June 2017

Trust in water

Water Services Regulation Authority (Ofwat) Annual report and accounts 2016-17

For the period 1 April 2016 to 31 March 2017

Ofwat

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Water Services Regulation Authority (Ofwat)

Annual report and accounts 2016-17

For the period 1 April 2016 to 31 March 2017

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About this document

This document sets out our annual report and accounts for the period 1 April 2016 to 31 March 2017.

It includes a description of the work we carried out during the year to fulfil our statutory responsibilities.

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

Our functions and duties are laid out primarily in the Water Industry Act 1991 as amended (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.

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Part 1: Our performance report

Overview

Chairman's foreword

Our job is to hold the water sector, a provider of a vital public service, to account in these challenging times. Ensuring customers and society get the best possible deal from a water company remains as important as ever, while expectations of service levels, and of the resilience, in every dimension, of public service providers, continue to rise.

We work to stimulate all companies to go above and beyond. Generally we do this by using economic incentives – including penalties – to create new frontiers for service or efficiency. We then require less effective companies to match the standards of the best. We do not shy away from being tough when companies fail to deliver.

Our decisions in the 2014 price review are currently bringing water bills down for customers and delivering a high level of investment in water infrastructure. The review also put in place specific incentives and penalties to help bring more focus by companies to the service and efficiency they deliver for their customers. Companies have made significant gains over the last decade from their financial structures at a time of reducing cost of equity and debt. Our increased focus on service and efficiency helps re-balance towards improving sustainable service benefits to customers.

The last year has been the second year in which we've been able to observe the effect that these new approaches are having. So far we believe these to be stretching water company managements to perform better, particularly for customers. During the year we published our approach to the next price review in 'Water 2020' which builds on these new approaches and we will be expecting companies to aim higher.

The opening of the competitive market for business customers in England on 1 April 2017 was the culmination of many years of policy development. I would like to pay tribute to the joint teams of Ofwat, Defra and market operator MOSL for their outstanding work. I would also like to acknowledge the contribution right across the sector in setting up the new market for success. At the same time, we continued to work hard to make sure all customers in Wales remain protected effectively by regulation.

Of course, neither Ofwat nor the water sector exist in a bubble. During the political and economic uncertainty that followed the Brexit referendum, I heard some say that 'now is not the time' for a continuing ambitious programme of reform in the water sector. However, the current environment reinforces the imperative to maintain the social 'legitimacy' of the sector, which our Water 2020 policy aims to do, by ensuring our regulatory framework continues to evolve. The continued attractiveness of the sector to investors, and we have a number of recent new investors, gives me confidence that our reforms can be implemented. We are also keenly aware that we must remain vigilant and we will step in robustly where companies fail to meet their obligations.

We operate within the strategic policy frameworks set by the UK and Welsh Governments. I was pleased to see a continued appreciation of the vital role of independent economic regulation in their respective draft strategic policy statements for Ofwat. We continue to have constructive discussions with both Governments on the underlying themes. The importance of independent regulation to maintain sustainability of services for customers, and attractiveness of the sector for investors, should not be underestimated.

We were pleased to welcome three new non-executive directors (Mark Bayley, Alison Munro and Tim Waggott) to our Board in the early part of the year. Alongside my more long-standing colleagues on the Board, they have already made a significant contribution. Shortly after the end of the financial year, we said goodbye to Richard Khaldi, who served on Ofwat's board as an Executive Director. He too has made a significant contribution to Ofwat's transformation in his time with us.

Finally, I would like to pay tribute to all colleagues in Ofwat, who operate under the strong leadership and inspirational culture that Cathryn Ross and her team have developed. Without them, we could not have achieved as much as we did this year – or be in the confident position of knowing that we will do even more over the next few years to push the frontiers in getting customers a better deal. On behalf of the Board, I thank all colleagues for their expertise, passion and hard work in helping us to do our job.

