

Water Services Regulation Authority (Ofwat)

# Annual report and accounts 2012-13

For the period 1 April 2012 to 31 March 2013



# Water Services Regulation Authority (Ofwat)

## Annual report and accounts 2012-13

For the period 1 April 2012 to 31 March 2013

Report presented to Parliament pursuant to section 192B of the Water Industry Act 1991  
(as amended by section 38 of the Water Act 2003)

Accounts presented to the House of Commons pursuant to section 6(4)  
of the Government Resources and Accounts Act 2000

Accounts presented to the House of Lords by Command of Her Majesty

Ordered by the House of Commons to be printed on 11 July 2013

This is part of a series of departmental publications which, along with the Main Estimates 2013-14 and the document Public Expenditure: Statistical Analyses 2013, present the Government's outturn for 2012-13 and planned expenditure for 2013-14.

© Crown copyright 2013

You may re-use this information (excluding logos) free of charge in any format or medium, under the terms of the Open Government Licence. To view this licence, visit OGL or email [psi@nationalarchives.gsi.gov.uk](mailto:psi@nationalarchives.gsi.gov.uk).

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

Any enquiries regarding this publication should be sent to us at [mailbox@ofwat.gsi.gov.uk](mailto:mailbox@ofwat.gsi.gov.uk).

You can download this publication from [www.ofwat.gov.uk](http://www.ofwat.gov.uk).

ISBN: 9780102982350

Printed in the UK for The Stationery Office Limited  
on behalf of the Controller of Her Majesty's Stationery Office

ID P002547873

07/13

Printed on paper containing 75% recycled fibre content minimum.

## About this report

This document sets out our annual report and accounts for the period 1 April 2012 to 31 March 2013.

It includes a description of the work we carried out during the year to deliver our strategy.

It also includes the accounts for the operation of the Water Services Regulation Authority (Ofwat) under International Financial Reporting Standards (IFRS). They have been prepared on an accruals basis in accordance with the Government Financial Reporting Manual (FRM).

Our duties are laid out primarily in the Water Industry Act 1991 (WIA91). We are directly accountable to Parliament and the National Assembly for Wales.

Further information about our work is available on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk).

# Contents

Chairman's foreword .....	4	
Chief Executive's report .....	6	
Our strategy – a summary .....	8	
Our Board .....	9	
Part 1: Annual report		
Ensuring a fair deal for customers .....	12	
Keeping companies accountable .....	14	
Making monopolies improve .....	16	
Harnessing market forces .....	18	
Contributing to sustainable development .....	20	
Delivering better regulation .....	22	
Part 2: Accounts .....		25
Part 3: Appendices .....		77

# Chairman's foreword



**Jonson Cox**  
**Chairman**

---

This is my first annual report and accounts since my appointment as Chairman in November 2012. The Water Services Regulation Authority (Ofwat) regulates an industry which provides a vital public service every day. The industry has the continuing challenge of delivering the 'promise of privatisation'. Our role in Ofwat is to hold the industry to the delivery of exceptional outcomes for customers and the environment while ensuring that the industry becomes ever more efficient and sustainable.

As part of my appointment process, I appeared before the UK Parliament's Environment, Food and Rural Affairs Committee. I set out my initial priorities for my chairmanship. Over my first four months we listened carefully following extensive discussions with many stakeholders. In March 2013 we published '[Observations on the regulation of the water sector](#)', which set out six, only slightly modified, priorities. These are as follows.

- **Customers:** ensuring customers get outstanding value through a period of austerity and

experience a step change in service.

- **Water resources:** improving the management of our scarce water resources and the resilience of services.
- **Financing water companies:** monitoring the sustainability of water company structures and how companies and customers share pain and gain.
- **Evolutionary reform:** ensuring regulation develops progressively to meet the challenges of the future and harnessing market forces for the benefit of consumers.
- **2014 price review:** a fair outcome for customers and companies.
- **Board leadership and governance:** ensuring effective leadership and governance of the sector.

Our first concern on my appointment was to resolve a conflict in the sector about reform. This was resolved and companies have accepted an obligation to engage constructively on reform. I welcome the subsequent discussions we have had with the

sector on the way we should regulate a sector which is largely a 'natural monopoly'.

In consultation on my six priorities, I was pleased that across the industry there was such broad agreement on these priorities and the common objective of providing an exceptional public service, financed under private franchise, and delivering the 'promise of privatisation'. We are reviewing our future strategy for regulating the sector. We will be working closely with the UK and Welsh Governments, other regulators, companies, customer representatives and others.

As the economic regulator we must ensure that we are driving companies to reach the service and efficiency levels seen in competitive markets. We must ensure the continued delivery of these essential services and also that the risk of failure by an operating company does not fall on customers or the public purse.

It is customers who are at the heart of what we do. Their needs – and their ability to pay their bills – should not be taken for granted. Customer legitimacy is vital to the continued success of the water

sector. In today's world, customers judge water companies by many factors: corporate behaviour, management practice, price, service levels and problem resolution. Customer respect is hard won and easily lost.

At the current time our highest priority over this year and next is to deliver the upcoming five-year price review in a way that benefits customers, while ensuring that the sector can efficiently raise funds. Ofwat's Chief Executive has led a new approach for the 2014 price review over recent years in consultation with companies. As a new Board we are rapidly getting to grips with this, and the final step is for the approach to be reviewed and approved by Ofwat's Board over the coming months.

Turning to the Board, there have been a number of changes over the past year. Before I started, the Board said goodbye and thank you to Gillian Owen, who stepped down as non-executive director. In May 2013, we welcomed Chris Burchell, Martin Lawrence and Professor Catherine Waddams as non-executive directors, who bring a wide and valuable experience to the Board.

During 2012-13, the Board also said goodbye to Philip Fletcher, who stepped down as Chairman in November. I would like to put on record our thanks to Philip for the leadership, steady hand and professionalism that marked his 12 years at Ofwat – first as Director General, then as Chairman.

Our Chief Executive, Regina Finn, has recently announced her resignation after six years at Ofwat. Regina has set in motion significant challenges to the water sector to make it more customer-focused and to overhaul the policy approach to regulation. There is much still to do, and the 2014 price review will test the new approach. We would like to thank Regina for her contribution to Ofwat and the sector and wish her well for the future.

In closing, I would put on record my personal thanks to the staff of Ofwat. Their warm welcome and commitment to our role have eased the transition to a new Board and a new style of working. I look forward to working with them to make the sector we regulate a continued and sustainable success.

# Chief Executive's report



**Regina Finn**  
**Chief Executive**

It is now almost 25 years since the water and sewerage sectors in England and Wales were privatised. And much has changed since then. Regulated by us, the sectors have invested more than £111 billion to deliver significant improvements to services to customers and the environment.

But more needs to be done. In particular, many customers continue to voice their frustration over the level of their bills – particularly during a period of financial hardship – and the service they receive from their water company. There are also challenges such as climate change and population growth for which the sectors must prepare over the next 25 years.

Maintaining the willingness of customers to pay their water and sewerage bills will be vital in securing resilient and sustainable services over the long term. This means that, as the economic regulator, we need to ensure companies place customers' needs, views and interests at the heart of their decision-making.

We were pleased that during the year the UK Government proposed legislation that will, among other things, allow all business and other non-household customers in England to choose their own water and sewerage supplier. This will bring about important changes that will deliver benefits for customers and the environment. In particular, it will give businesses the ability – just as they can for other goods and services – to pick the price and service package that best meets their needs. Over the past year, we have been working closely with the UK and Welsh Governments, companies, customer representatives and others to prepare to deliver on the final package of reforms Parliament decides on when the legislation is passed.

Despite the changes, all household customers in England and most customers in Wales will continue to receive their services

from monopoly suppliers. So we need to act in their long-term best interests. This includes ensuring monopoly suppliers are focused on delivering the outcomes their customers want. In 2014-15, we will set the price and service package ('price controls') that the monopoly companies must deliver for each of the five years from 2015 to 2020. In proposals we published during the year, we are giving customers a stronger voice in the way price controls are set.

In setting out their plans to us for the next five years, the companies will need to show they have listened to their customers and how their plan reflects this. We asked them to set up customer challenge groups (CCGs), which are independent bodies of customers. The CCGs will tell us how well the companies have engaged with their customers. And we will take account of what they tell us in deciding each company's price controls during 2014-15.

We have also taken steps to ensure that companies, who are the ones responsible for delivering for customers, have both the freedom and the responsibility for how they deliver. This will improve the opportunity for companies to innovate to meet

customers' needs and for well-performing companies to create additional value for their owners.

Measures include a move to assessing capital and operating expenditure on a new basis so as to remove any artificial bias towards capital expenditure – which might not be the best solution for customers and the environment in all cases. And we are introducing greater flexibility for companies in how they balance affordability, deliverability and financeability of their businesses.

It is in the long-term interests of customers that services are delivered sustainably. Our proposals for price setting include specific incentives to encourage companies to use our precious water resources efficiently, and take them from areas where it does not damage the environment. This approach will also allow them to consider less resource-intensive ways to provide services and meet their legal obligations. Because they will have to explore these options directly with their customers, challenged by their CCGs, this means that customers, stakeholders and the independent quality and environmental regulators will all have a strong

voice and can ensure their views are heard.

We want to deliver effective and efficient regulation in a proportionate way. This includes introducing progressive reforms and adopting less intrusive risk-based tools that:

- give companies the freedom to focus on hearing what their customers want and on finding the best ways to provide those services;
- provide investors the necessary confidence to invest at a cost that keeps bills affordable for customers; and
- allow us to concentrate our scrutiny on those areas where there are higher risks for customers and the environment.

To deliver on this proportionate approach, we have signalled that we expect company Boards to demonstrate clear and effective leadership – company Boards are ultimately responsible for business decisions that affect all customers, so this will be an important factor in our review of business plans.

To regulate the water and sewerage sectors effectively, we must also continue to have a

clear and relevant strategy for delivering our duties over the long term. It has been more than three years since we published our strategy for sustainable water, and much has changed in that time.

Over the coming year the Board will be refreshing our strategy to make sure we continue to deliver our legal duties. And we look forward to working with our stakeholders, whose help and challenge over the past year have continued to make a valuable contribution to our work.

Finally, this is my last annual report and accounts as Ofwat's Chief Executive. In May 2013 I announced my intention to step down to pursue new opportunities. I would like to thank Ofwat's staff and Board – past and present – for their help and support during my tenure. I am confident that together we have laid the foundations for sustainable effective change in the water and wastewater sectors that can deliver the customer-focused, resilient and sustainable water and sewerage services we all want, now and for the future.

# Our strategy – a summary

Our current strategy – ‘[Delivering sustainable water](#)’ – sets out our vision for regulating the water and sewerage sectors in England and Wales. We want to see a sustainable water cycle in which we are able to meet our needs for water and sewerage services while enabling future generations to meet their own needs.

The strategy also describes our mission to ensure customers continue to receive safe, reliable, efficient and affordable water and sewerage services that promote positive social, economic and environmental impacts today, tomorrow and over the long term.

Each year, we review how well we have done in delivering our vision, using the following goals.

- Ensuring a fair deal for customers.
- Keeping companies accountable.
- Making monopolies improve.
- Harnessing market forces.
- Contributing to sustainable development.
- Delivering better regulation.

Over the coming year, the Board will be refreshing our strategy to make sure we continue to deliver our legal duties. We will report on the outcome of this in next year’s annual report.

# Our Board



**Jonson Cox,**  
Chairman\*



**Regina Finn,**  
Chief  
Executive



**Keith  
Mason,**  
Senior  
Director of  
Finance and  
Networks



**Sonia  
Brown,**  
Senior Director  
of Markets  
and Economics



**Penny  
Boys,**  
Non-executive  
Director



**Gillian  
Owen,**  
Senior  
Non-executive  
Director\*\*



**Robin  
Paynter  
Bryant,**  
Non-executive  
Director



**Wendy  
Barnes,**  
Non-executive  
Director

\* From 1 November 2012

\*\* Until 31 July 2012



# Annual report





## > Ensuring a fair deal for customers

One of our primary duties is to protect the interests of consumers, wherever appropriate by promoting competition.

---

### 2012-13 highlights

---

#### Taking action now

In February 2013, we announced that [average water and sewerage bills across England and Wales](#) would be £388. This represents an increase of 3.5% in line with inflation.

In 2009, we decided how much the companies could charge customers between 2010 and 2015. Our challenge of their proposals means that bills have remained broadly in line with inflation – and are 10% lower than what companies asked for. Customers' bills are helping pay for an investment programme worth about £25 billion between 2010 and 2015 to maintain and improve services.



We understand that any increase in water and sewerage bills is unwelcome, particularly when there is huge pressure on household incomes. And some customers may struggle to pay their bills. So it is important that companies work closely with their customers – who also pay the costs of bad debt and managing those costs – and that this is done efficiently.

We want companies to share ideas about how they can support customers in financial difficulty by tackling affordability and by considering what innovative approaches are available to help them manage customer debt. So, in July 2012, we held a [workshop on addressing affordability and debt](#).

We also published [research on the impact of companies' charging practices on customers in debt or struggling to pay their bills](#). This shows how companies can use behavioural economics to develop effective charging practices, and lead to increasingly efficient debt management. And it has helped to inform our own charging, debt and affordability policies.

## Planning for the future

Given the pressure on household incomes, the legitimacy to customers of their water and sewerage services – and the bills they pay – will be even more important in future.

In January 2013, we announced proposals to encourage the companies to be more customer focused in future, and give customers a stronger voice in the way price and services are decided. This was part of our consultation on how we plan to decide the price and service package ('price controls') the water and sewerage companies in England and Wales must deliver in each of the five years between 2015 and 2020. See page 16.

Placing customers at the centre of price setting is just one way in which we are seeking to protect, engage and empower them. At [an event we held in July 2012 on putting customers first](#), we explored with stakeholders the best way to enable customers to get a fair deal from their water

and sewerage suppliers and to seek redress when things go wrong. The discussions are helping us to develop our thinking further and identify practical solutions for protecting, engaging and empowering customers.

For example, in October 2012 we consulted on [proposals to encourage companies to provide better information to their customers](#). Research we carried out suggested customers were not getting the information they need, when they asked for it. Better information can empower them to reduce their bills and and secure better quality services. It also improves their relationship with their company, and the legitimacy of the bills they pay.

Large infrastructure projects can have a sustained impact on the level of customers' bills. During the year, we continued to review progress on Thames Water's 'Thames Tideway' project, which involves building a very large sewer tunnel beneath London. Our work included making sure that the company's costs to customers will be justified by, among other things, challenging and reviewing their processes for managing risk and estimating costs for the Thames Tunnel. We also worked with Defra, HM Treasury and Thames Water to work out how to finance the project.



## > Keeping companies accountable

We expect companies to meet their customers' expectations and their legal obligations – and put things right where they go wrong. We hold them accountable on behalf of customers if they fail to do so.

### 2012-13 highlights

#### Taking action now

In November 2012, we reported that the companies received about 22,000 (or 11.9%) fewer written or emailed complaints from their customers in 2011-12. This is the fourth year in a row that complaints have fallen.

But while there were positive aspects to the companies' performance, there were also some negative areas.

For example, poorly maintained sewers can lead to the discharge of raw sewage into rivers and other water sources, which can have a significant impact on the environment. So the companies are required to maintain their



networks and manage their operations effectively.

During the year, the Environment Agency reported that the number of serious pollution incidents caused by water companies increased from 65 in 2010 to 120 in 2011.

A number of companies also reported to us [issues with their environmental performance](#) over the previous year.

We followed up those companies that identified issues with their performance to make sure they got back on track – and we are watching their performance closely to check that it improves. If companies fail to deliver the agreed environmental performance, we and the Environment Agency will consider together what action we each need to take to protect the environment and customers’ interests.

As well as their obligations to customers and the environment, the companies also have other legal obligations. This includes those under competition law.

During the year, we consulted on and [confirmed our decision to](#)

[accept binding commitments from Severn Trent plc under the Competition Act 1998](#) to divest Severn Trent Laboratories. This followed a complaint made to us by ALcontrol UK Ltd. ALcontrol alleged that Severn Trent Laboratories – which provided water analysis services to Severn Trent Water and other companies – had been able to win contracts by pricing below cost. This was enabled by the structural links between Severn Trent Water Limited, the regulated business, and Severn Trent Laboratories Limited.

Also during the year, we continued our investigation into whether Anglian Water abused its dominant position – and infringed the Competition Act 1998 – in relation to pricing for providing water and sewerage services to the ‘Fairfields’ development sites at Milton Keynes, which are in Anglian’s supply area. We also announced a [formal investigation into another company](#) for potentially abusing its dominant position in relation to charges made to self-lay operators to provide water mains at new development sites. We will provide an update on both cases in next year’s annual report.

## Planning for the future

Each company has a licence that sets out the conditions under which it is allowed to operate as a monopoly supplier. In 2012-13, we consulted extensively with the companies, investors and other key stakeholders on making changes to certain conditions within each company’s licence.

The current licence conditions are rigid and we wanted to make changes that allowed us to set price controls that best incentivise companies to respond efficiently, innovatively and sustainably to the challenges they face – such as climate change and population growth. By setting different price limits for different parts of each company’s business we can better target incentives to enable them to make the most efficient use of customers’ money.

Following extensive engagement and a final consultation on the changes, which we published in December 2012, [all water and sewerage and water only companies accepted our revised proposals](#). We will implement the changes in early 2013-14.



## > Making monopolies improve

Most people receive their water and sewerage services from one of 18 monopoly suppliers. In the absence of customer choice, we challenge these companies to deliver improved services, innovation and value for money.

---

### 2012-13 highlights

---

#### Taking action now

In November 2012, we announced that, in general, customer satisfaction with the overall manner in which companies handled their queries and concerns continued to be high. We asked 16,000 customers to give us their view of how well their water company did on a scale of 1 to 5 (where 5 indicates they were 'very satisfied'). The average result for all the companies in 2011-12 was 4.34.

