A	-	-	-	-	-	-	-	-

Net cash requirement 2005-06

	Note	2005-06			2004-05 Outturn (Restated) Outturn £000
		Estimate	Outturn	Net total outturn compared with estimated saving/ (excess) £000	
		£000	£000	£000	
Net cash requirement	3	507	40	467	38

Summary of income payable to the Consolidated Fund

In addition to appropriations in aid the following income relates to Ofwat and is payable to the Consolidated Fund (*cash receipts being shown in italics and figures in thousands*).

	Note	Forecast 2005-06		Outturn 2005-06	
		Income	<i>Receipts</i>	Income	<i>Receipts</i>
Total	4	-	-	1,163	1,163

Explanations of variances between Estimate and outturn are given in the Management Commentary.

The notes on pages 24 to 39 form part of these accounts.

Operating Cost Statement
for the year ended 31 March 2006

		2005-06			2004-05 (restated)
	Note	Staff Costs £000	Other Costs £000	Income £000	£000
Administration costs:					
Request for Resources 1:					
Staff costs	6	6,896	–	–	7,033
Other administration costs	7	–	3,675	–	4,163
Operating income	8	–	–	(10,571)	(11,196)
Totals		6,896	3,675	(10,571)	–
Net Operating Cost	2			–	–

All income and expenditure are derived from continuing operations

Statement of Recognised Gains and Losses
for the year ended 31 March 2006

	2005-06	2004-05 (restated)
	£000	£000
Net gain on revaluation of tangible fixed assets	5	4
Net gain/(loss) on revaluation of intangible fixed assets	–	–
Actuarial loss	(80)	(519)
Change in real discount rate	(171)	–
Recognised gains and losses for the financial year	(246)	(515)

The notes on pages 24 to 39 form part of these accounts.

Balance Sheet*as at 31 March 2006*

	Note	£000	31 March 2006 £000	31 March 2005 (restated) £000
Fixed Assets				
Tangible assets	9	358		715
Intangible assets	10	48		54
			406	769
Current assets:				
Debtors	11	313		402
Cash at bank and in hand	12	1,163		420
		1,476		822
Creditors (amounts falling due within one year)	13	(3,080)		(1,754)
Net current liabilities			(1,604)	(932)
Total assets less current liabilities			(1,198)	(163)
Provision for liabilities and charges	14		(39)	(49)
Total net liabilities excluding pension liabilities			(1,237)	(212)
Pension liabilities	14		(2,542)	(2,123)
Total net liabilities including pension liabilities			(3,779)	(2,335)
Taxpayers' equity:				
General Fund	15		(3,811)	(2,363)
Revaluation reserve	16		32	28
			(3,779)	(2,335)

Philip Fletcher
Accounting Officer

17 July 2006

The notes on pages 24 to 39 form part of these accounts.

Cash Flow Statement*for year ended 31 March 2006*

		2005-06	2004-05
	Note	<u>£000</u>	<u>(restated)</u> £000
Net cash inflow from operating activities			
Capital expenditure and financial investment	17a	1,097	472
Receipts due to the Consolidated Fund which are outside the scope of the Departments activities	17b	(39)	(64)
Payments due to the Consolidated Fund	17d	–	–
Financing	17c	(420)	(1,099)
		<u>105</u>	<u>817</u>
Increase/(decrease) in cash for the period		<u>743</u>	<u>126</u>

Statement of Operating Costs by Departmental Aim and Objectives

Aim	2005-06			2004-05 (restated)		
	Gross	Income	Net	Gross	Income	Net
	£000	£000	£000	£000	£000	£000
Objective 1	2,093	-	-	896	-	-
Objective 2	4,557	-	-	1,523	-	-
Objective 3	951	-	-	6,337	-	-
Objective 4	2,970	-	-	2,440	-	-
Net operating costs	10,571	(10,571)	-	11,196	(11,196)	-

Ofwat's objectives were as follows:

- Objective 1 To assess and report on each company's progress towards improving water and environmental quality, security of supply.
- Objective 2 To monitor and report on company efficiency, regulatory accounts and take action as required.
- Objective 3 To carry out an independent review of the 2004 Price Review and consider recommendations for the future.
- Objective 4 To promote effective competition and approving tariffs.