Jonson Cox
Chairman

Chief Executive's report

Over the past 12 months we have made significant progress in enabling and encouraging the sector to build greater trust and confidence in water and wastewater services.

This year was the second in the five-year control period following our 2014 price review (PR14). We are therefore able to see in practice now the improvements we brought about for customers through that review. The average residential water and wastewater bill in 2016-17 was 1% lower than it was at the end of the last control period, in 2014-15. And some companies are establishing new frontiers in performance for their customers. For example:

- Anglian Water have cut time lost due to water supply interruptions to 8 minutes 12 seconds per household – compared to their target of 16 minutes 54 seconds per household;
- Northumbrian Water have cut the number of properties suffering from internal flooding from sewers to 143 – compared to their target of 262;
- Welsh Water generated 50.21 gigawatt-hours (GWh) of renewable energy – compared to their target of 7.11 GWh; and
- SES Water engaged 13,134 children and adults in environmental education activities – compared to their target of 8,000.

Where companies have outperformed by exceeding our challenge on cost efficiency in PR14, or by delivering more of what their customers want, those companies will enjoy rewards in the next few years. But at our next price review in 2019, the new frontiers that these companies have established will enable us to set more challenging targets for all companies, benefitting all customers. Going beyond this, and building on our work at PR14, this year, we have set out an ambitious policy framework that will enable and encourage the sector to deliver a step change in efficiency through greater use of wholesale markets, and deliver more for customers on the basis of genuinely stretching performance commitments and excellent customer engagement.

I was particularly pleased that the relevant companies this year agreed the modifications to their licences to enable the delivery of PR19 in line with the ambitious policy framework we set out. This was a process that required considerable collaborative effort and, working together, we have achieved a good result that will benefit customers, the environment and society more widely.

We have worked successfully this year with Defra and MOSL the market operator, our partners in the Open Water programme, to open the market for business, public

sector and charitable sector customers in England to competition. Customers are already seeing the emergence of more choice and innovation as a result. But, while this will be a competitive market, it will remain a regulated market. And this year saw us prepare the ground for our continued oversight of the market, enabling us to ensure that competition is established effectively, in ways that deliver benefits for customers, and that customers remain appropriately protected so that they can participate in the market with confidence. Throughout this process we have remained in close contact with the Welsh Government to ensure that any insights we gain from the competitive market in England are used to best effect in our regulatory framework to benefit customers in Wales as well.

In addition, over this year, we have stepped in to hold companies to account, not only for their performance in delivering for customers today, but in relation to the resilience of their systems and services and their corporate and financial resilience. And we have improved our effectiveness in reducing harm to customers where we deal with disputes and complaints.

I also want to express my continued support for the UK Regulators Network (UKRN), which remains a highly effective means by which we have been able to draw on and learn from the experience and expertise of others across the regulatory community. This has been particularly useful for us as we have developed our policy thinking on introducing competition in retail markets and challenging ourselves to improve the effectiveness of our regulation of wholesale markets.

Internally, we continue to drive change in our organisation's capacity and capability to deliver our ambitious strategy. We established our programme and project based operating model two years ago and are working in line with the systems and processes that underpin it. But we continue to seek out opportunities to learn and improve the way we do things. Over the coming year we intend to keep our eye firmly on becoming the best regulator we can be, taking into account the ever-rising expectations of customers, the increasingly fast paced change in the sector we regulate and the emergence of new markets.

During the year I was delighted that we were able to strengthen our Senior Leadership Team, welcoming Aileen Armstrong, John Russell and Jenny Block to Ofwat and appointing David Black to the team. I would also like to welcome Alena Kozakova as our new Chief Economist. I would also like to put on record my personal thanks to Liz Hillman and Bev Messinger, who both left during the year, and to Richard Khaldi who will be leaving in early 2017-18. Liz, Bev and Richard played key roles in establishing Ofwat's strategy and in the transformation of the organisation. In the coming year, I am looking forward to welcoming a new Senior Director, Customers and Casework, who, among other things, will lead our new

Market Outcomes and Enforcement programme, and a new Senior Director, Business Improvement, who among other things will lead our Fit for the Future programme.