Both the number of complaints and level of customer satisfaction form part of our service incentive mechanism (SIM), which we introduced in April 2010. It is



designed to encourage the companies to focus on:

- identifying and meeting their customers' expectations;
- getting things right first time; and
- reducing the number of complaints they receive by improving their services overall.

The companies receive financial rewards and penalties depending on how they perform against the SIM.

## Planning for the future

One of the tools we use to ensure monopoly companies improve the services they deliver to customers is the price review. And in 2014 we will set price controls for each of the five years from 2015 to 2020.

In May 2012, we published [our long-term, principles-based approach to price setting](#). And during the year, we used this approach – and further extensive engagement with our stakeholders – to develop our [proposed methodology for how we will set price controls in 2014](#).

One of our core proposals is that we set separate price controls for different parts of each company's business for the first time. This will allow us to target our regulation on the different activities that companies carry out.

Our proposals build on the successful approach we have used in the past. They will drive company efficiency, keep costs down, and support economic growth, by:

- ensuring companies are able to continue to access low-cost financing, to enable continued investment in improving services while keeping bills down; and
- focusing companies on long-term outcomes rather than specific outputs, to encourage innovative ways of working that can deliver services for less money, and with less impact on the environment.

To help maintain investor confidence, we propose to retain the inflation (RPI) link for 'wholesale' investment – such as building and maintaining treatment works and pipes. This represents 90% of companies' business.

Our proposals will also ensure an increased focus on customers by:

- giving them an increased say in how their money is spent, and making companies more accountable for delivering what they want over the long term; and
- allowing us to look more closely at companies' retail services –

which includes activities such as billing and customer call centres – to drive better customer service and lower costs.

For example, we have asked each company to set up independent customer challenge group (CCG) to make sure they are engaging properly with their customers and reflect their views in developing their plans for 2015-20. When we set price controls in 2014, we will use reports from the CCGs to tell us how well the companies have done this. We also propose bringing the sectors more in line with others across the economy by not allowing the retail part of customers' bills to rise automatically in line with inflation.

Managing water sustainably is becoming ever more challenging, particularly in the context of population growth and increasingly volatile weather. Our proposals to enable the sectors to manage water sustainably include:

- encouraging companies to become smarter in how they value and manage water, ensuring costs are kept down, and water is available where and when it is needed most, over the long term; and
- protecting the natural environment by encouraging companies to make more sustainable choices about their water supplies.

We highlight these improvements in the 'Contributing to sustainable development' section on page 20.



## > Harnessing market forces

We make sure that where markets for water and sewerage services exist they operate efficiently and effectively, and deliver benefits to customers and the environment.

---

### 2012-13 highlights

---

#### Taking action now

**W**hile there is limited competition in today's water market, companies can be appointed to supply water, sewerage or water and sewerage services to a specific area in place of the previous supplier. These new appointments and variations (NAVs) can deliver benefits to customers and developers in the form of innovations that mean better, cheaper services. When we assess applications, we make sure customers will be no worse off than if the former service provider was still supplying them.



We granted six appointment variations during 2012-13. Four of these were to SSE Water, and the other two were to Independent Water Networks. More than 3,000 household customers will be supplied at the sites we approved. Customers will benefit in the following ways.

- Four of the six appointment variations offered customers a discount on the charges they would have paid to their previous supplier.
- At most of these sites, developers are being supplied with water, sewerage, gas and electricity infrastructure by a single company. This means they only have to deal with one supplier. It can also mean that the infrastructure is installed together, which can be quicker and cheaper.

We also developed our [revised approach to assessing the financial viability of applications for new appointments and variations](#). This will enable us to continue to protect customers' interests, while reducing the regulatory burdens on prospective new entrants and cutting the time taken to decide on applications for NAVs.

Water supply licensing is another means by which business and other non-household customers can choose their water supplier. During the year, the first customer switched supplier following the UK Government's decision in December 2011 to increase the number of customers that are eligible to switch.

## Planning for the future

In 2012-13, the UK Government published its Draft Water Bill to make changes to the water and sewerage sectors that will:

- increase choice and improve service for water and sewerage customers; and
- stimulate innovation and drive more sustainable approaches to managing our water resources.

A significant part of these reforms is to introduce more choice into the supply of water and sewerage services. Under the proposed legislation:

- all business and non-household customers in England will be able to choose their retail supplier for both water and sewerage services – and join up with arrangements in Scotland; and
- competition will be introduced into the supply of wholesale water and sewerage services.

Our approach to price setting, which we outlined in ['Setting price limits for 2015-20 – framework](#)

[and approach: a consultation](#)' (our 'methodology consultation'), supports the Bill's aims. For example, our proposal to set separate price controls for different parts of each company's business will prepare the sectors in England for the UK Government's market reforms. Our proposals also allow us to take a different regulatory approach in Wales, to reflect the Welsh Government's priorities.

Together, we estimate that our regulatory reforms and the proposed market reforms in the Draft Water Bill could deliver nearly £3.5 billion of net benefits to the economy. To illustrate, since competition was introduced in Scotland in 2008 more than 45,000 customers have renegotiated the terms of their supplies and are enjoying a range of benefits because of the competitive market. In particular, the Scottish public sector is forecast to save £25 million over three years from discounts to prices and new water efficiency measures.

We need to wait for legislation to go through Parliament to enact the UK Government's policy on market reforms. Over the past year, we have been working closely with the UK Government and other key stakeholders through the [High Level Group](#) – which was set up by Ministers – to plan how we can help markets open quickly and effectively should the proposed legislation become law.



## > Contributing to sustainable development

We have a duty to contribute to the achievement of sustainable development. This means we consider the social, environmental and financial issues together. Taking a long-term view is central to our strategy.

---

### 2012-13 highlights

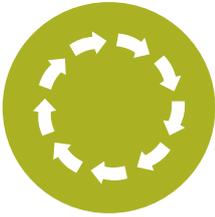
---

#### Taking action now

**W**ater is one of our most precious resources and is often undervalued.

Managing it sustainably is becoming ever more challenging in the face of changing weather patterns and a growing population. And encouraging companies to deliver safe, reliable, resilient and efficient water and sewerage services is a key part of our strategy.

To encourage companies to choose the most efficient and sustainable options to balance



the supply and demand for water services, we worked with the Environment Agency, Defra and the Welsh Government during 2012-13 to update the [water resources planning guideline](#). This is the guidance we expect companies to follow when they prepare their plans to balance water supply and demand over the following 25-year period. Improvements we helped make to the new guidance include:

- requiring companies to consider trading supplies and to make available information about water supply deficits and surpluses;
- making more explicit the need for companies to reduce demand for water by, for example, reducing leakage and encouraging water efficiency; and
- allowing third party individuals and organisations to offer solutions to balance supply and demand, which the companies must consider and only turn down if they can achieve the same results more efficiently.

We also made [changes to the water efficiency targets that companies need to meet each year until 2015](#), to help improve

the water savings that companies make and give them further encouragement to do more.

These improvements are important because, according to the Environment Agency, more than half of the UK's rivers are over-abstracted, while others have plentiful supplies. But, at the moment, less than 5% of the water in the UK is traded between companies across regions.

To help make this easier, we [consulted on guidance to help the companies negotiate the trading of bulk water supplies](#) where this the most efficient option for meeting the supply and demand for water. And we continued to work with the Environment Agency on long-term changes to the system for managing the abstraction of water from the environment, which the UK Government proposed in its Water White Paper.

## Planning for the future

The proposals we set out in our methodology consultation will encourage companies to deliver safe, resilient and sustainable services now and for the future. They will also encourage them to focus on long-term outcomes instead of short-term outputs. How they do this will be up to the companies to decide.

Our targeted incentives will encourage companies to find more sustainable ways to meet their customers' needs while also improving resilience. By incentivising water trading, we will reveal its true environmental, social and economic value – while the abstraction incentive mechanism (AIM) will incentivise companies to source water from where it does not damage the environment, and penalise them if they take it from where it does.

We also intend to change the way companies decide on which solutions they should invest in. Currently, we treat capital expenditure (capex) and operating expenditure (opex) differently. Some stakeholders consider that, because of this, companies often prefer capital- and carbon-intensive solutions – even if this is not the best thing for the environment.

Under our new total expenditure (totex) approach, both capital and operating costs could be treated in the same way. So, a company that may have preferred to tackle sewer flooding in the past by increasing its underground equipment to store more rainfall during storms might consider other options in future – including working with customers to manage the rainfall close to source, preventing it entering the sewers in the first place.



## > Delivering better regulation

Delivering better regulation means targeting our efforts on the biggest risks to customers, and taking consistent and proportionate action where necessary. It also means being transparent and accountable for the decisions we take, and delivering better regulation in practice.

---

### 2012-13 highlights

---

#### Taking action now

2012-13 was the first year of our [new risk-based approach to regulatory compliance](#). We introduced it at the end of 2011-12 to place the onus on companies to demonstrate to their stakeholders – rather than just us – on how they are doing at providing services to customers and meeting their legal obligations. In July 2012, companies:

- published their performance against a range of key performance indicators;



- reported to us in a statement (the 'risk and compliance statement') that they have met their obligations, risks and how they are managing them; and
- reported their financial performance in their yearly financial statements (their 'regulatory accounts').

Our approach has meant we can focus on the biggest risks to customers and the environment – and take action where necessary. It has also meant we have been able to reduce the burden to companies of reporting all information to us (see appendix 5).

During the year, we also applied a risk-based approach to other areas of our work to make sure what we do is targeted and proportionate, and delivers better regulation in practice. We:

- consulted on adopting a [risk-based process for assessing the information that companies provide to their customers](#) to encourage them to do better (see page 13);
- consulted on – and finalised – [our approach to assessing the financial viability of new appointments and variations](#) to improve our protection of customers and make the

process less burdensome for potential new entrants (see page 19); and

- consulted on – and finalised – [changes to our regulatory accounts guidance \(RAGs\) to companies](#). Our changes included adding our accounting separation requirements to the RAGs, which consolidated our requirements for the information that companies produce.

As part of delivering better regulation, we are also committed to transparency and accountability for our own performance. During 2012-13 we developed – and consulted on introducing – a framework to improve transparency and monitoring of our performance. We set out further details in appendix 1.

## Planning for the future

A key aim of our 2014 price review is to deliver better regulation in the price controls we set for 2015-20 – and in the processes we use to do it.

As part of the process of setting price controls, companies will need to develop business plans that set out how they intend to provide services to customers and meet their obligations – and the prices they want to charge. Building on our methodology consultation and shortly after the end of the reporting year, we published a [consultation on the](#)

[information we will want the companies to include in their plans](#) and how we will assess those plans.

One of our key proposals is that we rate the quality of each company's plan for the first time. Companies with high-quality plans will be rewarded with:

- lighter touch procedures;
- financial incentives; and
- earlier decisions.

This process will encourage companies to take ownership for preparing high-quality plans that focus on what their customers want, while meeting their legal obligations over the long term. It will also allow us to concentrate on getting improvements where they are weakest. Our approach is also consistent with the recommendations of the [independent review of Ofwat and consumer representation in the water sector](#) (the 'Gray review'), which was published in 2011.

Our strategy sets out our overall approach to meeting our legal duties by regulating the sectors for the long term. Our new Chairman took up his post in November 2012, and shortly after the end of the reporting year three new Non-executive Directors joined the Board. Over the coming year the Board will be refreshing our strategy to make sure we continue to deliver our legal duties. We will report on the outcome of this in next year's annual report.



# Accounts



# Management commentary

## Financial commentary

The financial highlights for Ofwat are summarised below.

### Operating costs summary

	2012-13 £000	2011-12 £000
<b>Income</b>		
Deferred income from prior periods	3	5,361
Licence fees received	18,934	18,435
Other income	13	116
	<b>18,950</b>	<b>23,912</b>
<b>Expenditure</b>		
Administration costs	(20,098)	(19,104)
	<b>(20,098)</b>	<b>(19,104)</b>
<b>Licence fee income deferred to the following period</b>		
Thames special fee refund in following period	–	(3)
Net operating cost	(1,148)	4,805

Ofwat is funded by fees charged to the regulated companies. Fees are recovered annually from appointed companies and licensed suppliers. Our fee income is subject to the constraints set out in the appointed companies' licence conditions. Our budget is subject to negotiation with HM Treasury.

The core regulation operating budget (excluding the regulation of the Thames Tideway project), set at the start of the year, was £19.2 million. This included a budget of £0.5 million, approved to cover the remainder of costs of the office reorganisation that took place between May 2011 and March 2012.

At the beginning of the financial year, we recovered £17.7 million in general licence fees. To support planned expenditure in 2012-13, the Chief Secretary approved a reserve claim in February 2012 for us to draw £1.5 million cash from the reserve as a supplementary estimate. The underspend against the total regulation budget was 1.7%; this was mainly due to staff turnover.

Due to the possibility of a referral to the Competition Commission (enabling licence modification project), in the fourth quarter, the Board meeting in December 2012 agreed a precautionary core operating budget

increase to £20.7 million. To fund this increase, Ofwat made a prudent decision to claim from the reserve a further £1.5 million of cash, which was approved by the Chief Secretary in January 2013. In January 2013, the companies accepted the licence modification on which we consulted in December 2012; as a result the cash from the reserve claim was not drawn. Including this precautionary reserve claim the overall underspend against operating budget in the year was 8.7%.

The separate budget for regulation of the Thames Tideway project was £1.5 million with a final outturn of £1.2 million, funded through two special fees recovered from Thames Water Utilities Ltd.

The underspend against capital budget relates to delays in the procurement of server-based software and the installation of telecommunication lines for our video conferencing facilities. This expenditure is recorded within our capital commitments, and will be incurred in 2013-14.

We continued to draw on provisions made in 2009-10 to cover redundancy and early retirement costs. An increase of £9 thousand was made to this existing provision for early departures in respect of inflation increase to pensions. The finalisation of the

2011-12 reorganisation required a new provision of £262 thousand to be created to cover the cost of compensation for loss of office payments due in 2012-13.

Ofwat plans to draw cash from the reserve in 2013-14 and 2014-15, to fund planned expenditure and enable reduced licence fees. HM Treasury has agreed a £1.8 million reserve claim to be drawn down in 2013-14. There is no reason to think that future reserve claims will not be approved. At 31 March 2013 the cumulative unspent licence fees that have been surrendered to the Consolidated Fund total £4.2 million (31 March 2012: £5.7 million).

## Financial instruments

We do not have borrowings and rely primarily on licence fee income, claims on the reserve and Contingency Fund repayable advances for our cash requirements. We are not, therefore, exposed to significant liquidity risks. Further details are provided at note 11 to the accounts.

## Going concern

The statement of financial position at 31 March 2013 shows negative taxpayers' equity of £4.3 million (2011-12: £3.5 million). In common with other government departments, the future financing of Ofwat's liabilities are accordingly to be met by future grants of Supply and the application of future income, both to be approved annually by Parliament. There is no reason to think that future approvals will not be forthcoming. Accordingly, it has been considered appropriate to adopt a going concerns basis for the preparation of these financial statements.

Under the Government Resource and Accounts Act 2000, no money may be drawn from the Fund other than required for the service of the specified year or retained excess of that need. All unspent monies, including those derived from our income, are surrenderable to the Fund.

## Roles and responsibilities

Ofwat is a non-ministerial government department with its own resource estimate. The Chairman of the Ofwat Board is Jonson Cox.

The Board has a Non-executive Chairman, and during 2012-13 had three Non-executive Directors and three Executive Directors, including the Chief Executive, Regina Finn, who is the Accounting Officer.

### Chief Executive Regina Finn

Non-executive Director of Mutual Energy Limited from 1 November 2008.

### Non-executive Directors Jonson Cox (Board Chairman),

from 1 November 2012.

Chairman of Coalfield Resources PLC. Non-executive Director at Wincanton Plc. Former Group Chief Executive Officer of Anglian Water Group Plc (2004-10). Former Chief Executive Officer of Valpak (2002-04). Former Chief Executive Officer of Railtrack (2000-01). Former Managing Director of Yorkshire Water (1996-2000).

### Philip Fletcher CBE

(Board Chairman and member of the Remuneration Committee) until 31 October 2012.

Director General of Water Services, 2000-06.

Member of the Archbishops' Council for the Church of England and Chair of its Mission and Public Affairs Council; both posts unpaid. Board member of Ofqual, the statutory regulator of examinations and qualifications, for which a small salary is paid.

### Penny Boys CB

(Chair of the Audit Committee, member of the Remuneration Committee)

Member of the Membership Selection Panel Network Rail Ltd. Non-executive Council member of the Competition Commission (appointed December 2012). Deputy Chairman of the Horserace Betting Levy Board 2008-11. Former Executive Director of the Office of Fair Trading.

### Gillian Owen

(Chair of the Remuneration Committee, member of the Audit Committee), until 31 July 2012.

Independent Consultant and Senior Research Associate at University College London. Deputy Chair of the Fuel Poverty Advisory Group and member of Consumer Challenge Group, Ofgem. Previously Senior Research Fellow at the Centre for Management Under Regulation (Warwick University) and Adviser to the Renewable Energy and Energy Efficiency Partnership. Former member of the Competition Commission.

## Robin Paynter Bryant

(Member of the Remuneration Committee)  
Non-executive Director of Go Modern Ltd. Director of The Trinity Column Ltd and Partner of The Trinity Column Partners LLP (subsidiary undertaking of The Trinity Column Ltd). Non-executive Director of Prime International Investments Group Ltd until September 2011.

## Wendy Barnes

(Chair of the Remuneration Committee, member of the Audit Committee)  
Director General at DECC from September 2011 until December 2012. Non-executive member of the Finance Committee of Chester Cathedral. Consultant with Practiq Consulting Limited and Practiq Ltd and Non-executive Director at FCO Services. Non-executive Director with the Met Office from 1 May 2013. Non-executive Director on the Audit Committee and Approvals Committee at DECC until September 2011. Non-executive Director of DE&S, part of the MOD, until September 2011.

## Non-executive Directors' terms of appointment

Jonson Cox was appointed on 1 November 2012, and his appointment is until October 2015. Robin Paynter Bryant's and Wendy Barnes' appointments are until January and February 2016 respectively. Penny Boys' appointment is until 31 March 2014.