Note:

Income received from licence fees and publications is not specific to one objective but applies to all regulatory objectives.

Direct costs are identified for each objective through the activity costing system. Overheads are apportioned to the objectives on the basis of direct costs.

Ofwat's capital is employed exclusively for administration purposes and supporting our regulatory functions. Its distribution between objectives is therefore not markedly different from the related gross administration cost.

Notes to the departmental resource accounts

1. Statement of accounting policies

The financial statements have been prepared in accordance with the 2005-06 *Government Financial Reporting Manual (FReM)* issued by HM Treasury. The accounting policies contained in the FReM follow UK generally accepted accounting practice for companies (UK GAAP) to the extent that it is meaningful and appropriate to the public sector.

In addition to the primary statements prepared under UK GAAP, the FReM also requires Ofwat to prepare two additional primary statements. *The Statement of Parliamentary Supply* and supporting notes show outturn against Estimate in terms of the net resource requirement and the net cash requirement. The *Statement of Operating Cost by Departmental Aim and Objectives* and supporting notes analyses Ofwat's income and expenditure by the objects agreed with Ministers.

Where the FReM permits a choice of accounting policy, the accounting policy which has been judged to be most appropriate to the particular circumstances of Ofwat for the purpose of giving a true and fair view has been selected. Ofwat's accounting policies have been applied consistently in dealing with items considered material in relation to the accounts.

1.1 Accounting convention

These accounts have been prepared under the historical cost convention modified to account for the revaluation of fixed assets at their present value to the business by reference to their current costs.

1.2 Fixed assets

Tangible and intangible assets have been stated at current cost using indices provided by the Valuation Office Agency.

Tangible fixed assets consist of furniture and fittings, office machinery, website development costs, IT and telecommunications equipment. Intangible fixed assets comprises of purchased software licences.

With the exception of PCs and office furniture, individual assets must exceed a capitalisation threshold of £1,000 for inclusion as fixed assets. PCs and office furniture items falling below the threshold are capitalised as groups. A threshold of £250 exists for individual items to be classified as grouped fixed assets.

1.3 Depreciation and amortisation

Depreciation is provided at rates calculated to write-off the value of tangible fixed assets by equal instalments over their estimated useful lives, to their estimated residual values. Asset lives are within the following ranges:

Asset classification	Asset life
Furniture, fixtures and fittings	10 years
IT equipment and website development costs	4-5 years
Office machinery	5 years
Telecommunications	5 years

Software licences and bespoke software are amortised over the shorter of the term of the licence or the useful economic life from the date the asset is brought into service.

1.4 Leases

Ofwat had no finance leases as at 31 March 2006 (31 March 2005: nil). Rentals due under operating leases are charged over the lease term on a straight-line basis or on the basis of actual rental payable where this fairly reflects usage.

1.5 Research and development

Expenditure on research is not capitalised. Expenditure on development in connection with a product or service which is to be supplied on a full cost recovery basis is capitalised if it meets those criteria specified in SSAP 13. Other development expenditure is capitalised if it meets the criteria specified in the FReM which are adapted from SSAP 13 to take account of the not-for-profit context. Expenditure which does not meet the criteria for capitalisation is treated as an operating cost in the year in which it is incurred. Fixed assets acquired for use in research and development are depreciated over the life of the associated project, or according to the asset category if the asset is to be used for subsequent production work.

1.6 Operating income

Operating income is income that relates directly to our operating activities. It consists, primarily of licence fees charged on a full cost recovery basis. There is also a small amount of operating income recovered from CCWater in respect of the Service Level Agreements we hold with them for provision of support services.

Since all costs are recovered via the licence fees, and are invoiced in advance based on estimated costs, any income from licence fees that exceeds the level of operating costs is treated as deferred income. This is taken into account when calculating the future level of licence fees charged to the water and sewerage companies under the Water Industry Act 1991.