Finally, I would like to reiterate Jonson's sentiment that our ability to enable and encourage the sector to go further for customers, rests entirely on the knowledge, commitment, energy and enthusiasm of our people. It has been another busy year for all of us, and I am acutely aware that – with business retail market opening and the run up to PR19 – we have more to do than ever. I am impressed on a daily basis with their thoughtfulness, passion and dedication to seizing every opportunity to establish new frontiers. And I look forward to working together to see further successes over the coming year.

Cathryn Ross
Chief Executive

Purpose and activities

Our Trust in water strategy is the means by which we fulfil our statutory functions and duties. We also carry out our relevant functions in accordance with the statements of strategic priorities and objectives we receive from the UK and Welsh Governments.

Ofwat's priorities for 2016-17 were as follows.

1. Working to ensure that markets deliver real benefits for customers, the environment and society.
2. Improving information and accountability.
3. Maintaining customer confidence through a period of change.
4. Maintaining investor confidence in the sector through a period of change.
5. To ensure that Ofwat has the skills, experience, systems, processes and culture that support our new strategy.

Our five-year business plan for 2017-18 to 2020-21 and our 2017-18 forward programme set out our future plans.

Key issues and risks

Our risk and opportunities strategy sets out our approach for managing and responding to risks and opportunities. Our strategy is based on HM Treasury's 'Orange Book: Management of risk – Principles and Concepts'. And in line with the principles of the UK Corporate Governance Code, risk and opportunity management is embedded across our organisation. Our governance statement on page 54 gives more information on risks.

Going concern basis

We have adopted a going concern basis for the preparation of these accounts, as set out in note 1.15 on page 92.

Performance summary

1. Working to ensure that markets deliver real benefits for customers, the environment and society

Highlights

Secured a better long-term deal for customers by securing commitment to new wholesale markets	Implemented choice of retailer for business, charity and public sector customers in England	Improved choice for developers to support growth	Launched our investigation into how the market for New Appointments and Variations (NAVs) is working	Reviewed the costs and benefits of introducing choice of retailer for residential customers in England

£1.6 billion

potential value of new bioresources and water trading markets

Benefits vs costs + risks

our review of introducing choice of retailer for residential customers in England

£200 million

estimated overall benefits of the business retail water market in England

49

number of licences granted for companies competing in the business retail market in England

2. Improving information and accountability

Highlights

Checked how well monopoly companies are delivering against the promises they made to their customers	Encouraged monopoly companies to produce information that can be trusted	Reviewed monopoly companies' approaches to asset health	Challenged the sector to be more transparent to customers and others through Discover Water	Supported and challenged the sector to be more transparent about its performance

2

companies we moved into the bottom category for information quality

9,876

users of the sector's Discover Water website in its first four months

Good

standard of reporting against our Board leadership, transparency and governance principles 2015-16

3. Maintaining customer confidence in the sector through a period of change

Highlights

Challenged the sector to engage customers in shaping the future of water and wastewater services	Reduced harm and detriment to customers by dealing more effectively with complaints, disputes and company failures	Raised awareness among customers eligible to choose their supplier in the business retail market	Decided monopoly companies' rewards and penalties for 2015-16	Explored how data sharing can support customers in vulnerable situations
				Challenged Thames Water to account for how its assets are maintained and operated

-1%

percentage change in average residential water and wastewater bill between 2014-15 and 2016-17

8 out of 10

monopoly water and sewerage companies that met their target for minor pollution incidents in 2015-16, versus 5 out of 10 in 2014-15

Active

encouraged companies to make customers active participants in planning and delivering services

4. Maintaining investor confidence in the sector through a period of change

Highlights

Provided early clarity on our policy framework for the next price review	Secured agreement on licence changes needed for the 2019 price review	Monitored changes to company ownership and corporate structures	Encouraged innovative delivery and financing models for large infrastructure projects	Acted in accordance with UK and Welsh Government strategic guidance
				Successfully introduced pre-appointment discussions with new regulated company non-executives