Philip Fletcher's contract terminated on 31 October 2012, following an extension pending the appointment of the new Chairman. Gillian Owen left the Board on 31 July 2012, after tending her resignation.

Non-executive Director appointments have no entitlement to performance related pay or pension entitlements. Compensation in the event of early termination is at the discretion of the Secretary of State. The recruitment of three new non-executives commenced in the fourth quarter with the aim of filling the posts early in the 2013-14.

## Audit Committee

Our systems of internal control, risk management and governance are scrutinised by the Audit Committee. Members of the committee in 2012-13 were Penny Boys (Chair), Gillian Owen until 31 July 2011, Wendy Barnes from 1 August 2012 and

Richard Kennett (Independent Member).

Richard Kennett is a chartered accountant with extensive experience in audit, business and risk management, and is currently an Independent Member of the Audit Committee of Hanover Housing Group, a Council Member of the Health and Care Professions Council, where he is the Chairman of the Finance and Resources Committee, a Non-executive Director of a West End theatre group and a Panel member of the Professional Discipline Tribunals of the Financial Reporting Council.

The NAO, internal audit (PricewaterhouseCoopers LLP), the Chief Executive and senior finance staff attend the committee by invitation. The Audit Committee met three times during the year.

## Equal opportunities policy

We recruit staff on merit through fair and open competition. This ensures equal opportunity for employment, regardless of:

- race;
- sex;
- sexual orientation;
- age;
- marital status;
- disability;
- religion and belief;
- gender reassignment;
- pregnancy and maternity; 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.

During the year, we carried out 28 separate recruitments, which in some cases sought more than one member of staff. Everyone was recruited through open competition.

## Employee involvement

We attach great importance to managing, developing and training staff. During the year we have invested in a broad range of development activities to support the achievement of our strategy. We hold regular staff briefings and seminars. We have a staff committee, which is consulted on a range of issues. We have a recognition agreement

	Short term	Long term	2012-13 total	Short term	Long term	2011-12 total
Days lost	604	358	962	679	545	1224
Percentage lost			2.6%			2.0%

with the trade unions that represent Ofwat staff, namely PCS, Prospect and FDA.

## Sickness absence

Our policy is to reduce employee absence and we rely on early intervention by line managers conducting a return to work interview after each period of absence.

Human Resources advisors inform line managers when the following trigger points have been reached for an individual to allow them to consider whether further action or support is required:

- three periods of absence in a rolling period of six months; and
- four periods of absence in a rolling period of twelve months.

The Positive People Company provides Ofwat with an Employee Assistance Programme that offers a voluntary and confidential support, information and counselling service to help employees and their immediate family members to resolve personal problems and concerns.

Sickness absence data is presented to the Board on a quarterly basis.

A long-term absence is any absence running over a consecutive period of 21 working days or more.

## Supplier payment performance

We achieved 87.9% against our target for paying 100% of agreed invoices within 30 days of receipt during 2012-13. The corresponding figure for 2011-12 was 96.5%. The reduction in performance was due to an increase in non-pay expenditure linked to the major high profile office programme and projects. We are implementing improved project invoice approval procedures.

## Protected personal data related incidents

We have an Information Risk Policy (IRP) and related procedures in place to manage the risk of protected personal data related incidents. There were three incidents where Ofwat devices were stolen. These incidents were all reported to the Police.

The two Ofwat tablets that were stolen were encrypted and access to the tablets requires a passcode. The tablets were completely wiped and network access denied. All data at rest on the laptop was encrypted and access to the device requires relevant authentication. The risk of data loss was very low.

There were no other incidents during the year.

## Internal audit

PricewaterhouseCoopers LLP (PwC) provided our internal audit

services in 2012-13. The service provides an independent appraisal service for management by measuring and auditing the adequacy, reliability and effectiveness of management, risk management, and financial control systems. The internal auditors 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 report to Parliament on this examination.

The Accounting Officer has taken all the steps that she ought to have taken to make herself aware of any relevant audit information, and to establish that our auditors are aware of that information. So far as she is aware, there is no relevant audit information of which our auditors are unaware. The notional cost of this service is £41 thousand (2011-12: £41 thousand).

**Regina Finn**  
**Accounting Officer**  
**25 June 2013**

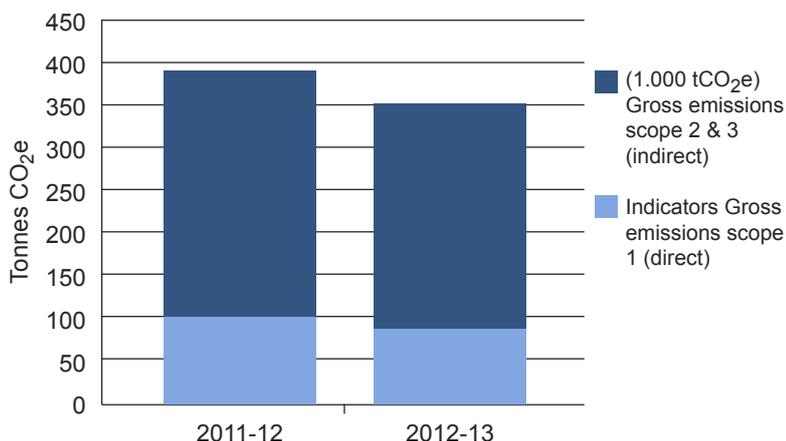
# Sustainability report

## Summary of performance

As a small department (<250 staff), Ofwat is not mandated to produce a sustainability report. However, because of its role in a regulated sector with a major environmental impact, Ofwat has voluntarily undertaken to provide a report. The report below follows the guidance issued by HM Treasury.

Greenhouse gas emissions		2012-13	2011-12
Non-financial indicators (1.000 tCO <sub>2</sub> e)	Total gross emissions	349.83	391.93
	Total net emissions	349.83	391.93
	Gross emissions scope 1 (direct)	86.63	99.88
	Gross emissions scope 2 & 3 (indirect)	263.2	292.05
Related energy consumption (million KWh)	Electricity: non-renewable	0.476	0.534
	Electricity: renewable	–	–
	Gas	–	–
	LPG	–	–
	Other	–	–
Financial indicators (£000)	Expenditure on energy	57.8	51
	CRC licence expenditure (2010 onward)	1.29	1.29
	Expenditure on accredited offsets (for example, GCOF)	1.96	–
	Expenditure on official business travel	299	274

### Greenhouse gas emissions



### Performance commentary (including measures)

**Scope 1** emissions are based on actual readings for air conditioning in 2012-13; estimates were used in the previous reported year.

**Scope 2** emissions include general electricity supplies to our accommodation and server room (195.14 tCO<sub>2</sub>e).

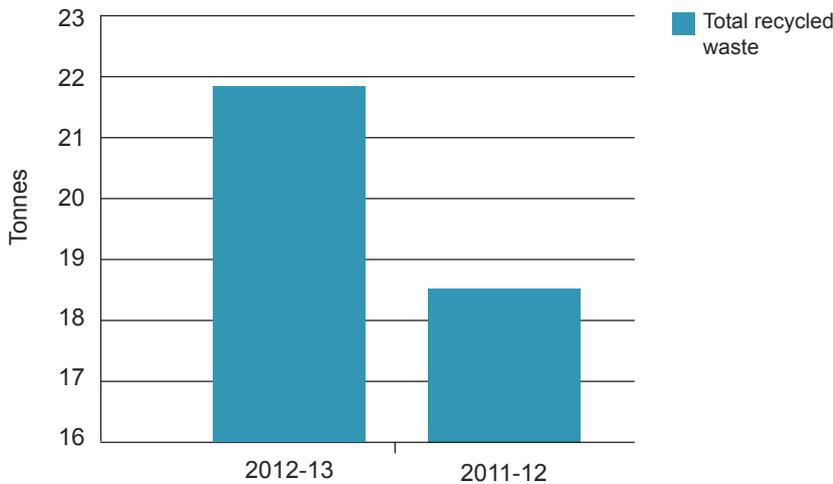
**Scope 3** emissions relating to business travel (68.06tCO<sub>2</sub>e)

### Controllable impacts commentary

New energy efficient lights and controls have been installed in most areas of our premises; a Green IT policy has been issued promoting sustainability issues to all users.

Waste			2012-13	2011-12
Non-financial indicators (tonnes)	Total waste		-	-
	Hazardous waste	Total	-	-
		Landfill	-	-
	Non-hazardous waste	Reused/recycled	21.8	18.5
		Composted	-	-
		Incinerated with energy recovery	-	-
Financial indicators (£000)	Total disposal cost		5.8	8
	Hazardous waste		-	-
		Landfill	-	-
	Non-hazardous waste	Reused/recycled	5.8	8
		Composted	-	-
		Incinerated with energy recovery	-	-
		Incinerated without energy recovery	-	-

**Waste**



**Performance commentary (including measures)**

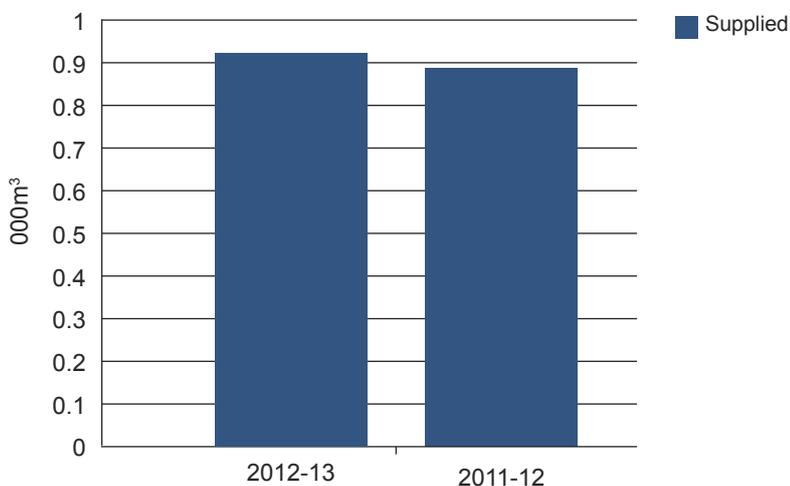
All waste is segregated for recycling or landfill disposal. We are unable to measure accurately our non-paper waste as this is disposed of via a central collection point in a multi-tenanted building. Our paper waste is recycled.

**Controllable impacts commentary**

Recycling is promoted throughout the office with central collection points on all floors. Plastics, glass and card are recycled through a centralised waste disposal facility provided by the building. Landfill waste is also collected in this manner.

Finite resource consumption			2012-13	2011-12
Non-financial indicators (000m <sup>3</sup> )	Water consumption (office estate)	Supplied	0.923	0.889
		Abstracted		NA
		Per FTE	0.00518	0.004
Financial indicators (£000)	Water consumption (Non-official estate)	Supplied	NA	NA
		Abstracted	NA	NA
	Water supply costs (office estate)		0.2	0.2
	Water supply costs (non-office estate)		NA	NA

Water consumption (Office estate)



**Performance commentary (including measures)**

Metered usage for the 2012-13 period indicates an average consumption of 5.18m<sup>3</sup> per FTE.

**Controllable impacts commentary**

Our water use is for essential welfare services only – for example, toilet/washroom facilities and drinking water.

**Overview of influenced impacts**

Ofwat occupies a multi-tenanted building and water supplies are provided by the landlords. We encourage the installation of efficient and sustainable fittings in landlord areas where possible.

**About our data**

2012-13 has seen an improvement in the accuracy of the non-financial sustainability information, where metered readings were widely available. We will continue to look at development in systems that will enhance our reporting requirements in 2013-14.

**Future plans**

We will continue to take steps to improve our energy and water efficiency. Recycling is now integrated with the use of our office accommodation. The use of trains is already the principal means of business transport and we are implementing a video conferencing facility in early 2013-14 to reduce travel needs.

# Remuneration report

## Executive Team

The composition of the Executive Team in the reporting period was as follows.

### Regina Finn\*

Chief Executive

### Keith Mason\*

Senior Director of Finance and Networks

### Sonia Brown\*

Senior Director of Markets and Economics

### Marian Spain

(until 31 January 2013)

Senior Director of Policy and Communications

### Stuart Crawford

Senior Director of Corporate Services and Programme Management

### Robert Beasley

(from 25 February 2013)

Interim Senior Director of Corporate Affairs

\* denotes Board member

## Service contracts

Remuneration of members of the Executive Team (with the exception of Stuart Crawford and Robert Beasley) is set out in their contracts and subject to annual review in line with awards recommended by the Senior Salaries Review Body. Stuart Crawford and Robert Beasley are not members of the Senior Civil Service (SCS).

The notice period for all members of the Executive Team does not exceed six months.

These contracts can be terminated by the standard process as set out in the Civil Service Management Code. The arrangements for early termination of members of the Executive Team are made in accordance with the service contract of the relevant individual. Each contract provides for a payment in lieu of notice on early termination based on the provisions of the Civil Service Compensation Scheme.

Each permanent member of the Executive Team (with the exception of Stuart Crawford) participates in a bonus scheme, which is in line with the Senior Salaries Review Body recommendations. The bonus is paid on the individual's performance. Bonus payments are non-consolidated and non-pensionable.

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

## Interim directors

During the financial year we employed the service of an externally appointed Interim Senior Director of Corporate Affairs – Robert Beasley. A six-month contract was awarded in January 2013 for a value of £72 thousand to Capita Resourcing Ltd T/A Veredus.

## Staff remuneration

The Remuneration Committee approves annual pay awards.

Salaries are set on the basis of recruiting and retaining high-calibre staff within the framework of controlling public expenditure set by the Government. A non-consolidated bonus may be awarded to staff with exceptional performance. Bonus nominations received are considered firstly by a panel of appointed staff who examine the applications for consistency and fairness before making a recommendation to the Executive Team. The Executive Team then meets to review and agree all bonus allocations. The annual bonus pot is agreed by the Remuneration Committee.

## Non-executive Directors

The Chairman and Non-executive Directors are remunerated in line with the guidance made by Cabinet Office.

## Remuneration Committee members

During the year, committee members were:

- Wendy Barnes, Chair (from 1 August 2012);
- Gillian Owen, Chair (until 31 July 2012);
- Robin Paynter Bryant (from 1 April 2012); and
- Philip Fletcher CBE (until 31 October 2012).

## 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 is 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 on page 35.

A full provision has been made in the accounts for liabilities arising in respect of the by-analogy pension schemes for both the former Directors General as required by HM Treasury (note

15.2). Claims are made on the Exchequer to cover the pension costs that relate to employment other than with Ofwat.

The roles of the Chairman and Non-executive Directors are non-pensionable.

### Compensation for loss of office

The continued use of the restructuring provision set up in

2009-10 is detailed in note 15.1. The office reorganisation which started in June 2011 meant that a further five employees left under voluntary redundancy terms in the year ending 31 March 2013. They received a compensation payment of between £11 thousand and £129 thousand.

Of the five, none took early retirement.

## Senior managers' remuneration

The following information was subject to audit.

	Salary £000	Bonus payments £000	2012-13 Benefits in kind (to nearest £100)	Salary £000	Bonus payments £000	2011-12 Benefits in kind (to nearest £100)
<b>Regina Finn</b> , Chief Executive	140-145	10-15	10,700	140-145	10-15	10,600
<b>Keith Mason</b> , Senior Director of Finance and Networks	110-115	–	–	105-110	5-10	–
<b>Sonia Brown</b> , Senior Director of Markets and Economics (from 1 March 2012)	125-130	–	8,300	5-10 (full year equivalent 115-120)	–	–
<b>Stuart Crawford</b> , Senior Director of Corporate Services and Programme Management	120-125	–	1,900	120-125	–	1,300
<b>Marian Spain</b> , Senior Director of Policy and Communications (Until 31 January 2013)	105-110	–	5,700	110-115	–	7,700
<b>Cathryn Ross</b> , Senior Director of Markets and Economics (until 7 August 2011)	–	–	–	50-55 (full year equivalent 130-135)	10-15	100
<b>Compensation for loss of office</b> Marian Spain	25	–	–	–	–	–
<b>Band of highest paid Director's total remuneration</b>	165-170	–	–	165-170	–	–
<b>Median salary £</b>	35,350	–	–	34,971	–	–
<b>Ratio</b>	4.7	–	–	4.8	–	–

## Third party payments\*

### Provision of interim manager services

The following information was subject to audit.

	2012-13 Payment £000	2011-12 Payment £000
<b>Keyworth Consulting Ltd</b> Tim Keyworth, Interim Chief Economist (from 1 August 2011 to 31 March 2012)	–	125-130
<b>Capita Resourcing Ltd T/A Veredus</b> Robert Beasley, Interim Senior Director of Corporate Affairs (six months from 25 February 2013)	15-20 (contract value 70-75)	–

\*Civil Service pension rights are not applicable to members of the senior Executive Team while contracted through a third party.

## Non-executive members of the Authority remuneration

The following information was subject to audit.

	2012-13 Salary £000	2012-13 Benefits in kind (to nearest £100)	2011-12 Salary £000	2011-12 Benefits in kind (to nearest £100)
<b>Jonson Cox,</b> Chairman (from 1 November 2012)	35-40 (full year equivalent 105-110)	1,000	–	–
<b>Philip Fletcher CBE,</b> Chairman (until 31 October 2012)	50-55 (full year equivalent 105-110)	1,400	105-110	1,200
<b>Penny Boys CB,</b> Non-executive Director	15-20	2,900	15-20	1,700
<b>Gillian Owen,</b> Non-executive Director (until 31 July 2012)	0-5 (full year equivalent 10-15)	800	10-15	800
<b>Robin Paynter Bryant,</b> Non-executive Director (from 24 January 2012)	10-15	1,400	0-5 (full year equivalent 10-15)	–
<b>Wendy Barnes,</b> Non-executive Director (from 7 February 2012)	10-15	2,000	0-5 (full year equivalent 10-15)	–

## Independent member of the Audit Committee remuneration

The following information was subject to audit.