1.7 Administration and programme expenditure

Administration costs are recorded in the operating cost statement. They include the costs of running Ofwat, as defined under the administration cost-control regime, together with associated operating income. There was no programme expenditure between 1 April 2005 to 31 March 2006 (2004-05: £nil).

1.8 Capital charge

A charge, reflecting the cost of capital utilised by Ofwat, is included in operating costs. The charge is calculated at the real rate set by HM Treasury (currently 3.5 per cent) on the average carrying amount of all assets less liabilities, except for:

- a Cash balances with the Office of the Paymaster General, where the charge is nil;
- b Consolidated Fund creditors, where the credit is nil.

1.9 Pensions

The majority of past and present employees are covered by the provisions of the Principal Civil Service Pension Schemes (PCSPS). The defined benefit schemes are unfunded and are non-contributory except in respect of dependant's benefits. Ofwat recognises the expected cost of these elements on a systematic and rational basis over the period during which it benefits from employees' services by payment to the PCSPS of amounts calculated on an accruing basis. Liability for payment of future benefits is a charge on the PCSPS. In respect of the defined contribution schemes, Ofwat recognises the contributions payable for the year.

The current and retired Director Generals are covered by 'by-analogy pension schemes' that offer similar benefits to the PCSPS. However, unlike the PCSPS a pension liability is included in the accounts as required by FRS17.

1.10 Value Added Tax

Most of our activities are outside the scope of VAT and, in general output tax does not apply and input tax on purchases is not recoverable. Irrecoverable VAT is charged to the relevant expenditure category or included in the capitalised purchase cost of fixed assets. Where output tax is charged or input VAT is recoverable, the amounts are stated net of VAT.

1.11 Comparative amounts and treatment of WaterVoice

CCWater came into being on 1 October 2005 and took on the functions and activities of WaterVoice, which was part of Ofwat. Comparative amounts have been restated for the removal of WaterVoice amounts, which have been disclosed as comparatives in CCWater's financial statements for 2005-06.

Merger accounting has been applied and the income, expenditure, assets and liabilities of WaterVoice for the six months ended 30 September 2005 have been accounted for in CCWater's financial statements for 2005-06.

1.12 Provisions

Ofwat provides for legal or constructive obligations which are of uncertain timing or amount at the balance sheet date on the basis of the best estimate of the expenditure required to settle the obligation. Where the effect of the time value of money is significant, the estimated risk-adjusted cash flows are discounted using the HM Treasury discount rate.

On 1 April 2005 the discount rate changed from 3.5 per cent to 2.8 per cent per annum for pension scheme liabilities and from 3.5 per cent to 2.2 per cent for other provisions.

1.13 Contingent liabilities

In addition to contingent liabilities disclosed in accordance with FRS12, Ofwat discloses for parliamentary reporting and accountability purposes certain statutory and non-statutory contingent liabilities where the likelihood of a transfer of economic benefit is remote, but which have been reported to Parliament in accordance with the requirements of Government Accounting.

Where the time value of money is material, contingent liabilities which are required to be disclosed under FRS12 are stated at discounted amounts and the amount reported to Parliament separately noted. Contingent liabilities that are not required to be disclosed by FRS12 are stated at the amounts reported to Parliament.

1.14 Going concern

Our balance sheet at 31 March 2006 shows negative taxpayers' equity of £3.8m. This reflects the inclusion of liabilities falling due in future years, which are to be financed mainly by drawings from the Consolidated Fund. Such drawings will be from grants of supply approved annually by Parliament, to meet our net cash requirement. Under the Government Resources and Accounts Act 2000, no money may be drawn from the Fund other than that required for the specified year or retained in excess of that need. All unspent monies, including those derived from the department's income, are surrenderable to the Fund.

In common with other government departments, the future financing of our liabilities is met by future grants of supply and the application of future income, both are approved annually by Parliament. There is no reason to believe that future approvals will not be forthcoming.

The accounts for 2005-06 have been prepared on a going concern basis. The property, rights and liabilities of the Director General of Water Services have been transferred to the Water Services Regulation Authority (Ofwat) under a transfer scheme.