£44 billion

planned sector investment ('total expenditure', or 'totex') during 2015-20

100%

number of companies we agreed licence changes with to enable our future price limits and markets plans

4

changes in ownership of companies during 2016-17

5. To ensure that Ofwat has the skills, experience, systems, processes and culture that support our new strategy

Highlights

Grown and developed our people	Developed our delivery model for the 2019 price review	Made Ofwat an even better place to work	Engaged our people	Improved our data management

82%

percentage of our people that reported they enjoyed their jobs in our annual survey

'In Source'

the new delivery model for our support services to provide extra resilience for our work

22%

the increase in training days carried out by our staff while still delivering frontline objectives

50

full-time equivalent staff appointed in 2016-17

7th

our ranking in the top 20 UK water supply sector brands on Twitter

+28

internal advocacy score for how likely our people would be to recommend Ofwat as a great place to work – up from -31 in 2014

Finance, accountability and sustainability

Highlights

Delivered our core regulation activities within budget	Opened the business retail water market in England on time and on budget	Cut our water use	Staff turnover decreased

£22.069 million

our operating expenditure in 2016-17

3.6 times

difference between the salary of our highest-paid director and the median remuneration of our workforce

90%

suppliers we paid within 30 days of receipt during the year

140 m^3

water we used in 2016-17, compared with 230 m^3 in 2015-16

47%

proportion of our full-time workforce that are women

9%

our staff turnover in 2016-17, a 2 percentage point decrease on the previous year

Performance analysis

Measuring our performance

Our vision for Ofwat is to be working at the leading edge, trusted and respected, challenging ourselves and others to build trust and confidence in water.

Here we report our performance against our strategic priorities, which we set out in 'Ofwat's forward programme 2016-17' in March 2016.

Our 2016-17 performance

1. Working to ensure that markets deliver real benefits for customers, the environment and society

Secured a better long-term deal for customers through new wholesale markets

The challenges posed by climate change and population growth mean we need bold, creative and innovative action to ensure we have reliable access to resilient, affordable water and wastewater services in the future.

In May 2016, following public consultation, we confirmed a number of major reforms to help boost resilience and secure a better deal for water customers, the environment and wider society. These included:

- strengthening the role of customers and Customer Challenge Groups (independent experts who provide assurance to Ofwat on the quality of companies' customer engagement) by placing greater expectations on companies involving their customers in their decision making process;
- stepping away from the use of the Retail Price Index (RPI) measure of inflation and moving towards a Consumer Price Index (CPI) − or Consumer Price Index including owner-occupiers' housing costs (CPIH) measure − in setting limits on monopoly companies' prices; and
- supporting new markets in bioresources – treated sewage – and water resources, taking account of the respective policy positions of the UK and Welsh governments. These markets could be worth £1.6 billion over 30 years.

Implemented choice of retailer for business, charity and public sector customers in England

Since April 2017, 1.2 million eligible business, charity and public sector customers, located mainly in England, have been able to shop around for their water retailer. In doing so they can benefit from lower prices, consolidated water bills, higher standards of service and more tailored services. The UK Government estimated the new market will deliver £200 million net benefit to the UK economy.

During the year, we consulted on, developed and implemented a number of the key arrangements to ensure the new retail market opened as planned. These included the following.

- Opened the application process for companies and business customers interested in becoming licensed to supply retail services in the market in good time.
- Processed licence applications to supply retail services from 30 companies and granted a total of 49 licences (24 water and 25 sewerage). We also granted a licence to a business customer to supply themselves with services ('self-supply').
- Consulted on and formally designated the main documents ('codes') setting out the way the market works.