	2012-13		2011-12	
	Salary £000	Benefits in kind (to nearest £100)	Salary £000	Benefits in kind (to nearest £100)
Richard Kennett, Independent Member	0-5	600	0-5	800

### Salary

'Salary' covers includes gross salary, overtime, recruitment and retention allowances, private office allowances and any other allowance to the extent that it is subject to UK taxation. This report is based on accrued payments made by Ofwat and thus recorded in these accounts.

### Benefits in kind

The monetary value of benefits in kind covers any benefits provided by Ofwat and treated by HM Revenue and Customs as a taxable emolument. Payments outlined above were net of tax and the tax amounts were paid over to HM Revenue and Customs. Items that fell into this category were subsistence and travel arrangements for the Authority.

### Bonuses

Bonuses are based on performance levels attained and are made as part of the appraisal process. Bonuses relate to the performance in the year in which they become payable to the individual. The bonuses reported in 2012-13 relate to performance in 2012-13 and the comparative bonuses reported for 2011-12 relate to performance in 2011-12.

### Median salary

Ofwat is required to disclose the relationship between the remuneration of the highest paid director in the organisation and the median remuneration of the organisation's workforce.

In 2012-13 no employees received remuneration in excess

of the highest paid director (2011-12: nil). Remuneration excluding senior managers ranged from £3,059 to £104,807 (2010-11: £3,246 to £107,973).

Total remuneration includes salary, non-consolidated performance related pay, benefits in kind as well as severance payments. It does not include employer pension contributions and the cash equivalent transfer value of pensions.

## Senior managers' pension benefits

The following information was subject to audit.

	Real increase in pension and related lump sum at age 60 £000	Accrued pension at age 60 at 31 March 2013 and related lump sum £000	CETV at 31 March 2012 £000	CETV at 31 March 2013 £000	Real increase in CETV £000	Employer contribution to partnership pension account Nearest £100
<b>Regina Finn,</b> Chief Executive	2.5-5: lump sum –	15-20: lump sum –	171	219	31	–
<b>Keith Mason,</b> Senior Director of Finance and Networks	0-2.5: lump sum 5-7.5	25-30: lump sum 80-85	473	546	44	–
<b>Sonia Brown,</b> Senior Director of Markets and Economics (from 1 March 2012)	2.5-5: lump sum 12.5-15	20-25: lump sum 65-70	196	261	50	–
<b>Stuart Crawford,</b> Senior Director of Corporate Services and Programme Management	0-2.5: lump sum –	10-15: lump sum –	176	228	36	–
<b>Marian Spain,</b> Senior Director of Policy and Communications (until 31 January 2013)	0-2.5: lump sum –	45-50: lump sum –	477	519	(3)	–

### Civil Service pensions

Pension benefits are provided through the Civil Service pension arrangements. From 30 July 2007, Civil Servants may be in one of four defined benefit schemes: either a final salary scheme (classic, premium or classic plus); or a whole career scheme (nuvos). These statutory arrangements are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under classic, premium, classic plus and nuvos are increased annually in line with Pensions Increase legislation. Members joining from October 2002 may opt for either

the appropriate defined benefit arrangement of a 'money purchase' stakeholder pension with an employer contribution (partnership pension account).

Employee contributions are salary related and range between 1.5% and 3.9% of pensionable earnings for classic and 3.5% and 5.9% for premium, classic plus and nuvos. Increases to employee contributions will apply from 1 April 2013. Benefits in classic accrue at the rate of 1/80th of final pensionable earnings for each year of service. In addition, a lump sum equivalent to three years' initial pension 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. Classic plus is essentially a hybrid with benefits for service before 1 October 2002 calculated broadly as per classic and benefits for service from October 2002 worked out as in premium. In nuvos, a member builds up a pension based on their pensionable earnings during their period of scheme membership. At the end of the scheme year (31 March), the member's earned pension account is credited with 2.3% of their pensionable earnings in that scheme year and

the accrued pension is updated in line with Pensions Increase legislation. In all cases members may opt to give up (commute) pension for a lump sum up to the limits set by the Finance Act 2004.

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

The accrued pension quoted is the pension the member is entitled to receive when they reach pension age, or immediately on ceasing to be an active member of the scheme if they are already at or over pension age. Pension age is 60 for members of classic, premium and classic plus and 65 for members of nuvos.

Further details about the Civil Service pension arrangements can be found at the website <http://www.civilservice.gov.uk/pensions>

### Cash Equivalent Transfer Value (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 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 figures include the value of any pension benefit in another scheme or arrangement that the individual has transferred to the Civil Service pension arrangements. They also include any additional pension benefit

accrued to the member as a result of their buying additional pension benefits at their own cost. CETVs are worked out within the guidelines and framework prescribed by the Institute and Faculty of Actuaries and do not take account of any actual or potential reduction to benefits resulting from Lifetime Allowance Tax which may be due when pension benefits are taken.

### Real increase in CETV

This reflects the increase in CETV effectively funded by the employer. It does not include 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.

**Regina Finn**  
**Accounting Officer**  
**25 June 2013**

## Statement of Accounting Officer's responsibilities

Under section 5 of the Government Resources and Accounts Act 2000, Ofwat is required to prepare resource accounts for each financial year, in conformity with HM Treasury direction, detailing the resources acquired, held, or disposed of during the year and the use of resources by the department during the year.

The resource accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of the department, the net resource outturn, resources applied to the 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 requirements of the Government Financial Reporting Manual and in particular to:

- observe the accounts direction issued by HM Treasury, including 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 has appointed Regina Finn, Chief Executive, Accounting Officer of the department.

The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which an Accounting Officer is answerable, for keeping proper records and safeguarding the department's assets, are set out in 'Managing Public Money' issued by HM Treasury.

# The Governance statement

## Scope of responsibility

The Accounting Officer and Ofwat Board have responsibility for maintaining corporate governance that supports the achievement of Ofwat's policies, aims and objectives, while safeguarding the public funds and departmental assets. This is in accordance with the responsibilities set out in 'Managing Public Money'. The Accounting Officer is accountable to the Chairman and Board for all aspects of Ofwat's work. This includes the management of risk.

Ofwat's duties are laid down by legislation, in particular the Water Industry Act 1991 and the Water Act 2003. Ofwat is a non-ministerial government department.

## The purpose of the governance framework

Ofwat adheres closely to the principles set out in the 'UK Corporate Governance Code' 2010 and 2012 (Code). The governance framework is designed to adopt the practices set out in the code wherever this is relevant and practical. The aim is to give assurance that Ofwat carries out its duties in a manner that meets the highest standards of internal control and risk management. This is based on processes designed to identify and prioritise the opportunities and risks to the achievement of Ofwat's strategy, policies, aims and objectives; to evaluate the likelihood of those opportunities and risks being realised (and the impact should they be realised); and to manage them efficiently, effectively and economically.

The governance framework has been in place in Ofwat for the year ended 31 March 2013 and up to the date of approval of the annual report and accounts, and accords with HM Treasury guidance. Assurance is provided to the Accounting Officer by each budget holder (directors and team leaders) who have signed an assurance statement covering the period from 1 April 2012 to 31 March 2013.

## Key elements of the governance framework

### The Board

The Board recognises the importance of leadership to create an environment where performance and risk management are effective. In line with the principles of the Code, Ofwat's Board has a majority of non-executives with a non-executive Chairman, three Non-executive Directors and three Executive Directors including the Chief Executive. The non-executive members are independent of management. The Board membership provides the necessary balance of experience and expertise covering Ofwat's duties and strategy. The Director of Legal Services is the Board secretary and legal adviser.

There were no examples of company appointments or consultancy arrangements, or other significant interests, held by Board members giving rise to a potential conflict with their responsibilities as members of the Board.

In November 2012, the new Chairman, Jonson Cox, was appointed. Following a review Board governance was further strengthened by the recruitment of a further three non-executives who are due to take up post in the first quarter of 2013-14.

To ensure compliance where possible with the Code, the Board's Rules of Procedure are updated periodically and published on the Ofwat website.

This includes:

- procedure for conflicts of interest;
- register of Board members' disclosable interests;
- matters reserved to the Board;
- Audit Committee terms of reference;
- Remuneration Committee terms of reference;
- New Company Appointments Committee terms of reference; and
- code of conduct.

Minutes of the Board's meetings are published on the Ofwat website.

## Non-executive Directors' attendance at the Board meetings and three sub-committee meetings

From April 2012 to March 2013.

Board members	10 Board meetings	2 Remuneration Committee meetings	3 Audit Committee meetings	NAV Committee meetings**
<b>Jonson Cox, Chairman*</b> (From 1 November 2012)	4/4	1/1	–	–
<b>Penny Boys, Non-executive Director</b>	10/10	1/2	3/3	–
<b>Wendy Barnes, Non-executive Director</b>	9/10	1/1	2/2	–
<b>Robin Paynter Bryant, Non-executive Director</b>	10/10	2/2	–	–
<b>Philip Fletcher CBE, Chairman</b> (Until 31 October 2012)	6/6	1/1	–	–
<b>Gill Owen, Non-executive Director</b> (Until 31 July 2012)	3/4	1/1	1/1	–
<b>Executive members</b>				
<b>Regina Finn, Chief Executive Director</b>	10/10	2/2	3/3	–
<b>Keith Mason, Senior Director of Finance and Networks</b>	10/10	–	–	–
<b>Sonia Brown, Senior Director of Markets and Economics</b>	10/10	–	–	–

\*Attended the October Board meeting as a designate.

\*\* The committee considered papers through correspondence up to 30 September 2012. The Board agreed that from 1 October the functions of the committee would be delegated to the Chief Executive.

The Chairman and non-executives have played a full part in Board business through their attendance and contributions at Board meetings and meetings of committees of the Board as indicated above.

The Board met in Wales in May 2012, using the occasion to meet informally with a Minister and officials of the Welsh Government.

In addition to its formal meetings the Board held a number of challenge sessions to test emerging thinking on key policy issues and workshops to receive more advanced draft proposals to facilitate discussion and shaping of new policy and developments.

These provide a valuable way for the Board to challenge and shape policy and developments ahead of consultation with stakeholders and final decision-making. During the year, there were Board workshops on setting price controls, customer engagement, wholesale incentives, market reform and casework strategy, and a challenge session on financing beyond the ring-fence. Board members also attended the sustainable water events in July and November 2012 at which Ofwat gave briefings on its strategy and listened to the views of stakeholders.

To provide further assurance to the decision-making process the Board regularly received

independent advice from external advisory experts. This includes joint discussions at workshops. This has been particularly important over the past year when the Board has not been at full strength.

During the year, the Board had three standing committees: the New Company Appointments Committee (until September 2012), the Audit Committee and the Remuneration Committee. Each was chaired by a Non-executive Director. The Chair of each committee reports to the Board after each meeting and the minutes are circulated for information.

A Nominations and Governance Committee will be established in 2013-14.

### Committees of the Board

#### Audit Committee

In line with the principles of the Code, the Audit Committee is chaired by Penny Boys, who is a Non-executive Director. The non-executive members who served during the year are Gillian Owen (until 31 July 2012), Wendy Barnes (from 1 August 2012) and Richard Kennett (Independent Member). The Chief Executive, directors, other staff, the external auditors (National Audit Office), the internal auditors (PwC), and the Assistant Board Secretary attend by invitation.

The committee's role is to support the Board in its responsibilities for issues of risk, control and governance and associated assurance. This is done by reviewing the comprehensiveness of assurances in meeting the Board and Accounting Officer's assurance needs, reviewing the reliability and integrity of these assurances, and providing an opinion on how well the Board and Accounting Officer are supported in decision taking and discharging their accountability obligations. The committee met three times during 2012-13. In June 2012, the committee submitted its annual report to the Board along with its recommendations to approve the annual accounts.

Matters discussed by the committee included:

- follow up of the recommendation arising from

the investigation (January 2012) into two anonymous letters alleging breach of the Civil Service Code, recruitment and procurement procedures.

Although the investigation did not identify any breaches of procedure, there were a few actions recommended that further strengthened procedures;

- the final stages of the office reorganisation project;
- financial systems audit findings; and
- risk assurance and management.

All of the audit reviews were completed. The 2012-13 internal audit findings were satisfactory. Apart from one medium risk rating all the other findings were low risk.

An anonymous letter sent to the Chairman designate in September 2012, alleged breaches of procedure in placing contracts. An immediate independent review of the allegations was made by the internal auditors. The review was thorough and rigorous in approach. The internal auditors reported back to the committee in November that no issues of concern were found. The committee decided no further action was required.

The risk assessment for the next financial year 2013-14 remains high. The main areas of risk are:

- initial phases of market development; and
- the launch of the next periodic review of price controls project.

Following a review of strategic risk, the March 2013 Audit

Committee meeting agreed the internal audit plan for 2013-14 should cover the following areas:

- risk management policies and procedures;
- price review 2014 readiness and risk assurance;
- performance measurement (deferred from 2012-13 to give time for stakeholder consultation); and
- financial and human resources systems.

The aim is to ensure risk management is effective and strategy delivery is not compromised.

In March 2013 the Audit Committee approved its three – year forward plan for 2013-14 to 2015-16.

#### Remuneration Committee

In line with the principles of the Code, the Remuneration Committee was chaired by a Non-executive Director, Gillian Owen up to 31 July 2012 and Wendy Barnes from 1 August 2012. The other non-executive members who served during the year were Robin Paynter Bryant and Philip Fletcher. The committee's role is to consider matters relating to the pay and conditions of employment of Ofwat's staff and succession planning. Issues discussed during the year included:

- key performance indicators;
- the 2011-12 reorganisation; and
- pay and grading.

During 2013-14, the committee will be focusing particularly on succession planning and development at a senior level.

## New Company Appointments Committee

The New Company Appointments Committee was chaired by Philip Fletcher until its cessation in September 2012 when decision – making was delegated by the Board to the Chief Executive with reservation that novel issues were referred to the Board. The committee considered the following:

- applications from SSE Water to serve the Marine Wharf, Norwich Common and Riverlight sites;
- an application from IWNL to serve the Oakham phase one site; and
- Ofwat's revised approach to assessing the financial viability of applications for new appointments and variations.

## Executive Team and audit arrangements

### Executive Team

The Executive Team comprises the executive members of the Board and the Senior Directors. Its role is to assist the Chief Executive in the day-to-day running of the office. It meets frequently and decides on key matters relating to policy, management and resources, subject to the overall direction, reserved powers and control of the Board. Progress is fed back to each Board meeting in the Chief Executive's report.

During 2012-13, we continued to develop and strengthen our programme and project management delivery using the governance procedures set out

in 'Managing Successful Programmes' (MSP) and Prince 2.

### Auditors

The Comptroller and Auditor General, who has been appointed under statute and reports to Parliament, has audited the accounts. The notional cost of providing audit services in respect of the accounts was £41 thousand. There was no auditor remuneration (actual or notional) for non-audit work.

Our internal audit service provides an independent appraisal service for management by measuring and evaluating the adequacy, reliability and effectiveness of management and financial control systems. Internal audit makes recommendations based on the appraisal of each system reviewed. An annual assurance report is provided to the Accounting Officer and Audit Committee. We have chosen to outsource the provision of the internal audit service to ensure wholly independent and fully professional analysis and recommendations. For 2012-13, our provider is PwC, who were appointed on 1 April 2010, following a competitive tender. The 2012-13 internal audit was performed in accordance with the Government Internal Audit Standards (GIAS).

The Accounting Officer has taken all necessary steps to make herself aware of any relevant audit information and to establish that our auditors are aware of that information. So far as she is aware, there is no relevant audit information of which our auditors are unaware.

## Risk management

In line with the principles of the Code, the Board, Audit Committee and Executive Team regularly review the strategic risk register. In addition, the Audit Committee receives risk assurance presentations on a rolling basis from programme and project directors. Risk management is embedded into programmes, projects and operational work streams. Senior managers, and their staff, are committed to managing risk. To strengthen its oversight we continue to have an Independent Member of our Audit Committee, who is not a Board member.

Strategic risks are managed by the senior responsible owner. The framework is based on HM Treasury standard guidance in the Orange book. The key elements are:

- the goal of risk management is to support the delivery of our strategy;
- risk ownership responsibilities have been clearly allocated from the Accounting Officer and Board to specific 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;

- risk management workshops are held with project managers;
- project and operational risk registers are reviewed regularly;
- programme and project directors attend the Audit Committee to provide briefings on risk management;
- the strategic risk register is updated regularly and reports prepared for Executive Team and Audit Committee; and
- actions are followed up from internal audit studies to the agreed timetable.

Our risk strategy is reviewed annually and updated as required.

## Risk environment

The overall risk environment remained high during the year due to the office reorganisation and the launch of extensive consultations key to the delivery of the Ofwat strategy, notably on the implementing price limits (IPL) and enabling licence modification (ELM) projects. We continue to seek broad based stakeholder support for our proposals to secure the long-term financial, social and environmentally sustainable future for the water and sewerage sectors. The key risks managed during the year were:

- the IPL and ELM projects required effective risk management at the highest level to ensure key strategy goals were progressed. This required significant additional resources and external engagement to ensure the highest risks were mitigated;
- the office reorganisation was completed by March 2012. However, risk remained in filling

new posts notably at director level. This risk was mitigated by contracting interim directors to ensure programme delivery continued. The majority of key posts were filled by the year end; and

- the delays in the recruitment of a new Chairman and three non-executives was a key risk during the year. The new Chairman took up post on 1 November 2012. The appointment of three new Non-executive Directors was completed in May 2013. Risks posed by this were mitigated by seeking independent external expert assurance on key policy decisions and the agreement of the previous Chairman to continue in post for a short extension.

Looking ahead the risk environment remains uncertain with effective risk management an essential component of the price review 2014, market reform and Water Bill projects.

## Information security statement

Ofwat holds a range of information covering commercial and personal data. We have an Information Risk Policy (IRP) and related procedures in place. In June 2012, we reported to the Cabinet Office our Annual Security Report. No areas of concern were identified.