2. Reconciliation of outturn to net operating cost and against Administration Budget

2(a) Reconciliation of net resource outturn to net operating cost

	2005-06		Outturn compared with Estimate	2004-05
	Outturn	Supply Estimate		(restated)
	£000	£000	£000	Outturn £000
Net Resource Outturn	-	3	3	-
Non-supply income (CFERs)	-	-	-	-
Net operating cost	-	3	3	-

2(b) Outturn against final administration budget

	2005-06		2004-05	
	Budget	Outturn	Budget	Outturn
	£000	£000	£000	£000
Gross Administration Budget	12,101	10,571	11,402	11,196
Income allowable against the Administration Budget	(12,098)	(10,571)	(11,400)	(11,196)
Net outturn against final Administration Budget	3	-	2	-

3. Reconciliation of resources to cash requirement

	Note	Estimate	Outturn	Net total outturn compared with estimate saving/ (excess)
		£000	£000	
Resource Outturn	2	3	-	3
Capital				
Acquisition of fixed assets	9,10	400	39	361
Investments		-	-	-
Non-operating A in A		-	-	-
Proceeds of fixed assets disposals		-	-	-
Accruals adjustments				
Non-cash items	7	(574)	(471)	(103)
Non cash items (staff)	17a	-	(41)	41
Pension contributions	17c	-	(65)	65
Changes in working capital other than cash	17a	580	(672)	1,252
Changes in creditors falling due after more than one year	13	-	-	-
Use of provision	14	100	87	13
Excess cash to be surrendered to the Consolidated Fund	4	-	1,163	(1,163)
Adjustment to remove token vote increase		(2)	-	(2)
Net cash requirement		507	40	467

The token vote increases by one for each supplementary estimate submitted to HM Treasury. The explanation of the variance between the outturn net cash requirement and the Estimate can be found in the Management Commentary.

4. Analysis of income payable to the Consolidated Fund

In addition to appropriations in aid the following income relates to Ofwat and is payable to the Consolidated Fund.

	Note	Forecast 2005-06		Outturn 2005-06	
		Income	Receipts	Income	Receipts
		£000	£000	£000	£000
Excess cash surrenderable to the Consolidated Fund	12	–	–	1,163	1,163
Total income payable to the Consolidated Fund		–	–	1,163	1,163

5. Reconciliation of income recorded within the Operating Cost Statement to operating income payable to the Consolidated Fund.

	Note	2005-06	2004-05 (restated)
		£000	£000
Operating Income	8	10,571	11,196
Income authorised to be appropriated in aid	8	(10,571)	(11,196)
Operating Income payable to the Consolidated Fund		–	–

6. Staff numbers and related costs

Staff costs consist of:

	2005-06				2004-05 (restated)**
	Total	Permanently employed staff	Others	Non-exec advisory directors	Total
	£000	£000	£000	£000	£000
Wages and salaries	5,464	5,197	208	59	5,842
Social security costs	414	409	–	5	463
Other Pension costs	1,027	1,027	–	–	728
Sub Total	6,905	6,633	208	64	7,033
Less recoveries in respect of outward secondments	(9)	(9)	–	–	–
Total Net Costs*	6,896	6,624	208	64	7,033

* Of the total no charge has been made to capital.

** Staff costs for 2004-05 reduced by cost of provision of services to WaterVoice (£200k).

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded multi-employer defined benefit scheme but Ofwat is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out as at **31 March 2003**. Details can be found in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice-pensions.gov.uk).

For 2005-06, employer's contributions of £985,644 were payable to the PCSPS (2004-05: £751,795) at one of four rates in the range 16.2 to 24.6 per cent (2004-05: 12 to 18.5 per cent) of pensionable pay, based on salary bands. The scheme's Actuary reviews employer contributions every four years following a full scheme valuation. The salary bands and contribution rates were revised for 2005-06.

From 2006-07 the salary bands will be revised and the rates will be in a range between 17.1 per cent and 25.5 per cent. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme.