Taking account of the experiences of introducing competition in other utility markets in the UK, we put in in place a framework for effective competition with a robust market monitoring framework to ensure we understand how the market is developing and when, or where, we might need to intervene. The framework includes a Customer Protection Code of Practice, which sets out the minimum standards that all retailers will need to comply with when dealing with customers. This includes additional protections for the very smallest business customers. We also consulted on and finalised our principles for voluntary codes of practice for Third Party Intermediaries (TPIs), such as brokers or price comparison websites, operating in the market.

Improved choice for developers to support growth

Housing and commercial property is a significant part of the UK economy and new water connections is one area where customers can choose their service provider. During the year we consulted on how this can be improved to make the process of getting new connections faster and more straightforward. This included finalising new rules to make the charges for new water connections to housing

developments in England fairer, simpler and clearer. This will help support development and growth.

Reviewed the costs and benefits of introducing competition for residential customers in England

We take our duty to protect current and future customers, and ensure they get the best possible deal, very seriously. So in November 2015, we welcomed the UK Government's request that we look into the costs and benefits to residential customers in England of competition for retail water services, reporting back by summer 2016. 1.2 million business customers are now able to choose their retail supplier – and there are 18 times as many residential customers. We committed to a rigorous review that was:

- open, transparent and evidence based;
- learned from other sectors and listened to a wide range of views; and
- took full account of the best interests of customers and wider society.

During 2016-17, we carried out our review. After consulting on our initial findings, we found such a market might:

- deliver net benefits worth almost £3 billion over 30 years – or £8 per customer per year; and
- lead to innovation, improved customer service, new offers – including bundling of products such as energy and telecoms with water, and the provision of value added services.

But we also found that there would likely to be:

- a limited reduction in bills in the short-term;
- significant set-up and ongoing costs;
- as in the business customer market, a need to ensure through our regulation that public health and safety is maintained and customer protection measures are in place to ensure all customers are treated fairly; and
- an ongoing need for appropriate assistance for vulnerable customers and those struggling to pay their bills.

In consulting on its statement setting out its strategic priorities for economic regulation in water, the UK government said "Further work needs to be done both to ensure that these benefits can be realised, and to understand and mitigate any

impacts on vulnerable customers. It is also important that we learn the lessons from the opening of the business market. Ofwat should work with the government to build the evidence base further, in order to enable the government to fully understand the case for extending competition to households."

It is now for the UK Government to decide whether and how to introduce competition.

Investigated how the market for new appointments and variations (NAVs) is working

We commissioned and oversaw an investigation into how the market for new appointments and variations (NAVs) is working. The NAV market allows alternative companies ('new appointees') to become monopoly providers within pre-existing areas in certain circumstances.

While NAV applications have increased in recent years, the scale of the market is still modest. Our investigation will enable us to highlight any issues in the market and to:

- consider the extent to which current initiatives and policy developments may help to address these issues; or
- identify other areas where it may be appropriate to intervene using the full range of our regulatory tools, including our concurrent competition law powers.

We will report on the outcome of our investigation and the steps we have taken in next year's report.

2. Improving information and accountability

Checked how well monopoly companies are delivering against the promises they made to their customers

In July 2016, monopoly companies published information showing customers how they performed against a range of indicators during 2015-16. We examined their performance and published our first full report of companies' overall service delivery.

We have no major concerns so far but there is a mixed picture among companies. We are also conscious that this is only the first year of five for the delivery of these outcomes and performance commitments. Companies met 70% of their performance commitments in 2015-16. In some cases, where they exceeded their commitments,

companies earned rewards. However, some companies have incurred significant penalties for failing to deliver the outcomes they committed to in our PR14 price review. Overall in 2015-16 the monopoly companies earned net rewards of £31 million in respect of their performance against their commitments to customers.

We also published our first full report focusing on the financial resilience of the water sector in England and Wales.

Where we have concerns about a company's performance, we have raised this with them and we are pro-active in checking they get back on track.