## Ofwat's effectiveness

The Accounting Officer and Board have responsibility for reviewing the effectiveness of the system of performance management and internal control. The evidence of performance and risk

management is informed by the work of the internal auditors and the senior managers within Ofwat who have a responsibility for developing and maintaining the internal control framework, and comments made by the external auditors in their management letter and other reports. The Accounting Officer has been advised on the implications of the result of her review of the effectiveness of the system of internal control by the Board and the Audit Committee and a plan to address weaknesses and ensure continuous improvements of the system is in place.

The vision, mission and goals from our strategy provide the basis of our annual priorities which are set out in and consulted on, in the forward programme each year. This sets out our high-level objectives for the coming financial year plus a look forward to the following two years. This forward programme drives programme and project plans and ultimately each member of staff's objectives. Directors, project managers and team leaders regularly review progress on programme, project and team plans. The Executive Team reviews monthly the progress of key projects. The Executive Team and the Board review progress on the strategy each quarter. We have a process of individual performance review for staff in place. The resource requirements for Ofwat are assessed regularly against the forward programme and developing priorities. The Non-executive Directors also provide the Accounting Officer with an independent view of our performance.

The Board, Audit Committee and Executive Team regularly assess and monitor our performance and related systems of internal control. Our internal auditors in 2012-13, PwC, review and advise on our risk management processes and internal controls and during the year reviewed systems and procedures in respect of finance and information security.

PwC 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 systems of internal control together with recommendations for improvement. The opinion of the Head of Internal Audit is that Ofwat has adequate and effective risk management, control and governance processes to manage the achievement of its objectives.

**Regina Finn**  
**Accounting Officer**  
**25 June 2013**

# 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 Water Services Regulation Authority (Ofwat) for the year ended 31 March 2013 under the Government Resources and Accounts Act 2000. The financial statements comprise: the Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity; and the related notes. I have also audited the Statement of Parliamentary Supply and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

## Respective responsibilities of the Accounting Officer and auditor

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Accounting Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Government Resources and Accounts Act 2000. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the department's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Accounting Officer; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

I am required to obtain evidence sufficient to give reasonable assurance that the Statement of Parliamentary Supply properly presents the outturn against voted Parliamentary control totals and that those totals have not been exceeded. The voted Parliamentary control totals are Departmental Expenditure Limits (Resource and Capital), Annually Managed Expenditure (Resource and Capital), Non-Budget (Resource) and Net Cash Requirement. I am also required

to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

## Opinion on regularity

In my opinion, in all material respects:

- the Statement of Parliamentary Supply properly presents the outturn against voted Parliamentary control totals for the year ended 31 March 2013 and shows that those totals have not been exceeded; and
- the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

## Opinion on financial statements

In my opinion:

- the financial statements give a true and fair view of the state of the department's affairs as at 31 March 2013 and of its net operating cost for the year then ended; and
- the financial statements have been properly prepared in

accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions issued thereunder.

## Report

I have no observations to make on these financial statements.

## Opinion on other matters

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with HM Treasury directions made under the Government Resources and Accounts Act 2000; and
- the information given in the annual report for the financial year for which the financial statements are prepared is consistent with the financial statements.

**Amyas C E Morse**  
**Comptroller and Auditor General**  
**157-197 Buckingham Palace Road**  
**Victoria**  
**London**  
**SW1W 9SP**  
**26 June 2013**

## Matters on which I report by exception

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- adequate accounting records have not been kept or returns adequate for my audit have not been received from branches not visited by my staff; or
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- I have not received all of the information and explanations I require for my audit; or
- the Governance Statement does not reflect compliance with HM Treasury's guidance.

# Statement of Parliamentary Supply

for the year ended 31 March 2013

Summary of resource and capital outturn 2012-13

		Estimate			Outturn			2012-13 £000	2011-12 £000
	Note	Voted	Non-voted	Total	Voted	Non-voted	Total	Voted outturn compared with Estimate: saving/ (excess)	Total
<b>Departmental expenditure limit</b>	3								
– Resource		3,126	–	3,126	1,148	–	1,148	1,978	(4,805)
– Capital		500	–	500	268	–	268	232	362
<b>Annually managed expenditure</b>									
– Resource		–	–	–	–	–	–	–	–
– Capital		–	–	–	–	–	–	–	–
<b>Total budget</b>		<b>3,626</b>	<b>–</b>	<b>3,626</b>	<b>1,416</b>	<b>–</b>	<b>1,416</b>	<b>2,210</b>	<b>(4,443)</b>
Total resource		3,126	–	3,126	1,148	–	1,148	1,978	(4,805)
Total capital		500	–	500	268	–	268	232	362
<b>Total</b>		<b>3,626</b>	<b>–</b>	<b>3,626</b>	<b>1,416</b>	<b>–</b>	<b>1,416</b>	<b>2,210</b>	<b>(4,443)</b>

## Net cash requirement 2012-13

	2012-13 £000	2011-12 £000
Outturn compared with Estimate: saving/ (excess)		
Note	Estimate	2010-11 Outturn
	3,467	406
		3,061
		821

## Administration costs 2012-13

	2012-13 £000	2011-12 £000
Note	Estimate	Outturn
	3,126	1,148
		(4,805)

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

# Statement of Comprehensive Net Expenditure

## for the year ended 31 March 2013

	Note	2012-13 £000	2011-12 £000
<b>Administration costs</b>			
Staff costs	6	10,607	12,351
Other costs	7	9,491	6,753
Income	8	(18,950)	(23,909)
<b>Net operating costs for the year ended 31 March 2013</b>		<b>1,148</b>	<b>(4,805)</b>
<b>Total expenditure</b>			
		20,098	19,104
<b>Total income</b>			
		(18,950)	(19,104)
<b>Income deferred from prior years</b>			
		–	(4,805)
<b>Net operating costs for the year ended 31 March 2013</b>		<b>1,148</b>	<b>(4,805)</b>
<b>Net gain on revaluation of property, plant and equipment</b>			
		–	–
<b>Non-cash charges – actuarial (gain)/loss</b>			
		99	110
<b>Other comprehensive income/expenditure for the year ended 31 March 2013</b>		<b>99</b>	<b>110</b>
<b>Total comprehensive expenditure for the year ended 31 March 2013</b>			
		<b>1,247</b>	<b>(4,695)</b>

# Statement of Financial Position

## as at 31 March 2013

	Note	31 March 2013 £000	31 March 2012 £000
<b>Non-current assets:</b>			
Property, plant and equipment	9	619	617
Intangible assets	10	192	259
<b>Total non-current assets</b>		<b>811</b>	<b>876</b>
<b>Current assets:</b>			
Trade and other receivables	12	447	555
Cash and cash equivalents	13	1,712	1,679
<b>Total current assets</b>		<b>2,159</b>	<b>2,234</b>
<b>Total assets</b>		<b>2,970</b>	<b>3,110</b>
<b>Current liabilities:</b>			
Trade and other payables	14	(4,234)	(3,672)
Provisions			
<b>Total current liabilities</b>		<b>(4,234)</b>	<b>(3,672)</b>
<b>Non-current assets less net current assets/liabilities</b>		<b>(1,264)</b>	<b>(562)</b>
<b>Non-current liabilities:</b>			
Provisions	15	(392)	(354)
Pension liabilities	15	(2,651)	(2,600)
Other payables	14	(9)	–
<b>Total non-current liabilities</b>		<b>(3,052)</b>	<b>(2,954)</b>
<b>Assets less liabilities</b>		<b>(4,316)</b>	<b>(3,516)</b>
<b>Taxpayers' equity:</b>			
General Fund		(4,354)	(3,554)
Revaluation Reserve		38	38
<b>Total equity</b>		<b>(4,316)</b>	<b>(3,516)</b>

# Statement of Cash Flows

## for the year ended 31 March 2013

	Note	2012-13 £000	2011-12 £000
<b>Cash flows from operating activities</b>			
Net operating cost	3	1,148	(4,805)
Adjustments for non-cash transactions	7	(769)	(675)
Decrease in trade and other receivables		(108)	(171)
Less movements in receivables relating to items not passing through the Comprehensive Statement of Net Expenditure		–	–
(Increase)/decrease in trade payables		(571)	5,191
Less movements in payables relating to items not passing through the Comprehensive Statement of Net Expenditure		(40)	653
Use of provisions	15	403	204
<b>Net cash outflow from operating activities</b>		<b>63</b>	<b>397</b>
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment		248	178
Purchase of intangible assets		20	187
Proceeds of disposal of property, plant and equipment		–	(3)
Net movement in capital receivables (payables)		77	62
<b>Net cash outflow from investing activities</b>		<b>345</b>	<b>424</b>
<b>Cash flows from financing activities</b>			
From the Consolidated Fund (Supply) – current year		(2,118)	(2,500)
Advance from the Contingencies Fund		4,500	3,000
Repayment to the Contingencies Fund		(4,500)	(3,000)
Capital element of payments in respect of finance leases		(2)	–
<b>Net financing</b>		<b>(2,120)</b>	<b>(2,500)</b>
<b>Net increase in cash and cash equivalents in the period before adjustment for receipts and payments to the Consolidated Fund</b>			
		<b>1,712</b>	<b>1,679</b>
Receipts due to the Consolidated Fund which are outside the scope of the department's activities		–	–
Payment of amounts due to the Consolidated Fund		(1,679)	(965)
<b>Net increase in cash and cash equivalents in the period after adjustment for receipts and payments to the Consolidated Fund</b>		<b>33</b>	<b>714</b>
<b>Cash and cash equivalents at the beginning of the period</b>	<b>13</b>	<b>1,679</b>	<b>965</b>
<b>Cash and cash equivalents at the end of the period</b>	<b>13</b>	<b>1,712</b>	<b>1,679</b>

# Statement of Changes in Taxpayers' Equity

## for the year ended 31 March 2013

		General Fund	Revaluation Reserve	Total reserves
	Note	£000	£000	£000
<b>Balance at 1 April 2011</b>		(9,112)	40	(9,072)
<b>Changes in taxpayers' equity for 2011-12</b>				
Total comprehensive net expenditure for the year		4,697	(2)	4,695
Non-cash charges – auditor's remuneration	7	41	–	41
Net Parliamentary funding drawn down		2,500	–	2,500
Amounts issued from Consolidated Fund but not spent at year end	14	(1,679)	–	(1,679)
<b>Balance at 31 March 2012</b>		<b>(3,554)</b>	<b>38</b>	<b>(3,516)</b>
<b>Changes in taxpayers' equity for 2012-13</b>				
Total comprehensive net expenditure for the year		(1,247)	–	(1,247)
Non-cash charges – auditor's remuneration	7	41	–	41
Net Parliamentary funding drawn down		2,118	–	2,118
Amounts issued from Consolidated Fund but not spent at year end	14	(1,712)	–	(1,712)
<b>Balance at 31 March 2013</b>		<b>(4,354)</b>	<b>38</b>	<b>(4,316)</b>

# Notes to the departmental accounts

## 1. Statement of accounting policies

These financial statements have been prepared in accordance with the 2012-13 Government Financial Reporting Manual (FReM) issued by HM Treasury. The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of Ofwat for the purpose of giving a true and fair view has been selected. The particular policies adopted by Ofwat are described below. They have been applied consistently in dealing with items that are considered material to the accounts.

In addition to the primary statements prepared under IFRS, the FReM also requires Ofwat to prepare one additional primary statement. The Statement of Parliamentary Supply and supporting notes show outturn against Estimate in terms of the net resource requirement and the net cash requirement.

### 1.1 Accounting convention

These accounts have been prepared under the historical cost convention modified to account for the

revaluation of property, plant and equipment, and intangible assets at fair value to the business by reference to their valuation in existing use.

### 1.2 Property, plant and equipment

Items of property, plant and equipment have been stated at fair value. An annual verification exercise is completed to ensure that the assets are present and in working condition. Any items of damaged equipment are disposed of.

Items include furniture and fittings, office machinery and telecommunications equipment, leasehold improvements and IT equipment.

All individual items must exceed a capitalisation threshold of £2,500 for inclusion as property, plant and equipment.

Depreciation is provided at rates calculated to provide for the impairment of an item of property, plant and equipment by equal instalments over their estimated useful life. Property, plant and equipment lives are normally in the following ranges:

Asset classification	Asset life
Leasehold improvements	Term remaining on lease
Furniture, fixture and fittings	10 years
IT equipment	3-5 years
Office machinery and telecommunications	5 years

Assets under development are not depreciated until the asset is in operational use.

### 1.3 Intangible assets

Intangible assets include separable software licences such as those for the finance system. They are separable in that the IT equipment will operate without them.

Operating software is included with the cost of the tangible asset it supports.

### 1.4 Amortisation

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.

Assets under development are not depreciated until the asset is in operational use.

## 1.5 Financial instruments

Ofwat does not hold any complex financial instruments. Financial instruments included within these accounts are receivables and payables (notes 12 and 14). Trade receivables are recognised initially at fair value less provision for impairment. A provision for impairment is made when Ofwat is unable to collect an amount due in accordance with the agreed terms.

## 1.6 Financing

Ofwat is primarily resourced by licence fees. Licence fees are charged to companies that Ofwat regulates in the water and sewerage sectors. The licence fees levied are subject to a ceiling governed by condition N of the Water Industry Act 1991.

## 1.7 Operating income

Operating income is income that relates directly to the operating activities. It consists primarily of licence fees charged on a full cost recovery basis.

Since all costs are recovered through 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 surrenderable to the Consolidated Fund. The balance of surrendered unspent licence fee income is taken into account when calculating the future levels of licence fees charged to the water and sewerage companies and water only companies under the Water Industry Act 1991 by application to HM Treasury to draw cash from reserves. There is no reason to think that future reserve claims will not be met.

## 1.8 Cash

Cash is primarily generated through licence fees and the activities outlined in 1.6. At the end of a financial year any cash remaining (net of accrued expenditure) in Ofwat's bank accounts is paid over to the Consolidated Fund. As Ofwat does not receive the income from companies at the start of the financial year a sum is borrowed from the Consolidated Fund and repaid later.

During 2012-13, Ofwat held bank accounts with Citibank and Royal Bank of Scotland.

## 1.9 Trade receivables

Trade receivables are recognised initially at fair value less provision for impairment. A provision for impairment of trade receivables is established when Ofwat has evidence that it will not be able to collect all amounts due in accordance with the original terms of the receivables.

## 1.10 Fines and penalty income

Income recovered from fines and penalties is not recorded as income in the Statement of Comprehensive Net Expenditure. It is recognised as a payment due to the Consolidated Fund at the date the legal notice is served.

The income is collected by Ofwat and surrendered to the Consolidated Fund within 30 days of receipt.

## 1.11 Administration and programme expenditure

Administration costs are recorded in the Statement of Comprehensive Net Expenditure. They include the costs of running Ofwat, as determined under the administration cost-control regime. There was no programme expenditure between 1 April 2012 and 31 March 2013 (2011-12: nil).

## 1.12 Leases

Rentals due on 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.

Equipment purchased under a finance lease is charged to the Statement of Comprehensive Net Expenditure through depreciation on a straight line basis over the minimum term of the lease. An annual interest charge is calculated at either the rate explicit in the lease or the Bank of England base rate as at the contractual date if no rate is explicit in the lease.

## 1.13 Pensions

The majority of past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (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 the 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 contribution payable for the year.

The retired Directors General 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 IAS19.

### 1.14 Value added tax

Most of Ofwat's 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 assets. Where output tax is charged or input tax is recoverable, the amounts are stated net of VAT.

### 1.15 Provisions

Ofwat provides for legal or constructive obligations which are of uncertain timing or amount at the date of the Statement of Financial Position 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.

Discount rates of 2.35% per annum apply for pension liabilities at 31 March 2013 (31 March 2012: 2.8%).

### 1.16 Contingent liabilities

In addition to contingent liabilities disclosed in accordance with IAS37, 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 IAS37 are stated at discounted amounts and the amount reported to Parliament separately noted. Contingent liabilities that are not required to be disclosed by IAS37 are stated at the amounts reported to Parliament.

### 1.17 Going concern

The Statement of Financial Position at 31 March 2013 shows negative taxpayers' equity of £4.3 million. In common with other government departments, the future financing of Ofwat's liabilities are accordingly to be met by future grants of Supply and the application of future income, both to be approved annually by Parliament. There is no reason to think that future approvals will not be forthcoming. Accordingly, it has been considered appropriate to adopt a going concern basis for the preparation of these financial statements.

Under the Government Resource and Accounts Act 2000, no money may be drawn from the Fund other than required for the service of the specified year or retained excess of the need. All unspent monies, including those derived from our income, are surrenderable to the Fund.

We confirm our funding for 2013-14 has been approved by HM Treasury.

### 1.18 Staff costs

Under IAS19 Employee Benefits all staff costs must be recorded as an expense as soon as an organisation is obliged to pay them. This includes the cost of any untaken leave at the end of the financial year.

### 1.19 Accounting Estimates

No material accounting estimates or judgements were made by Ofwat in preparing these accounts.