Employees can opt to open a **partnership** pension account, a stakeholder pension with an employer contribution. Employers' contributions of £4,687 for 2005-06 (2004-05: £14,935) was paid to one or more of a panel of four appointed **stakeholder** pension providers. Employer contributions are age-related and range from 3 to 12.5 per cent (2004-05: 3 to 12.5 per cent) of pensionable pay. Employers also match employee contributions of up to 3 per cent of pensionable pay. In addition, employer contributions of £180, 0.8 per cent (2004-05: £828, 0.8 per cent) of pensionable pay, were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service and ill health retirement of these employees.

Other pension costs include amounts paid to the by analogy pension scheme for Philip Fletcher.

Contributions due to the **partnership** pension providers at the balance sheet date were nil.

Contributions prepaid at that date were nil.

Average numbers of people employed

The average number of whole-time equivalent persons employed during the year was as follows.

Objective	2005-06				2004-05 (restated)
	Total	Permanent staff	Others	Non-exec advisory directors	Total
1	48	46	2	0	25.5
2	78	74.5	3	0.5	27
3	16.5	15.5	1	0	107
4	45.5	43	2.5	0	40.5
Total	188	179	8.5	0.5	200

7. Other Administration Costs

	2005-06 Outturn	2004-05 (restated)
	£000	£000
Rentals under operating leases:		
Accommodation	873	789
Office equipment	49	53
	922	842
Non cash items:		
Depreciation	349	374
Amortisation	14	14
Loss on disposal of fixed asset	1	131
Cost of Capital Charges	(107)	(53)
Other Finance costs	125	57
Unwinding of discount on provisions	-	1
Overnight change to provision	1	-
External Auditors' remuneration	32	22
Provision provided for in year	13	315
Permanent diminution of fixed assets	43	35
	471	896
Other expenditure:		
Consultancy services	803	825
Training	104	105
Travel and subsistence	127	99
Rates	171	161
Computer hire and maintenance	190	144
Other hire and maintenance	22	29
Seminars, meetings and conferences	66	47
Publications	100	201
Books and periodicals	128	167
Postal services and couriers	28	51
Telecommunications	41	65
Recruitment costs	112	52
Accommodation expenses	156	204
Internal Audit fees	40	33
Other	194	242
	2,282	2,425
Total	3,675	4,163

Other expenditure for 2004-05 reduced by cost of provision of support services to WaterVoice (£100k).
During the year there was no remuneration for non-audit work.

8. Income

This note analyses the income recorded in the Operating Cost Statement.

	2005-06 Outturn	2004-05 (restated)
	£000	£000
Licence fees	10,738	10,547
Licence fees received in advance – prior year	893	1,533
Licence fees received in advance – current year	(1,329)	(893)
Publication sales	4	6
CCWater administration support fees	266	–
Miscellaneous	11	3
Deferred income CCWater administration costs	(12)	–
Total	10,571	11,196

Ofwat provide support services to the CCWater under Service Level Agreements. These agreements cover service provisions of Information and Communications Technology, Library and Information, Finance, Facilities Management and Human Resources. An amount of £116,306 plus VAT was received for the provision of service from 1 October 2005 to 31 March 2006. An additional amount of £150,000 was retained in Licence Fees to cover the cost of provision of these services to WaterVoice during the period 1 April 2005 to 30 September 2005. Service level agreement for Information and Communications Technology to run until September 2006 and all other support services will be reviewed in December 2006.

Service Provided

	Amount Received	Actual cost of provision of service	Surplus (Deficit)
	£000	£000	£000
Information and Communications Technology	101	99	2
Library and Information	36	33	3
Finance	30	30	0
Facilities Management	30	19	11
Human Resources	69	73	(4)
Total for the year	266	254	12

9. Tangible fixed assets

Tangible fixed assets consist of furniture and fittings, office machinery, website development costs, IT and telecommunications equipment.