Supported and challenged the sector to be more transparent about its performance

During the year we also consulted on and finalised changes to our regulatory accounting guidelines for 2016-17. This comparative information helps customers, investors and other stakeholders challenge companies' decisions, performance and future targets.

We commissioned a targeted review of corporation tax to improve our understanding of monopoly companies' tax positions and consider and evaluate future options for funding tax in companies' price limits and improving transparency of reporting. We are considering the issues highlighted in the review and will make appropriate changes to our draft methodology for the 2019 price review, which we will publish in July 2017.

Challenging the sector to be more transparent to customers and others

We supported the development of 'Discover Water', a website which brings together a range of information about companies and water and wastewater services in a user-friendly and interactive way. Discover Water allows users to compare water companies' performance on issues such as leakage, water quality and supply interruptions.

Encouraged monopoly companies to produce information that can be trusted

Our company monitoring framework (CMF) rates each company depending on the quality of the information they provide to us and their other stakeholders, providing the assurance needed to maintain trust and confidence in the sector. There are three categories and companies can move up and down depending on our assessment of their performance in this respect.

The rating each company gets decides the level of assurance we expect from them in future. The higher the rating, the greater the confidence both their customers and Ofwat can have in companies' delivery, and so the more freedom they have over the assurance they provide. The lower the rating, the less freedom they have. We will also take account of the quality of companies' information in our next review of companies' prices beyond 2020.

During 2016-17, we published our first full rating of companies under the CMF. Three companies (South East Water, Severn Trent Water and United Utilities moved up to the top ('self-assurance') category while two companies (Yorkshire Water and Southern Water) moved down to the bottom ('prescribed') category. South West Water and Affinity Water moved down to the middle ('targeted') category. All other companies stayed in the targeted category.

Reviewed monopoly companies' approaches to asset health

Customers need confidence that water company assets are being maintained appropriately for the benefit of current and future generations, and companies have legal obligations to ensure that they do this. So during 2016-17 we commissioned a targeted review on asset health to consider:

- how asset health contributes to the sector's wider approach to resilience;
- how well companies understand the risks associated with poor asset health;
- how companies identify and measure those risks, and what they are doing to mitigate them; and
- what assurance processes companies have in place, and how they respond to failures when these occur.

We will publish the outcome of our review in autumn 2017.

Driving improved monopoly services in the future

We want companies to focus even more on delivering the outcomes that matter to customers, the environment and wider society.

- We introduced an outcomes-focused approach for the first time at the 2014 price review (PR14) to encourage companies to focus more on delivering what their customers want such as the quality and reliability of their water supply, how well water companies look after their local environment and how good their customer service is.

- To support this approach and make sure companies are on the right track, they all have pledges about the outcomes they will deliver for their customers ('performance commitments'). The companies agreed their performance commitments after speaking with, and listening to, their customers. And each company's independent 'customer challenge group' provided assurance to us about the quality of that engagement and how it fed through into the companies' pledges.
- Companies also get rewards and penalties ('outcome delivery incentives') depending on how successful they are in delivering their performance commitments.

During 2016-17 we consulted on how companies should engage with customers about their performance in the future. In particular, we consulted on:

- how companies' performance commitments can be made more stretching (higher service levels);
- how outcome delivery incentives (ODIs) can be strengthened;
- how we can better reflect resilience in outcomes;
- the extent to which performance commitments should be common across companies or tailored to reflect the priorities of customers in different areas; and
- how performance commitments can be made more transparent to customers.

We will reflect views in our price review methodology consultation to be published in July 2017.

3. Maintaining customer confidence through a period of change

Challenged the sector to engage customers in shaping the future of water and wastewater services

As part of our decisions on future price limits and markets in May 2016, we published our expectations for monopoly companies in engaging with their customers during the 2019 price review (PR19). Our policy significantly strengthens customers' role in the way services are delivered and in deciding companies' price and service levels.

We met with the chairs of the Customer Challenge Groups to inform them of our overall approach to different aspects of price setting and how they can help challenge companies to deliver better services.