## 2. Net resource outturn

### 2.1 Analysis of net resource outturn by section

£000	2012-13 Outturn						2012-13 Estimate		2011-12	
	Administration			Programme			Net total compared to		Outturn	
	Gross	Income	Net	Gross	Income	Net	Total	Net total	Estimate	Total
Spending in Departmental Expenditure Limit										
Voted: A	20,098	(18,950)	1,148	–	–	–	1,148	3,126	1,978	(4,805)
<b>Total</b>	<b>20,098</b>	<b>(18,950)</b>	<b>1,148</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>1,148</b>	<b>3,126</b>	<b>1,978</b>	<b>(4,805)</b>

Section A: Water Services Regulation Authority

### 2.2 Analysis of net capital outturn by section

£000	2012-13 Outturn			2012-13 Estimate		2011-12
	Administration			Net total compared to		Total
	Gross	Income	Net	Net total	Estimate	Total
Spending in Departmental Expenditure Limit						
Voted: A	268	–	268	500	232	362
<b>Total</b>	<b>268</b>	<b>–</b>	<b>268</b>	<b>500</b>	<b>232</b>	<b>362</b>

Section A: Water Services Regulation Authority

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

#### 3.1 Reconciliation of net resource outturn to net operating cost

			2012-13 £000	2011-12 £000	
	Note	Outturn Supply Estimate	Outturn compared with Estimate	Outturn	
Total resource outturn in Statement of Parliamentary Supply	2	1,148	3,126	1,978	(4,805)
<b>Net operating cost in Consolidated Statement of Comprehensive Net Expenditure</b>		<b>1,148</b>	<b>3,126</b>	<b>1,978</b>	<b>(4,805)</b>

#### 3.2 Outturn against final Administration Budget and Administration net operating costs

	2012-13 £000	2011-12 £000
	Outturn	Outturn
Estimate – Administration costs limit	3,126	103
Outturn – Gross Administration costs	20,098	19,104
Outturn – Gross income relating to administration costs	(18,950)	(23,909)
<b>Outturn – Net administration costs</b>	<b>1,148</b>	<b>(4,805)</b>

## 4. Reconciliation of Net Resource Outturn to Net Cash Requirement

				2012-13 £000
				Net total outturn compared with Estimate; saving (excess)
	Note	Estimate	Outturn	
<b>Resource outturn</b>	2.1	3,126	1,148	1,978
<b>Capital outturn</b>	2.2	500	268	232
<b>Accruals to cash adjustments:</b>				
Adjustments to remove non-cash items:				
Depreciation	7	(220)	(331)	111
New provisions and adjustments to previous provisions	7	(177)	(271)	94
Other non-cash items	7	(60)	(167)	107
Adjustments to reflect movements in working balances:				
Increase/(decrease) in receivables		–	(108)	108
Increase/(decrease) in payables		(69)	(536)	467
Use of provisions	15.1, 15.2	367	403	(36)
<b>Net cash requirement</b>		<b>3,467</b>	<b>406</b>	<b>3,061</b>

## 5. Operating costs

### 5.1 Statement of operating costs by strategy strand

Ofwat operates a time recording system capturing staff hours against strategy strand. The percentage of staff time per strand is apportioned against all administration costs excluding consultancy services. Consultancy contracts are allocated individually to the appropriate strategy strand.

	2012-13 £000	2011-12 £000
<b>Description of strands:</b>		
Ensuring a fair deal for customers	2,796	2,923
Keeping companies accountable	3,047	2,713
Making monopolies improve	3,509	2,150
Harnessing market forces	3,912	3,368
Contributing to sustainable development	2,073	2,109
Delivering better regulation	3,526	5,110
Thames Tideway project regulation	1,235	731
<b>Total expenditure</b>	<b>20,098</b>	<b>19,104</b>
<b>Total income</b>	<b>(18,950)</b>	<b>(23,909)</b>
<b>Net expenditure</b>	<b>1,148</b>	<b>(4,805)</b>

## 6. Staff costs

### 6.1 Staff numbers and related costs

Staff costs comprises:

				2012-13 £000	2011-12 £000
	Total	Permanently employed staff	Others	Non- executive Directors	Total
Wages and salaries	8,221	7,958	120	143	8,052
Social Security costs	741	726	–	15	656
Other pension costs	1,581	1,581	–	–	1,505
Other staff costs	64	64	–	–	2,138
<b>Sub-total</b>	<b>10,607</b>	<b>10,329</b>	<b>120</b>	<b>158</b>	<b>12,351</b>
Less recoveries in respect of outward secondments	–	–	–	–	–
<b>Total net costs*</b>	<b>10,607</b>	<b>10,329</b>	<b>120</b>	<b>158</b>	<b>12,351</b>

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

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. The scheme actuary valued the scheme as at 31 March 2007. Details can be found in the accounts of the Cabinet Office: Civil Service Superannuation ([www.civilservice.gov.uk/pensions](http://www.civilservice.gov.uk/pensions)).

For 2012-13, employer's contributions of £1,538,824 were payable to the PCSPS (2011-12: £1,567,832) at one of four rates in the range 16.7% to 24.3% (2011-12: 16.7% to 24.3%) of pensionable pay, based on salary bands. The Scheme Actuary reviews employer contributions usually every four years following a full scheme valuation. The salary bands and contribution rates are set to meet the cost of the benefits accruing during 2012-13 to be paid when the member retires and not the benefits paid during this period to existing pensioners.

Employees can opt to open a partnership pension account, a stakeholder pension with an employer contribution. Employers' contributions of £32,693 (2011-12: £36,812) were paid to one or more of the panel of three appointed stakeholder pension providers. Employer contributions are age-related and range from 3% to 12.5% of pensionable pay. Employers also match employee contributions up to 3% of pensionable pay. In addition, employer contributions of £2,269, 0.8% (2011-12: £2,497; 0.8%) of pensionable pay, were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service or ill health retirement of these employees.

Contributions due to the partnership pension providers at the date of the Statement of Financial Position were £2,576 (2011-12: £3,010).

Contributions prepaid at that date were nil (2011-12: nil).

## 6.2 Average number of persons employed

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

	2012-13 £000			2011-12 £000	
	Total	Permanently employed staff	Others	Non- executive Directors	Total
Ensuring a fair deal for customers	31.35	31.23	–	0.12	33.90
Keeping companies accountable	33.78	33.66	–	0.12	38.72
Making monopolies improve	21.98	21.86	–	0.12	27.15
Harnessing market forces	33.95	33.83	–	0.12	37.29
Contributing to sustainable development	24.58	24.46	–	0.12	29.08
Delivering better regulation	31.90	28.47	3.31	0.12	31.34
Thames Tideway Project Regulation	2.12	2.00	–	0.12	2.00
<b>Total</b>	<b>179.66</b>	<b>175.51</b>	<b>3.31</b>	<b>0.84</b>	<b>199.48</b>

## 6.3 Reporting of Civil Service and other compensation schemes – exit packages

Redundancy and other departure costs have been paid in accordance with the provisions of the Civil Service Compensation Scheme, a statutory scheme made under the Superannuation

Act 1972. Exit costs are accounted for in the year that obligation has arisen. Where the department has agreed early retirements, the additional costs are met by the department and

not by the Civil Service pension scheme. Ill-health retirement costs are met by the pension scheme and are not included in the table.

	2012-13	2012-13	2012-13	2011-12
Cost band	Number of compulsory redundancies	Number of other departures agreed	Total number of exit packages by cost band (total cost)	Total number of exit packages by cost band (total cost)
<£10,000	–	–	–	6
£10,000 – £25,000	–	3	3	15
£25,001 – £50,000	–	–	–	16
£50,001 – £100,000	–	–	–	7
£100,001 – £150,000	–	2	2	3
£150,001 – £200,000	–	–	–	1
<b>Total</b>	<b>–</b>	<b>301</b>	<b>301</b>	<b>1,739</b>

## 7. Other administration costs

	2012-13 £000	2011-12 £000
	Outturn	Outturn
<b>Rentals under operating leases:</b>		
Accommodation	1,073	924
Office equipment	36	41
	<b>1,109</b>	<b>965</b>
<b>Non-cash items:</b>		
Depreciation	244	204
Amortisation	87	53
Loss on disposal of assets	3	12
Restructuring provisions	271	229
Other finance costs	123	136
External auditors' remuneration	41	41
	<b>769</b>	<b>675</b>
<b>Other expenditure:</b>		
Consultancy services	5,378	3,038
Training	109	135
Travel and subsistence	400	375
Taxation charges	50	9
Rates	205	201
Computer hire and maintenance	354	455
Other hire and maintenance	85	29
Seminars, meetings and conferences	159	125
Minor items and stationery	21	24
Publications	45	42
Books and periodicals	33	37
Postal services and couriers	11	7
Telecommunications	142	104
Recruitment costs	199	91
Office consumables	58	46
Accommodation expenses	141	157
Internal audit fees	38	37
Professional subscriptions	51	54

	2012-13 £000	2011-12 £000
	Outturn	Outturn
<b>Other expenditure:</b>		
Transfer allowance – relocation	–	8
Payroll and pension services	29	32
Business continuity	23	21
Record management	19	22
Other	63	64
	<b>7,613</b>	<b>5,113</b>
<b>Total</b>	<b>9,491</b>	<b>6,753</b>

## 8. Income

	2012-13 £000	2011-12 £000
	Outturn	Outturn
Licence fees	18,934	18,435
Licence fees received in advance – prior year	3	5,361
Licence fees received in advance – current year	–	(3)
CCWater administration support fees	–	–
Miscellaneous	13	116
<b>Total</b>	<b>18,950</b>	<b>23,909</b>

This note analyses the income recorded in the Statement of Comprehensive Net Expenditure.

Ofwat plans to draw cash from the reserve in 2013-14 and 2014-15, to fund planned expenditure and enable a reduced industry licence fee. HM Treasury has agreed a £1.8 million reserve claim to be drawn down in 2013-14. There is no reason to think that future reserve claims will not be approved. At 31 March 2013 the cumulative unspent licence fees that

have been surrendered to the Consolidated Fund total £4.2 million (31 March 2012: £5.7 million).

Ofwat is mandated to collect licence fees from the appointed companies and licensed suppliers in respect of CCWater's operating costs. In 2012-13 we collected £5.1 million which was transferred to the Department for Environment, Food and Rural Affairs. In accordance with HM Treasury guidance, we do not record these transactions in our financial statements.

## 9. Property, plant and equipment

Property, plant and equipment consists of furniture and fittings, office machinery and telecommunications, leasehold improvements and IT equipment.

	£000	£000	£000	£000	£000	£000
	Furniture and fittings	Office machinery and telecoms	Leasehold Improvements	Information technology payments on account	Information technology	Total
<b>Cost or valuation</b>						
At 1 April 2012	58	350	381	102	1,517	2,408
Additions	7	16	176	–	49	248
Reclassifications	–	–	–	(102)	102	–
Disposals	–	(39)	(7)	–	(113)	(159)
Revaluation	–	–	–	–	–	–
<b>At 31 March 2013</b>	<b>65</b>	<b>327</b>	<b>550</b>	<b>–</b>	<b>1,555</b>	<b>2,497</b>
<b>Depreciation</b>						
At 1 April 2012	14	267	153	–	1,357	1,791
Charged in year	6	62	79	–	96	243
Disposals	–	(39)	(4)	–	(113)	(156)
Revaluation	–	–	–	–	–	–
<b>At 31 March 2013</b>	<b>20</b>	<b>290</b>	<b>228</b>	<b>–</b>	<b>1,340</b>	<b>1,878</b>
<b>Carrying amount at 31 March 2013</b>	<b>45</b>	<b>37</b>	<b>322</b>	<b>–</b>	<b>215</b>	<b>619</b>
<b>Carrying amount at 31 March 2012</b>	<b>44</b>	<b>83</b>	<b>228</b>	<b>102</b>	<b>160</b>	<b>617</b>
<b>Asset financing:</b>						
Owned	45	26	322	–	215	608
Finance leased	–	11	–	–	–	11
<b>Carrying amount at 31 March 2013</b>	<b>45</b>	<b>37</b>	<b>322</b>	<b>–</b>	<b>215</b>	<b>619</b>

	£000	£000	£000	£000	£000	£000	£000	£000
	Furniture and fittings payments on account	Furniture and fittings	Office machinery and telecoms	Leasehold improvements payments on account	Leasehold Improvements	Information technology payments on account	Information technology	Total
<b>Cost or valuation</b>								
At 1 April 2011	12	47	340	21	343	113	1,412	2,288
Additions	–	6	26	–	17	87	42	178
Reclassifications	(12)	12	–	(21)	21	(98)	98	–
Disposals	–	(7)	(16)	–	–	–	(35)	(58)
Revaluation	–	–	–	–	–	–	–	–
<b>At 31 March 2012</b>	<b>–</b>	<b>58</b>	<b>350</b>	<b>–</b>	<b>381</b>	<b>102</b>	<b>1,517</b>	<b>2,408</b>
<b>Depreciation</b>								
At 1 April 2011	–	15	219	–	111	–	1,297	1,642
Charged in year	–	6	61	–	42	–	95	204
Disposals	–	(7)	(13)	–	–	–	(35)	(55)
Revaluation	–	–	–	–	–	–	–	–
<b>At 31 March 2012</b>	<b>–</b>	<b>14</b>	<b>267</b>	<b>–</b>	<b>153</b>	<b>–</b>	<b>1,357</b>	<b>1,791</b>
<b>Carrying amount at 31 March 2012</b>	<b>–</b>	<b>44</b>	<b>83</b>	<b>–</b>	<b>228</b>	<b>102</b>	<b>160</b>	<b>617</b>
<b>Carrying amount at 31 March 2011</b>	<b>12</b>	<b>32</b>	<b>121</b>	<b>21</b>	<b>232</b>	<b>113</b>	<b>115</b>	<b>646</b>
<b>Asset financing:</b>								
Owned	–	44	30	–	228	102	160	564
Finance leased	–	–	53	–	–	–	–	53
<b>Carrying amount at 31 March 2012</b>	<b>–</b>	<b>44</b>	<b>83</b>	<b>–</b>	<b>228</b>	<b>102</b>	<b>160</b>	<b>617</b>

## 10. Intangible assets

Purchased software licences.

		£000	£000
	Purchased software licences	Assets under development	Total
<b>Cost or valuation</b>	409	26	435
At 1 April 2012	20	–	20
Additions	13	(13)	–
Reclassifications	(67)	–	(67)
Disposals	–	–	–
<b>At 31 March 2013</b>	<b>375</b>	<b>13</b>	<b>388</b>
<b>Amortisation</b>			
At 1 April 2012	176	–	176
Charged in year	87	–	87
Disposals	(67)	–	(67)
Revaluation	–	–	–
<b>At 31 March 2013</b>	<b>196</b>	<b>–</b>	<b>196</b>
<b>Carrying amount at 31 March 2013</b>	<b>179</b>	<b>13</b>	<b>192</b>
<b>Carrying amount at 31 March 2012</b>	<b>233</b>	<b>26</b>	<b>259</b>

		£000	£000
	Purchased software licences	Assets under development	Total
<b>Cost or valuation</b>			
At 1 April 2011	305	13	318
Additions	174	13	187
Reclassifications	–	–	–
Disposals	(71)	–	(71)
Revaluation	–	–	–
<b>At 31 March 2012</b>	<b>408</b>	<b>26</b>	<b>434</b>
<b>Amortisation</b>			
At 1 April 2011	181	–	181
Charged in year	53	–	53
Disposals	(59)	–	(59)
Revaluation	–	–	–
<b>At 31 March 2012</b>	<b>175</b>	<b>–</b>	<b>175</b>
<b>Carrying amount at 31 March 2012</b>	<b>233</b>	<b>26</b>	<b>259</b>
<b>Carrying amount at 31 March 2011</b>	<b>124</b>	<b>13</b>	<b>137</b>

## 11. Financial Instruments

Ofwat is not exposed to the degree of financial risk faced by commercial entities because of the largely non-trading nature of its activities and the way in which government departments are financed. Ofwat has no powers to borrow or invest surplus funds. 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.

### 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 Ofwat is not exposed to interest rate risk or foreign currency risk.

### Fair values

There is no material difference between the book values and the fair values of Ofwat's financial assets and liabilities at 31 March 2012.

## 12. Trade receivables and other current assets

Analysis by type.

	2012-13 £000	2011-12 £000
<b>Amounts falling due within one year</b>		
Trade receivables	17	20
Deposits and advances	55	57
Other receivables	–	–
HM Revenue and Customs (VAT)	53	48
Prepayments and accrued income	322	430
	<b>447</b>	<b>555</b>

## 13. Cash and cash equivalents

	2012-13 £000	2011-12 £000
Balance at 1 April 2012	1,679	965
Net change in cash and cash equivalent balances	33	714
<b>Balance at 31 March 2013</b>	<b>1,712</b>	<b>1,679</b>
The following balances are held at:		
Government Banking Services (GBS)	1,712	1,679
<b>Balance at 31 March 2013</b>	<b>1,712</b>	<b>1,679</b>

## 14. Trade payables and other current liabilities

Analysis by type.

	2012-13 £000	2011-12 £000
<b>Amounts falling due within one year</b>		
Trade payables	175	229
Other payables	174	145
Accruals	1,894	1,361
Licence fee deferred income	–	3
Deferred income	15	19
Current part of finance leases	3	2
Other taxation and social security	261	234
Consolidated Fund extra receipts due to be paid to the Consolidated Fund	–	–
– receivable		
Amounts issued from Consolidated Fund for supply but not spent at year end	1,712	1,679
	<b>4,234</b>	<b>3,672</b>
<b>Amounts falling due after more than one year</b>		
Finance leases	9	–

## 15. Provisions for liabilities and charges

### 15.1 Provisions

		2012-13 £000	2011-12 £000
	Restructure costs	Total	Total
Balance at 1 April 2012	354	354	167
Provided in the year	271	271	229
Provisions utilised in the year	(233)	(233)	(42)
Borrowing costs (unwinding of discounts)	–	–	–
Provisions not required written back	–	–	–
<b>Balance at 31 March 2013</b>	<b>392</b>	<b>392</b>	<b>354</b>

		2012-13 £000	2011-12 £000
Analysis of expected timing of discounted flows	Restructure costs	Total	Total
Not later than one year	294	294	232
Later than one year and not later than five years	98	98	107
Later than five years	–	–	15
<b>Balance at 31 March 2013</b>	<b>392</b>	<b>392</b>	<b>354</b>

### 15.2 Pension liabilities

	2012-13 £000	2011-12 £000
Balance at 1 April 2012	2,600	2,516
<b>Analysis of the amount charged to the Statement of Comprehensive Net Expenditure</b>		
Interest costs	122	136
<b>Benefits paid</b>		
Benefits paid	(170)	(162)
<b>Analysis of the amount recognised in the Statement of Changes in Taxpayers' Equity</b>		
Experience (gain)/loss	24	71
Actuarial (gain)/loss	75	39
<b>Balance at 31 March 2013</b>	<b>2,651</b>	<b>2,600</b>

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 when they fall due and are guaranteed by Ofwat. There is no fund and therefore no surplus or deficit.

In accordance with the requirements of HM Treasury, Ofwat makes full provision for liabilities arising in respect of the pension entitlements of the former Directors General. These include benefits accrued in respect of non-Ofwat employment; 63% and 95% respectively of these entitlements relate to non-Ofwat employment and are funded from the Exchequer.