	Furniture fixtures and fittings	Office machinery	Tele- communications	IT equipment & website development costs	Total
	£000	£000	£000	£000	£000
Cost or valuation					
At 1 April 2005 (Restated)	260	115	102	1,622	2,099
Additions	4	–	–	20	24
Disposals	(4)	(1)	–	(1)	(6)
Revaluation	7	–	–	(58)	(51)
At 31 March 2006	267	114	102	1,583	2,066
Depreciation					
At 1 April 2005 (Restated)	177	103	102	1,002	1,384
Charged in year	17	5	–	327	349
Disposals	(3)	(1)	–	(1)	(5)
Revaluation	2	–	–	(22)	(20)
At 31 March 2006	193	107	102	1,306	1,708
Net book value at 31 March 2006	74	7	–	277	358
Net book value at 31 March 2005 Restated	83	12	–	620	715

10. Intangible fixed assets

Intangible fixed assets comprises of purchased software licences.

	Purchased Software Licences	Assets Under Development	Total
	£000	£000	£000
Cost or valuation			
At 1 April 2005 (Restated)	141	11	152
Additions	11	4	15
Disposals	–	–	–
Revaluation	(13)	–	(13)
At 31 March 2006	139	15	154
Amortisation			
At 1 April 2005 (Restated)	98	–	98
Charged in year	14	–	14
Disposals	–	–	–
Revaluation	(6)	–	(6)
At 31 March 2006	106	–	106
Net book value at 31 March 2006	33	15	48
Net book value at 31 March 2005 Restated	43	11	54

11. Debtors**11(a) Analysis by type**

	2005-06	2004-05 (restated)
	£000	£000
Amounts falling due within one year:		
Trade debtors	4	39
Deposits and advances	17	16
HM Revenue and Customs (VAT)	12	47
Prepayments and accrued income	280	300
Total debtors at 31 March 2006	313	402

11(b) Intra-Government Balances

	2005-06	2004-05 (restated)
	£000	£000
Amounts falling due within one year:		
Balances with other central government bodies	12	89
<i>Subtotal: intra-government balances</i>	12	89
Balances with bodies external to government	301	313
Total debtors at 31 March 2006	313	402

12. Cash at bank and in hand

	2005-06	2004-05 (restated)
	£000	£000
Balance at 1 April	420	294
Net change in cash balance:	743	126
Balance at 31 March	1,163	420
The following balances are held at :		
Office of HM Paymaster General (OPG)	1,161	419
Commercial banks and cash in hand	2	1
Balance at 31 March	1,163	420

13. Creditors**13(a) Analysis by type**

	2005-06	2004-05 (restated)
	£000	£000
Amounts falling due within one year:		
Trade creditors	55	222
Other creditors	197	-
VAT creditor	-	5
Accruals	169	55
Deferred Income	1,341	893
Other tax and social security	155	159
Excess cash due to be paid to the Consolidated Fund	1,163	420
	3,080	1,754

13(b) Intra-government balances

	2005-06	2004-05 (restated)
	£000	£000
Amounts falling due within one year:		
Balances with other central government bodies	1,527	420
<i>Subtotal:</i> intra-government balances	1,527	420
Balances with bodies external to government	1,553	1,334
Total creditors at 31 March 2006	3,080	1,754

14. Provision for liabilities and charges

	Early departure costs	Onerous leases	2005-06 Total
	£000	£000	£000
Balance at 1 April 2005	49	-	49
Provided in year	-	13	13
Overnight charge to provision	1	-	1
Provision utilised in year	(24)	-	(24)
Unwinding of discount	-	-	-
Balance at 31 March 2006	26	13	39

We meet the additional costs of benefits beyond the normal PCSPS benefits in respect of employees who retire early by paying the required amounts annually to the PCSPS over the period between early departure and normal retirement date. We provide for this in full when the early retirement programme becomes binding on us by establishing a provision for the estimated payments discounted by the HM Treasury discount rate of 2.2 per cent in real terms.

The discount rate changed from 3.5 per cent in 2004-05 to 2.2 per cent in 2005-06. This resulted in an overnight change to the provision.

The Onerous lease provision relates to a property previously occupied by WaterVoice that was not included in the transfer scheme to CCWater. This lease expires at 30 September 2006.