Challenging the sector to think differently about customers

To help water companies identify the possibilities for them and consider what they need do to bring customers into their thinking as active participants, we commissioned and published 'Tapped In - From passive customer to active participant'. This report encourages companies to recognise that customers, their choices and actions are central to how water and waste water services are provided. It looks at best practice in customer participation from other sectors and other countries.

Raised awareness among customers eligible to choose their supplier in the business retail market

In October 2016, we commissioned an awareness survey of the business retail market among eligible customers. The survey told us that awareness had risen from just 8% at the start of 2016 to 32% but we took the view that more needed to be done. The survey was used to inform a wider national awareness campaign, funded by companies, to raise awareness of the new market in England among eligible customers. We will be conducting further awareness research later in the year. We will report on the results in next year's report.

Agreed monopoly companies' rewards and penalties for 2015-16

During 2016-17, we consulted on and finalised the rewards and penalties for three water companies, based on their performance against outcome commitments for 2015-16. These companies elected to reflect their performance in customer bills on an annual basis during the control period, rather than at the end of the control period as part of the next price review. This allowed customer bills to better reflect the outcomes that customers received.

- Severn Trent Water exceeded its commitments for minor wastewater pollution incidents, sewer flooding and leakage (saving 10 million litres a day). This resulted in a performance reward worth £18.8 million.
- Anglian Water also exceeded its commitment on leakage (saving 3 million litres a day). This resulted in a performance reward of £0.5 million.
- South West Water will incur a £1.7 million penalty for missing targets, mostly connected with significant wastewater pollution incidents.

Explored how data sharing can support customers in vulnerable situations

Building on our own work on affordability and vulnerability, we joined forces with Ofgem and the UK Regulators Network (UKRN) to identify the potential benefits, opportunities and challenges that may arise from data sharing across water and energy. We engaged with a number of stakeholders such as Water UK, Citizens Advice and the Information Commissioner's Office (ICO), to get a wider perspective on the developments on this issue.

We are aiming to publish our findings in summer 2017-18. At that stage we will consider whether more work should be done, and which parties are best placed to take it forward. We will report on progress made in next year's report.

Reduced harm and detriment to customers by dealing more effectively with complaints, disputes and company failures

We continued to resolve cases that we received effectively (see 'Performance against standards of service' on page 108) – or directed issues to other organisations better placed to resolve them. We exceeded our target for responding to general enquiries within 10 days. We were more successful in our early interventions on complaints and disputes, enabling issues to be resolved more informally. This had the impact that where we did open formal cases, they were generally more complex. And to make our decisions more widely understood – and help avoid similar disputes or complaints occurring – we:

- shared simple case summaries on our website;
- produced a quarterly electronic bulletin ('On the Case') for companies and customers; and
- engaged directly with individual companies.

Challenged Thames Water to account for how its assets are maintained and operated

We expect companies to take ownership and be accountable for their services, charges and relationships with their customers. That includes putting things right where things go wrong.

In December 2016, a series of water mains burst in Thames Water's operating area in London. We met some affected residents and heard about the damage, distress and frustration the bursts and their aftermath caused.

We have sought assurance from the Board of Thames Water that the company is meeting its legal obligations.

Refreshed our perspective on the impacts of climate change

We published our latest climate adaptation update report, setting out how we enable, incentivise and encourage climate adaptation in the water sector. This includes a report on the independent Task and Finish group, which examined and promoted resilience across the sector.

4. Maintaining investor confidence in the sector through a period of change

Provided early clarity on our policy framework for the next price review

We provided early clarity on our decisions to support the better use of markets in the sector to enable a step change in efficiency and improve resilience; and on how we will set price limits in our forthcoming 2019 review. This included confirming we will:

- introduce new markets for bioresources and water resources;
- encourage market testing of new network-based projects; and
- move to a more robust and legitimate measure of inflation in price controls, ie by phasing out the use of RPI and replacing it with CPI or CPIH.