An actuarial valuation was carried out by the Government Actuary's

Department (GAD) at 31 March 2013.

The demographic assumptions are consistent with those used elsewhere in Central Government for accounting purposes and those adopted in previous years. The main demographic assumptions are as follows:

- mortality rates to 2010 are based on historic population experience for those years. Improvements from 2010 in line with the 2010 based UK principal population projections; and
- all members are assumed to have a spouse or eligible partner from the date their pension is assumed to be paid. Spouses' assumed mortality is in line with that of members of the same age and gender. Husbands are assumed to be

three years older than their wives.

The main financial assumptions (used to assess liabilities at 31 March 2013) are as follows:

- the net discount rate is assumed to be 2.35% (31 March 2012: 2.80%);
- the gross discount rate is assumed to be 4.10% a year (31 March 2012: 4.85%);
- the rate of increase in salaries is assumed to be 3.95% (31 March 2012: 4.25%);
- the rate of increase in pensions in payments is assumed to be 1.7% (31 March 2012: 2.00%); and
- consumer price inflation 1.70% (31 March 2012: 2.00%).

A cumulative actuarial loss of £1.7 million has been incurred by the scheme since 1 April 2004.

## Analysis of actuarial loss

Analysis of actuarial (gain)/loss	2012-13 £000	2011-12 £000	2010-11 £000
Experience losses arising on the scheme liabilities	24	71	15
Changes in assumptions underlying the present value of scheme liabilities	75	39	(118)
<b>Per Statement of Changes in Taxpayers' Equity</b>	<b>99</b>	<b>110</b>	<b>(103)</b>

## History of experience losses

	2012-13	2011-12	2010-11	2009-10	2008-09
Experience losses arising on the scheme liabilities					
Amount (£000)	24	71	15	63	69
Percentage of the present value of the scheme liabilities	0.9%	2.7%	0.6%	2.2%	2.9%
Total amount recognised in Statement of Taxpayers' Equity					
Amount (£000)	99	110	(103)	546	(136)
Percentage of the present value of the scheme liabilities	3.7%	4.2%	(4.1)%	18.8%	(5.7)%

## 16. Capital commitments

Contracted capital commitments at 31 March 2013 not otherwise included in these financial statements.

	2012-13 £000	2011-12 £000
Contracted capital commitments at 31 March not otherwise included in these financial statements		
Property, plant and equipment	9	49
Intangible assets	149	1
	<b>158</b>	<b>50</b>

## 17. Commitments under leases

### 17.1 Operating leases

Total future minimum lease payments under operating leases are given in the table below for each of the following periods.

	2012-13 £000	2011-12 £000
<b>Obligations under operating leases comprise:</b>		
Buildings		
Not later than one year	1,131	818
Later than one year and not later than five years	2,874	3,274
Later than five years	–	273
	<b>4,005</b>	<b>4,365</b>

### 17.2 Finance leases

Total future minimum lease payments under operating leases are given in the table below for each of the following periods.

	2012-13 £000	2011-12 £000
<b>Obligations under finance leases comprise:</b>		
Other		
Not later than one year	4	2
Later than one year and not later than five years	9	–
Later than five years	–	–
	13	2
Less interest element	(1)	–
	<b>12</b>	<b>2</b>

## 18. Contingent liabilities disclosed under IAS37

During a survey of the Centre City Tower electrical networks (November 2011) a meter was identified as being connected to air conditioning units installed in 2007 by Ofwat. The meter had not been read for charging purposes since installation. Following the sale of the building in February 2012 the new owner has confirmed that it will not backdate any charges on this meter. It remains uncertain whether the official receivers, acting in respect of the previous owner, will charge for the period between 2007 and February 2012. The official receivers have not contacted Ofwat in respect of the possible liability due.

A rent review was anticipated in August 2009, but was delayed due to the previous building

owners going into liquidation and the subsequent sale of Centre City Tower in February 2012. There is uncertainty over whether this review will now take place.

Ofwat is currently in dispute with the provider of telecommunication lines, enabling transmission of data to our previous London offices, for termination of contract. Our understanding, and previous correspondence from the provider, indicates that the contract was superseded on our relocation. However, there remains a risk that a liability may arise.

During 2012-13, an employee gave notice of an intended Employment Tribunal appeal against Ofwat. The outcome of the proceedings is unknown, and

this could give rise to a compensation payment being due in 2013-14.

On occasion Ofwat may be subject to legal challenge and judicial review of decisions made in the normal course of its business. Legal judgments 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. Ofwat is not aware of any potential legal challenges at the reporting date.

## 19. Related party transactions

Ofwat transferred £5.1 million to the Department for Environment, Food and Rural Affairs in respect of CCWater's operating costs for 2012-13.

handover of responsibilities prior to his official appointment as Ofwat's Chairman on 1 November 2012.

Ofwat reimbursed Stonebrook Associates Ltd the value of £16 thousand relating to Jonson Cox's role as Chairman Designate during September and October 2012. This was to facilitate an efficient

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.

## 20. Events after the reporting period

Chief Executive Regina Finn announced on 15 May 2013 that she intended to step down from her position in November 2013.

The Board has begun the recruitment process for her successor, which included appointing recruitment advisors and publishing details of the vacancy on our website on 30 May.

The Board also announced transitional arrangements to provide continuity and accountability for the price review on 4 June. The arrangements are as follows.

- Regina Finn will continue to lead and finalise Ofwat's

methodology and business plan requirements over the coming months. Once these are complete, Sonia Brown (Senior Director of Markets and Economics) will take on the direct lead responsibility for the delivery of the five-yearly price review.

- Sonia Brown will be released from her casework responsibilities. Regina Finn will lead a review of Ofwat's strategically important casework programme.
- Keith Mason (Senior Director of Finance and Networks) will retain responsibility for the Thames Tideway, the work on Board leadership and governance in the sector, and his duties in finance, networks

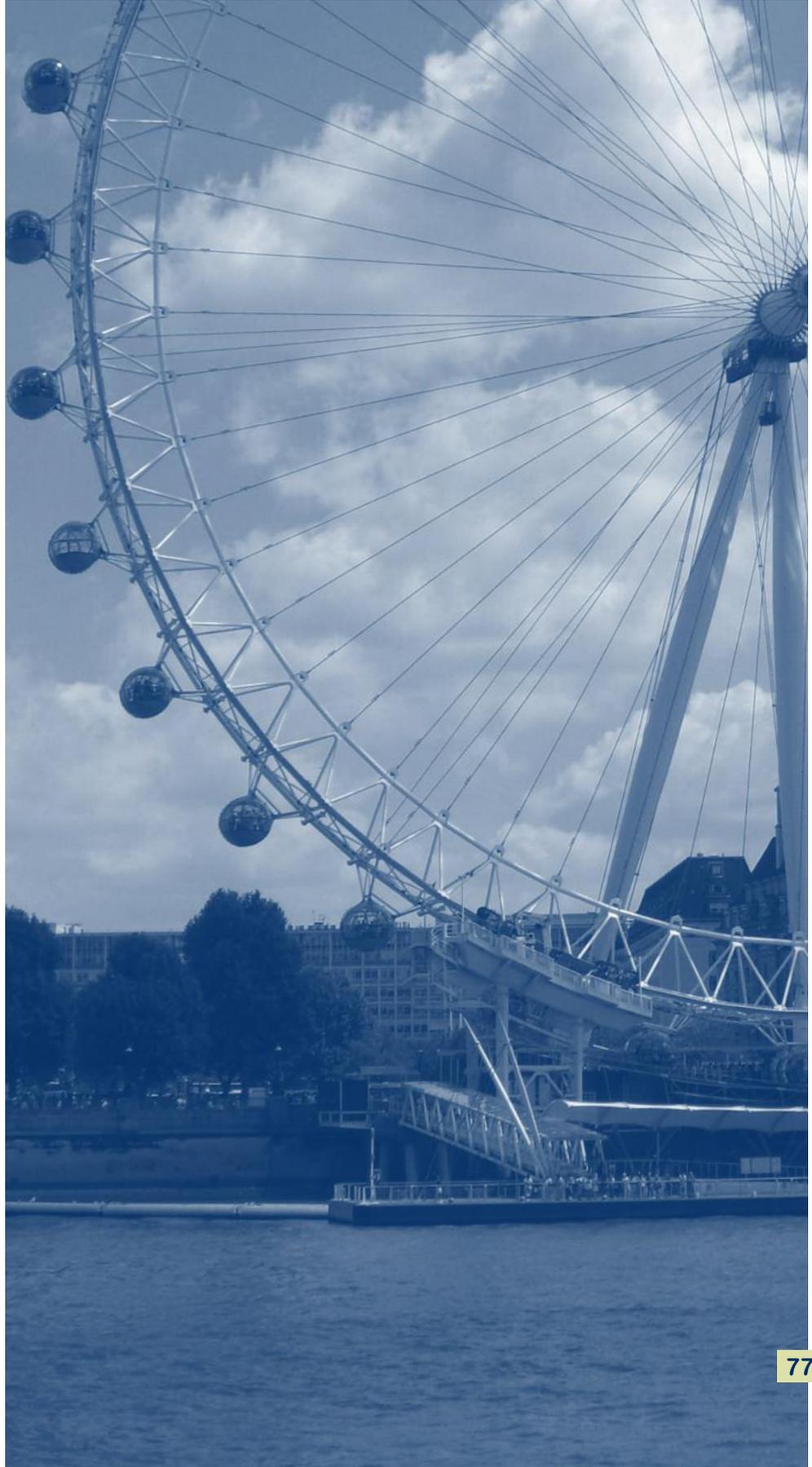
and regulatory compliance. He will continue to be substantially involved in the price review.

- Andrew Beaver (Director of Strategy) will take on responsibility for Ofwat's input into the Open Water programme.

The financial statements do not reflect events after 26 June 2013.



# Appendices



# Appendix 1:

## > Measuring our performance



In our strategy, we committed to developing the approach we use to hold the companies to account for their performance. We also need a framework to monitor our own performance as the economic regulator. This will:

- improve transparency for our stakeholders of the impact of our actions;
- help us to identify the impact of any action we take; and
- help us target and use our resources most effectively.

During 2012-13, we [consulted on an outcome-based performance framework](#) that will help us measure the progress we are making towards delivering our strategy.

Stakeholders welcomed this work and provided useful comments and ideas in response to our consultation. We are using their responses to develop our final performance framework.

We will test a reduced version of our framework during 2013-14 before we implement it in full in 2014-15.

We will begin reporting against our framework in next year's annual report.

## Appendix 2:

### > Having regard to directions and guidance from Government



Under the Water Industry Act 1991 (WIA91), the Secretary of State for Environment, Food and Rural Affairs and the Welsh Government have powers to issue separate social and environmental guidance to the Water Services Regulation Authority (Ofwat). We are required to have regard to both sets of guidance.

Also, under the WIA91 we have a duty to keep the water and sewerage sectors under review and to collect information on the carrying out of licensed activities. Under section 27(3) the Secretary of State may give us general directions indicating what considerations we must have particular regard to in prioritising matters for review and also in determining whether and how to exercise our powers under particular parts of the WIA91.

In March 2013, and following consultation, the UK Government published a [strategic policy statement \(SPS\) to us, including revised social and environmental guidance](#). This set out the UK Government's ten priority areas, which represent their directions to us under the WIA91. The ten areas are as follows.

- A transparent and predictable regulatory regime.
- Supporting economic growth.
- Effective engagement.
- Ofwat's sustainability duty.

- Intergenerational equity: long-term versus short-term investment.
- Ecosystem services.
- Effective water management.
- A fair deal for customers.
- Extra support for vulnerable customers and those that struggle to pay.
- Customers: increasing choice, improving service.

We set these out in full on pages 86-87.

We will agree the details of reporting arrangements against this guidance during 2013-14, and will begin reporting using the new arrangements in our next forward programme and annual report and accounts. For 2012-13, we have reported against the UK Government's previous guidance to us, which was issued in 2008.

The Welsh Government issued social and environmental guidance to us in 2009. They recently consulted on new guidance, but until this is finalised we will have regard to their 2009 guidance.

We highlight below how we have had regard to guidance from the UK and Welsh Governments in our key decisions in 2012-13. We have also demonstrated in our annual report and accounts how we have contributed to the policies set out in both sets of guidance.

## Adopting a risk-based approach to regulation, April 2012 – March 2013

<b>Description</b>	<p>In '<a href="#">Delivering proportionate and targeted regulation – a risk-based approach</a>', which we published at the end of the 2011-12 reporting year, we confirmed that we were adopting a risk-based approach to regulation.</p> <p>2012-13 was the first full year of Ofwat using this new proportionate and targeted approach, which has helped us to prioritise our regulatory action.</p> <p>It has also meant us looking carefully at the full range of regulatory tools available to us – refining and consolidating some, and stopping the use of others.</p> <p>Under this new approach, among other things, we:</p> <ul style="list-style-type: none"><li>• worked with Defra, the Environment Agency and the Welsh Government to agree revised guidelines for companies in drafting their water resources management plans, including promoting more sustainable options such as water trading and better customer engagement;</li><li>• asked companies to provide a risk and compliance statement and published their performance against a set of specified key indicators. We expect this to drive better performance among the companies;</li><li>• issued new guidance to the companies on the service incentive mechanism (SIM) that consolidated and simplified historic reporting requirements into one document;</li><li>• used a risk-based approach for the approval of companies' 2013-14 charges, where we focused our attention on the most problematic charging areas and accepted assurances in respect of most charges in general;</li><li>• consulted on and published revised regulatory accounting guidelines for the companies;</li><li>• consulted on changing our approach to companies' information provision requirements; and</li><li>• consulted on revised guidance to companies on negotiating bulk supplies to make water trading easier.</li></ul>
<b>How we have had regard to the guidance in England</b>	<p>Our approach:</p> <ul style="list-style-type: none"><li>• encourages companies to look at their own operations and performance (sustainable development, page 5);</li><li>• is modern, effective and risk based (better regulation, page 8);</li><li>• is a proportionate, innovative regulatory solution informed by best practice (better regulation, page 8);</li><li>• reflects the principles of good regulation – proportionality, accountability, consistency, transparency and targeting (better regulation, page 8);</li><li>• streamlines the information requirements placed on companies (better regulation, page 8); and</li><li>• requires us to justify new burdens on compelling cost-benefit grounds (better regulation, page 8).</li></ul>

**How we have regard to the guidance in Wales**

Our approach:

- frees companies to develop their own indicators of performance based on local priorities (paragraph 24);
- means our decisions will take into account the long- and short-term effects on society and the costs and benefits of action and inaction (paragraph 26);
- encourages companies to look at their own operations and performance (paragraph 36);
- streamlines information requirements on the sectors and requires us to justify any new burdens on compelling cost-benefit grounds (paragraph 38); and
- means our decisions will take account of costs as well as benefits (paragraph 48).

**Any departures from the guidance**

None.

## Adopting a targeted and proportionate approach to setting price controls, January 2013

### Description

In our consultation on [‘Setting price controls for 2015-20 – framework and approach’](#) we proposed setting separate retail and wholesale price controls. This will give retail businesses greater incentives and focus on delivering efficient costs and services to household and non-household customers in England and Wales.

We also proposed safeguarding investment in the water and sewerage sectors by allocating all the existing asset base to the wholesale business, and using the regulatory capital value (RCV) and indexation to the Retail Price Index (RPI) for the wholesale control. This will deliver the stability and returns that will allow the sectors to continue to raise low-cost finance on the capital markets to fund investment.

Our more targeted incentives, along with greater ownership by companies of what they deliver, will give greater scope for companies to innovate in delivery and boost efficiency.

By setting separate retail price controls, we will:

- increase the focus of the retail businesses on their customers; and
- improve the scope for innovation in delivery and the drive to keep costs down.

This will reduce the regulatory burden on this segment of the market and free up companies to respond to the demands of their business and other non-household customers.

Our proposed wholesale price control gives companies greater responsibility and accountability for how they deliver outcomes. This will allow them to find more innovative and sustainable approaches to managing water resources.

To encourage more flexible and sustainable use of water, we also proposed giving companies incentives to trade water, where that is the best solution for their customers and the environment.

---

Our approach:

- encourages companies to deliver integrated solutions which generate effective economic outcomes that minimise costs and maximise social and environmental impacts (sustainable development, pages 4–5);
- encourages companies to take account of the economic, social and environmental impacts of their businesses (sustainable development, pages 4–5);
- takes steps to ensure each company delivers high standards of service at a reasonable cost for all its customers (social policies, page 6);
- allows companies to take a long-term perspective in the stewardship of assets (fairness and affordability, page 7);

- enables companies to take a long-term view of climate change adaptation, balancing supply and demand for services, surface water flooding, resilience and water quality (environmental policies, pages 8–15);
- encourages companies to engage proactively with stakeholders in effective planning for surface water management (surface water flooding, page 13); and
- supports companies that wish to adopt innovative approaches to improving water quality, including working with land managers to control diffuse water pollution at source, where this is to the benefit of customers (water quality, page 15).

---

Our approach:

- help minimises the potential financial burden on water customers in Wales while maintaining services and enabling the Welsh Assembly Government and water industry to meet their statutory national and European obligations and other desired outcomes, whilst maximising benefits to the environment and society (paragraph 56);
- encourages companies to respect environmental limits, so that resources are not irrevocably depleted or the environment irreversibly damaged (paragraph 81);
- supports water companies in developing long-term, sustainable solutions to challenges (paragraph 90);
- helps encourage companies to consider a twin-track approach to water resources management (paragraph 106);
- helps encourage more sustainable management of surface water (paragraph 124); and
- supports water companies who wish to adopt innovative approaches to improving water quality (paragraph 145).

---

None.

## Adopting a risk-based review of companies' business plans, April 2013

### Description

In our consultation on '[Setting price controls for 2015-20 – business planning expectations](#)' we proposed using a new risk-based approach to reviewing companies' business plans for the next price review. This will encourage companies to prepare high-quality plans that focus on what their customers want, while delivering sustainable services over the long term. It will also give companies greater ownership of, and accountability for, their plans.