Pension liabilities

	2005-06 Total £000	2004-05 Total £000
Balance at 1 April 2005	2,123	460
Transfer from Department of Transport	–	763
Liability recognised in prior year creditors	–	40
Analysis of the amount charged to the Operating Cost Statement :		
Current service costs	41	13
Past service costs	–	128
Uplift of transfer value to reflect extra years	–	188
Interest cost	125	57
Employee contributions :		
Additional voluntary contributions	65	16
Benefits paid :		
Benefits paid	(63)	(61)
Analysis of the amount recognised in the STRGL :		
Experience losses	80	227
Change of discount rate	171	–
Actuarial loss	–	292
	2,542	2,123

The former Directors General are covered by 'by-analogy pension schemes' that offer similar benefits to the PCSPS. They are unfunded, defined benefit schemes with the benefits being paid as and when they fall due and are guaranteed by Ofwat. There is no fund and therefore no surplus or deficit.

Total liabilities for both schemes take into account that Ofwat is required to make full provision for pension benefits. This is a HM Treasury requirement even though 63 per cent and 84 per cent of the former Directors General pensions relates to employment prior to Ofwat and will be funded from the Exchequer. An actuarial valuation was carried out by the Government Actuary's Department (GAD) at 31 March 2006. The major assumptions used by the Actuary were:

	At 31 March 2006 % (per annum)	At 31 March 2005 % (per annum)
Inflation assumption	2.5	2.5
Rate of increase in salaries	4	4
Rate of increase for pensions in payment and deferred pensions	2.5	2.5
Rate used to discount scheme liabilities	5.4	6.1
Experience loss as percentage of total discounted scheme liabilities as at 31 March	3.1	10.7
Total actuarial loss as a percentage of total discounted scheme liabilities as at 31 March	3.1	24.5

Analysis of actuarial loss

	2005-06 £000	2004-05 £000
Experience gains/losses arising on the scheme liabilities	80	227
Changes in assumptions underlying the present value of scheme liabilities	–	292
Per statement of Recognised Gains and Losses	80	519

History of Experience losses

	2005-06	2004-05
	£000	£000
Experience gains/losses arising on the scheme liabilities		
Amount (£000)	80	227
Percentage of the present value of the scheme liabilities	3.1%	10.7%
Total amount recognised in statement of total recognised gains and losses		
Amount (£000)	251	519
Percentage of the present value of the scheme liabilities	3.1%	24.5%

The real discount rate changed from 3.5 per cent in 2004-05 to 2.8 per cent in 2005-06.

15. General Fund

The General Fund represents the total assets less liabilities of Ofwat, to the extent that the total is not represented by other reserves and financing items.

	2005-06	2004-05
	£000	(restated) £000
Balance at 1 April	(2,363)	(1,524)
Net Parliamentary Funding:		
Drawn Down	40	38
Net Transfer from Operating Activities	-	-
Excess cash repayable to Consolidated Fund	(1,163)	(420)
Non Cash Charges		
Cost of Capital	(107)	(53)
Auditors remuneration	32	22
Overnight Charge to provision		
Actuarial loss	(80)	(519)
Change in discount rate	(171)	-
Transfer from Revaluation Reserve	1	93
Balance at 31 March	(3,811)	(2,363)

16. Revaluation Reserve

The revaluation reserve reflects the unrealised element of the cumulative balance of indexation and revaluation adjustments.

	2005-06	2004-05
	£000	(restated) £000
Balance at 1 April	28	117
Arising on revaluation during the year (net)	5	4
Transferred to general fund of realised element of Revaluation reserve	(1)	(93)
Balance at 31 March	32	28

17. Notes to the Cash flow statement**17(a) Reconciliation of operating cost to operating cash flows**

	2005-06	2004-05 (restated)
Note	£000	£000
Net operating cost	2	-
Adjustments for non-cash transactions	7	(896)
Adjustment for non-cash transactions staff costs	14	(13)
Increase/(Decrease) in Debtors	11	(31)
<i>Less movements in debtors relating to items not passing through the OCS</i>	-	-
(Increase)/Decrease in Creditors	13	365
<i>Less movements in creditors relating to items not passing through the OCS</i>	-	-
Use of provisions	14	103
Net cash (inflow)/outflow from operating activities	(1,097)	(472)

17(b) Analysis of capital expenditure and financial investment

	2005-06	2004-05 (restated)
	£000	£000
Payments to acquire intangible fixed assets	15	35
Payments to acquire tangible fixed assets	24	29
Proceeds of disposal of fixed assets	-	-
Net cash outflow from investing activities	39	64

17(c) Analysis of financing

	2005-06	2004-05 (restated)
Note	£000	£000
From the Consolidated Fund (Supply) – current year	15	38
Transfer from Department for Transport (DfT) in respect of current DG pension	-	763
Pension Contributions	14	16
Advance from the Contingencies Fund	1,500	2,000
Repayment to the Contingencies Fund	(1,500)	(2,000)
Net financing	105	817

17(d) Reconciliation of Net Cash Requirement to increase in cash

	2005-06	2004-05 (restated)
Note	£000	£000
Net cash requirement	(40)	(38)
From the Consolidated Fund (Supply) – current year	15	38
Amounts due to the Consolidated Fund – received in a prior year and paid over	13(a)	(336)
Cash balance transferred to CCWater	-	42
Excess cash to be surrendered to the Consolidated Fund	13(a)	420
Increase in cash	743	126

18. Capital commitments

As at 31 March 2006 there were no capital commitments (31 March 2005: nil)

19. Commitments under operating leases

Commitments under operating leases to pay rentals during the year following the year of these accounts are given in the table below, analysed to the period in which the lease expires.

	2005-06	2004-05 (restated)
	£000	£000
Buildings:		
Expiry within 1 year	133	–
Expiry within 2 to 5 years	174	289
Expiry thereafter	548	545
	855	834
Other:		
Expiry within 1 year	15	13
Expiry within 2 to 5 years	7	6
Expiry thereafter	–	–
	22	19

20. Financial instruments

FRS13, derivatives and other financial instruments, requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities. Because of the largely non-trading nature of its activities and the way in which government departments are financed, Ofwat is not exposed to the degree of financial risk faced by businesses. Moreover, financial instruments play a much more limited role in creating or changing risk than would be typical of the listed companies to which FRS13 mainly applies. Ofwat has no powers to borrow or invest surplus funds and financial assets and liabilities are generated by day-to-day operational activities and are not held to change the risks facing the office in undertaking its activities.

Short term debtors and creditors have been excluded from the disclosures.

Liquidity risk

Ofwat has no borrowings and relies primarily on licence fee income and Contingency Fund loans for its cash requirements, and is therefore not exposed to liquidity risks.

Interest rates and foreign currency risks

All material deposits are held at the Office of the Paymaster General and all material assets and liabilities are denominated in sterling, so it is not exposed to interest rate risk or currency risk.

Fair values

There is no material difference between the book values and the fair values of Ofwat's financial assets and liabilities as at 31 March 2006.

21. Contingent liabilities

From time to time Ofwat will be subject to legal challenge and judicial review of decisions made in the normal course of its business as regulator of the water and sewerage industry. Legal judgements could give rise to liabilities for legal costs, but these cannot be quantified as the outcome of current proceedings is unknown, and therefore considerable uncertainty exists as to the nature and extent of any subsequent liability.

As at 31 March 2006 there were no contingent liabilities requiring disclosure.

22. Related party transactions

Ofwat transferred £5.971m to CCWater in respect of their operating costs for 2005-06.

Ofwat hold Service Level Agreements with CCWater for the provision of support services and £266k was received during the year.

Ofwat has a creditor of £197k due to CCWater in respect of the costs associated with the Early Retirement Scheme benefits. This post did not transfer to CCWater and became redundant with effect from 6 December 2005. The liability of the early retirement will be met by CCWater.

Ofwat also has a small number of immaterial transactions with other government departments.

There are no related party transactions between Ofwat and any of its Directors.

23. Post balance sheet events

There were no reportable post balance sheet events.

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