We proposed using one of three categories to assess companies' business plans – 'enhanced', 'standard' and 'resubmission'. We expect all companies to work hard to try to fall into the first two categories. But we proposed the option of the third category for any company that submits a business plan with serious shortcomings.

While it will be a high standard to meet, the companies that receive enhanced status will have greater rewards – in the form of lighter-touch procedures, earlier decisions and financial incentives. We know that external stakeholders, especially investors, value highly how Ofwat assesses companies, so these companies will also benefit from an enhanced reputation, including with capital markets.

The views of the independent customer challenge groups (CCGs) will be crucial in our risk-based review. The CCGs are a new and powerful forum through which companies can engage with all of their customers, including bill payers and environmental regulators. We would expect the CCG reports to highlight both consumer and environmental concerns and how companies have addressed these.

We will continue to work with our stakeholders including the other regulators – specifically the Environment Agency, the Drinking Water Inspectorate and Natural Resources Wales – as we progress the price review.

Our approach:

- encourages companies to deliver integrated solutions which generate effective economic outcomes that minimise costs and maximise social and environmental impacts (sustainable development, pages 4–5);
- ensures that greater emphasis is placed on strategic and long-term planning within the water industry (sustainable development, pages 4–5);
- takes steps to ensure each company delivers high standards of service at a reasonable cost for all its customers (social policies, page 6);
- ensures that we strike a balance between the need to limit price increases and the need to generate improvements in services that are financed through higher bills. It also takes regional variations into account (page 6);
- ensures that companies charge customers in a way which is both fair and protects vulnerable groups (page 7);
- allows companies to take a long-term perspective in the stewardship of assets (fairness and affordability, page 7); and
- streamlines the information requirements placed on companies (better regulation, page 8).

**How we have regard to the guidance in Wales**

Our approach:

- draws on a wide range of expertise in our decision making and involves working in partnership with all stakeholders (paragraph 23);
- encourages companies to adopt a closely integrated and comprehensive approach to forward planning and robust options appraisal (paragraph 33);
- reduces our information requirements on the sectors (paragraph 38);
- encourage companies' decisions to reflect the needs and priorities of local communities (paragraph 44);
- reflects the specific circumstances of Wales (paragraph 45);
- ensures that the wishes of water bill payers are given a high priority within the price review process (paragraph 46);
- involves us taking decisions affecting water companies which reflect the potential effects on affordability (paragraph 57);
- support water companies in developing long term, sustainable solutions, including encouraging innovative approaches and new ways of tackling issues (paragraph 90); and
- encourages companies to fully meet all of their obligations, including under the carbon reduction commitment (paragraph 97).

None.

## Directions to Ofwat, issued in accordance with sections 27(3) and 192B of the Water Industry Act 1991 by the Secretary of State

---

### Priority 1

Ofwat shall, as a matter of priority, keep under review the impacts of any changes to the regulatory framework on investment prospects for the water industry; seeking to avoid undue regulatory uncertainty wherever possible; taking appropriate account of investor views on the impact of the existing regulatory framework and any proposals for reform. Where proposed changes are sufficiently substantive, Ofwat will be expected to provide a thorough assessment of the impact of their proposals on both consumers and investors, including evidence of the costs and benefits. Ofwat will report regularly to the Secretary of State on investment prospects for the water sector in the context of Ofwat's duties to ensure that efficient companies can finance their functions and protect consumers.

---

### Priority 2

Ofwat shall, as a matter of priority, keep under review the proportionality of its regulatory framework and the actions they have taken to minimise burdens and reduce costs for business. Ofwat will report regularly to the Secretary of State on this matter taking account of the relevant recommendations of the Ofwat Review and their response to this.

---

### Priority 3

Ofwat shall, as a matter of priority, keep under review whether its regulatory framework has an impact on the profile of investment in the water and sewerage sector. Ofwat will report regularly to the Secretary of State on the issue of cyclical investment in the water sector, building on its previous work in partnership with Infrastructure UK.

---

### Priority 4

Ofwat shall, as a matter of priority, keep under review their contribution to the achievement of the Government's sustainable development objectives. Ofwat will report annually to the Secretary of State on the outcomes achieved, using the Government's Sustainable Development Indicators as a guide and publish this alongside their Annual Report.

---

### Priority 5

Ofwat shall, as a matter of priority, keep under review the impact of their assessment methodologies, penalties and incentives on activity by water and sewerage sector to prepare for longer-term challenges. Ofwat will report regularly to the Secretary of State on this matter.

This should consider the profile of investment in the full range of measures required to ensure the future sustainability of the sector over the long-term, taking account of evidence of future pressures such as the Climate Change Risk Assessment and the Environment Agency's Case for Change work.

---

## Priority 6

Ofwat shall, as a matter of priority, keep under review the impact of their regulatory approach on the widespread implementation of innovative approaches, such as catchment management schemes, that offer both good value for customers and the potential to deliver multiple benefits. They should also consider whether the regulatory framework presents any barriers to innovation in this area. Ofwat will report periodically to the Secretary of State, having reviewed the impact of their regulatory framework on implementation of innovative approaches, such as catchment management.

---

## Priority 7

Ofwat shall, as a matter of priority, keep under review the impact of their regulatory approach on the overall resilience of water companies' networks. This should embrace their approach to resource management, including in times of drought; and to risk management, in the context of their duties to provide public sewers which ensure effectual drainage. Ofwat will report regularly to the Secretary of State with an assessment of the impact of their regulatory framework on sustainable water management by water companies, setting out key risks and mitigation.

---

## Priority 8

Ofwat shall, as a matter of priority, keep under review whether companies are taking sufficient action to have a measurable positive impact on the needs of those customers that may struggle to afford their charges. Ofwat will report on this matter annually to the Secretary of State.

---

## Priority 9

Ofwat shall, as a matter of priority, keep under review its approach to promoting the progress of competition in the water sector to ensure this continues to reflect the aims set out in the Water White Paper and the clear boundaries set by Government. Ofwat must ensure that all changes to the regulatory framework are fully consistent with Government policy regarding future reform of the sector. Ofwat will report annually to the Secretary of State on the alignment of its approach to competition with wider Government policy for the water sector.

---

## Priority 10

Ofwat shall, as a matter of priority, keep under review the effectiveness of the 2014 price determination; assessing its impact against priority outcomes for customers and other stakeholders. Ofwat will report to the Secretary of State on its evaluation of the impact of the 2014 price determination towards the end of the price review period; making particular reference to the outcomes delivered for customers and other key stakeholders.

## Appendix 3:

### > List of impact assessments carried out during 2012-13



During 2012-13, we published the following impact assessments.

- 'Future price limits – statement of principles, appendix 1: impact assessment', May 2012.
- 'Consultation on changes to the regulatory accounting guidelines (RAGs) – draft impact assessment', July 2012.
- 'Consultation on changes to the regulatory accounting guidelines (RAGs) – impact assessment', February 2013.

# Appendix 4:

## > Review of Board effectiveness



This year has been seen important changes to Ofwat's Board. In October 2012, Philip Fletcher retired as Chairman of the Board. Jonson Cox was appointed as his successor and took up his post in November 2012. Two new Non-executive Directors also joined the Board earlier in the year.

Jonson set an early key priority of further strengthening the Ofwat Board and a recruitment process for three additional Non-executive Directors was initiated immediately on his appointment. The new appointments joined the Board in May 2013. This is the first major step in strengthening the effectiveness of the Board, and other plans are already well advanced to address the three

specific recommendations linked to this area outlined in the final report of the independent review of Ofwat and consumer representation in the water sector ('the Gray review').

- "Recommendation 15: The Ofwat Board should recognise active stakeholder engagement as a key part of the non-executive director role, particularly during price reviews, and it should agree how to achieve greater exposure to stakeholders."
- "Recommendation 16: The new Chair of Ofwat once appointed, should undertake to carry out and publish a full review of the Board's effectiveness."

- "Recommendation 24: Ofwat's new Chair should publish a report on Ofwat's progress in responding to the issues and recommendations [set out in the review] in line with its annual reporting processes."

In the meantime, the Board continues to review its own effectiveness and that of the Board Committees. This is done, for example, through individual discussions between the Chairman and Board members, and surveys of attendees at the Board Committees.

## Appendix 5:

### > Progress in reducing regulatory burdens

The UK Government introduced the Regulatory Enforcement and Sanctions Act 2008 to deliver better regulation. The Act placed a duty on us to:

- review the regulatory burdens we impose;
- reduce any that are unnecessary and unjustifiable; and
- report on our progress each year.

When we report on progress, we have to set out what we have done in the past 12 months, and what we will do in the coming year, to review our functions in line with the duties set out above. We also have to set out the reasons for maintaining any burdens.

Our forward programme sets out what we intend to do over the coming 12 months. Our report on what we have done in the past year is set out below.

#### [Report on progress](#)

As we noted on page 14, this year was the first year that companies reported their performance under [our new approach to regulatory compliance](#). As a result, they no longer had to send us the main annual regulatory submission (the 'June return'), which we previously collected from each company. The June return comprised more than 80 tables of data and 800 pages of instructions. Under our new approach, in July 2012 all companies reported on their



performance against a range of indicators and sent us a risk and compliance statement that confirmed they met their obligations and highlighted risks of any failures.

Our approach is based on an assessment of risks. It makes our decisions more transparent to customers, the companies and other stakeholders. It also ensures that we regulate in line with the better regulation principles, and take appropriate steps to minimise the burden we place on the companies we regulate.

Our more targeted and proportionate approach to price setting focuses on the most important areas in setting companies' price controls. This

has meant we have been able to reduce the overall regulatory burden on companies. Unlike previous price reviews, we have only required each company to send us one business plan and a data submission instead of draft and final plans. We have also [proposed to reduce substantially the information that each company needs to include in its plan](#). This will allow companies to focus on delivering high-quality plans for providing services to customers and meeting their legal obligations.

And during the year, we also reduced regulatory burdens on new entrants. We did this by [revising our approach to assessing the financial viability of applications for new appointments and variations](#),

which can be made by existing companies and interested third parties. Our new approach is that we:

- adopt a company-based assessment of financial viability, rather than a detailed site-based assessment, where it is appropriate to do so;
- allow applicants greater flexibility when satisfying us that they can finance their functions; and
- give applicants more responsibility and accountability for their business and business risks.

# Appendix 6:

## > Performance against stated levels of service



Every year, we respond to general public enquiries for information. We also investigate disputes between customers and their water companies.

We set out our performance for 2012-13 against our standards of service below.

### General enquiries

In 2012-13, we replied to more than 4,700 enquiries, including phone calls and emails. This compares with 1,501<sup>1</sup> written enquires in 2011-12.

During the year, we continued to work with the Consumer Council for Water (CCWater) to put in place revised arrangements to ensure that complaints are handled effectively, efficiently and by the organisation best placed to deal with specific matters that customers raise.

#### Performance standard for general enquiries

Standard	2012-13	2011-12
At least 95% of all enquiries to be dealt with within ten working days	97.3%	98% <sup>1</sup>

**Note:**

1. During 2012, we changed our reporting arrangements and systems so that we now record all written and phone enquiries. Our 2011-12 performance relates to written enquiries only and covers 11 months (there are no statistics for October 2011). We have also restated our performance for 2011-12 following the discovery of an error in the way written enquiries were recorded. We previously reported that we dealt with 100% of written enquiries within ten working days.

## Information requests

The Freedom of Information Act 2000 (FOIA) and the Environmental Information Regulations 2004 (EIR) provide a general right of access to all types of recorded information held by public authorities. They place a number of obligations on public authorities and also set out exemptions to rights of access.

The FOIA and the EIR apply to Ofwat because we are a public authority. We have a responsibility to provide a response to any written request, normally within 20 working days. There are some exceptions to this deadline; we are able to take further time in order to consider the public interest in the disclosure of information.

Over the past year, we received 117 information requests that we dealt with under the FOIA and EIR. We responded to 84% within the 20-day deadline.

Detailed information on the FOIA and EIR is available from the Ministry of Justice (MoJ) and the Information Commissioner’s Office (ICO). The MoJ collects and publishes statistics on the handling of requests for information by more than 40 central government bodies, including Ofwat. You can view the performance of participating bodies on the MoJ website.

## Disputes and complaints about water and sewerage services

CCWater represents consumers in the water and sewerage sectors. It deals with most complaints from consumers about the service their water or sewerage company provides that the company itself cannot resolve.

We are responsible for handling certain disputes and complaints, including:

- complaints about regulatory policy;
- allegations of breach of duty by a company;
- water supply and sewer connection charges;
- requisitioning of water mains, sewers and lateral drains;
- adoption and financial arrangements in respect of self-laid mains;
- sewer appeals;
- refusals by the companies to install an optional meter;
- guaranteed standards scheme (GSS) payments;
- trade effluent appeals; and
- pipe-laying in streets and across private land.

The time taken to resolve complaints depends on the nature and complexity of individual cases, but we aim to deliver our performance standard.

Performance against this standard is shown in the table below.

### Performance standard for complaints about water and sewerage services

Standard	2012-13	2011-12
Initial response to 95% of all complaints within ten working days	96%	94%

We resolved 289 complaints about water and sewerage services during the year. Of these:

- 80% were resolved within three months (compared with 63% in 2011-12); and
- 82% were resolved within six months (compared with 78% in 2011-12).

We continue to keep our performance under review.

## Private sewer transfer appeals

On 1 October 2011, regulations introduced by the UK Government transferred the ownership of existing private sewers and lateral drains to regulated sewerage companies in England and Wales. In total, they took on responsibility for an estimated 224,500 km of private gravity sewers and lateral drains.

Before this transfer took place, we consulted on and published [guidance for customers who wished to appeal the transfer of specific private sewers, lateral drains and pumping stations](#). In total, 352 customers contacted us because they considered they had grounds to appeal the transfer. We summarise the outcome of these cases in the table below.

Outcome of private sewer appeals	Number of appeals
Ineligible or withdrawn appeals	289
Company carrying out further assessment	22
Appeals pending a decision	29
Formal decision issued	12
<b>Total</b>	<b>352</b>

# Appendix 7:

## > Resource management 2012-13



### Staff recruitment (by gender and ethnic group)

Level and salary range	2012-13 <sup>1</sup>		
	Full-time equivalent staff appointed <sup>2</sup>	Proportion of women (%) <sup>2</sup>	Proportion from ethnic minorities (%) <sup>2</sup>
Band 1 – £15,469 to £22,000	2	0	50
Band 2 – £22,001 to £31,137	7	85	44
Band 3 – £31,138 to £46,680	10	31	16
Band 4 – £46,681 to £71,400	8	49	25
Band 5 – £71,401 to £107,100	6	0	0
<b>Total</b>	<b>33</b>	<b>40</b>	<b>25</b>

**Notes:**

1. We introduced a new pay banding system during 2012-13, so data for 2011-12 are not comparable.
2. Rounded to the nearest whole number.

## Employed staff information

Area	As at 31 March 2013	As at 31 March 2012
Full-time equivalent staff	177	174
Proportion of women (%)	47	49
Proportion from ethnic minorities (%)	18	17.5
Proportion disabled (%)	2.3	1.7
Members of the Senior Civil Service	11	9
Number of fixed-term and casual contracts	13	7
Number of staff working part-time	30	26
Staff turnover (%)	16	24

## Staff training attendance (by ethnic group)

Ethnic group	2012-13		2011-12	
	Number of training days (rounded up)	Percentage (%) (rounded to nearest whole number)	Number of training days (rounded up)	Percentage (%) (rounded to nearest whole number)
White	418	77	166	86
Other ethnic groups	89	17	27	14
Unknown	32	6		
Total number of training days	539	100	193	100



The Water Services Regulation Authority (**Ofwat**) is a non-ministerial government department. We are responsible for making sure that the water and sewerage sectors in England and Wales provide consumers with a good quality and efficient service at a fair price.



Published by TSO (The Stationery Office) and available from:

**Online**

[www.tsoshop.co.uk](http://www.tsoshop.co.uk)

**Mail, telephone, fax and email**

TSO

PO Box 29, Norwich NR3 1GN

Telephone orders/general enquiries: 0870 600 5522

Order through the Parliamentary Hotline Lo-Call 0845 7 023474

Fax orders: 0870 600 5533

Email: [customer.services@tso.co.uk](mailto:customer.services@tso.co.uk)

Textphone: 0870 240 3701

**The Houses of Parliament Shop**

12 Bridge Street, Parliament Square, London SW1A 2JX

Telephone orders/general enquiries: 020 7219 3890

Fax orders: 020 7219 3866

Email: [shop@parliament.uk](mailto:shop@parliament.uk)

Internet: <http://www.shop.parliament.uk>

TSO@Blackwell and other accredited agents



Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA

Phone: 0121 644 7500

Fax: 0121 644 7699

Website: [www.ofwat.gov.uk](http://www.ofwat.gov.uk)

Email: [mailbox@ofwat.gsi.gov.uk](mailto:mailbox@ofwat.gsi.gov.uk)

Photographs: Stockvault: Geoffrey Whiteway, 2happy, Damien van holtén, Ian L, Marjan, Jakub Krechowicz, Environment Agency, Getty Images, Highways Agency, Shine Pix, Transport for London  
© Crown copyright 2013

You may reuse this information (excluding logos) free of charge in any format or medium, under the terms of the Open Government Licence. To view this licence, visit <http://www.nationalarchives.gov.uk/doc/open-government-licence/> or email [psi@nationalarchives.gsi.gov.uk](mailto:psi@nationalarchives.gsi.gov.uk).

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

Any enquiries regarding this document should be sent to us at [mailbox@ofwat.gsi.gov.uk](mailto:mailbox@ofwat.gsi.gov.uk).

This publication is available for download from our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk).

ISBN: 978-0-10-298235-0

Printed in the UK by The Stationery Office Limited on behalf of the Controller of Her Majesty's Stationery Office

ID: 2547873 07/13

Printed on paper containing 75% recycled fibre content minimum.

ISBN 978-0-10-298235-0



9 780102 982350