We also consulted on our approach to setting the allowed cost of debt.

Secured agreement on licence changes needed for the 2019 price review

All regulated companies have licences to operate, which set out the terms with which they must comply. Licences provide protection to customers and certainty to companies and their investors. Each company must agree to any changes to its licences, or we must take our case to the Competition and Markets Authority.

We wanted to ensure our licences supported the changes we wished to make to future price setting and wholesale markets, which will:

- help companies respond to and meet the challenges within the sector; and
- contribute to improving resilience and drive efficiency, so helping to maintain affordable bills for customers.

During the year we engaged, consulted on, and agreed a number of changes to licences with all 17 of the largest companies. The changes we made were as follows.

- Changed to index price controls for most purposes based on the CPI or CPIH instead of RPI. Using this less volatile index will mean less uncertainty for customer bills and stakeholders.
- Enabled separate controls to be set for water resources and bioresources and water and wastewater network plus controls.
- Established market information for water resources and bioresources activities. Both of these will enable the market to open up in bio and water resources, potentially unlocking substantial benefits to customers, companies, investors and the environment.
- Allowed for in-period adjustments to price control revenue for outcome delivery incentive (ODI) rewards and penalties for all companies.

Monitored changes to company ownership and corporate structures

We have duties to make sure that efficient companies are able to finance their functions and to protect customers' interests. As part of this we monitor changes to company ownership and their corporate structures. This included the following.

- We provided evidence to the Competition and Markets Authority (CMA) on the impact of the proposed merger between Severn Trent Water and Dee Valley Water on our ability to make comparisons between water companies. We concluded that it would not prejudice our ability to do so and the CMA agreed, clearing the merger. The merger was completed in March 2017, and we continue to work with the company to ensure that their plans, post-merger, protect customers' interests. We will report on the outcome in next year's report.
- We considered changes of ownership at Southern Water, Bristol Water and South East Water during the year and worked with these companies to ensure that appropriate new "Condition P" undertakings from the Ultimate Controllers or UK holding companies were put in place.
- In April 2016 we granted consent (for a period of five years) for United Utilities to provide working capital through a series of loans of no more than £100 million to a joint venture company in which United Utilities PLC will own 50% of the equity. We published a notice setting out the reasons why we have given consent and explaining the background.

We also successfully introduced pre-appointment discussions with new regulated company non-executives as part of our approach to improving board leadership, governance and transparency.

Encouraged innovative delivery and financing models for large infrastructure projects

We continued to work alongside the UK Government, Thames Water and the infrastructure provider, Bazalgette Tunnel Limited (Tideway), to deliver value for money for customers during the construction phase of the 25 km Thames Tideway Tunnel. Unprecedented in scale, size and complexity in the water sector in England and Wales, the project will deal with the problem of untreated sewage going into the River Thames.

Tideway's shareholders were new to UK water and a number have since expanded their investment interests into other UK water companies, highlighting the continuing attractiveness of UK water to long-term investors.

Acted in accordance with UK and Welsh Government strategic guidance

Under the Water Industry Act 1991, the Secretary of State for Environment, Food and Rural Affairs and the Welsh Government have powers to issue policy statements setting out strategic priorities and objectives for us. We are required to act in accordance with these statements when carrying out relevant legal functions (in practice, most of our work as an economic regulator) in relation to water company areas wholly or mainly in England or Wales respectively.

During the year we engaged with both Governments as they developed and consulted on their respective new statements for us.

Until the new statements have been issued in final form, we must act in accordance with both Governments' previous statutory guidance to us on social and environmental matters. We set out how we have done this in 'A3 How our work aligns with the UK and Welsh Governments' priorities and guidance'.

5. To ensure that Ofwat has the skills, experience, systems, processes and culture that support our new strategy

Grown and developed our people

During the year we implemented a new learning and development package to develop our staff – from formal training to mentoring and sharing skills through communities of interest. The take-up of training by our staff increased by 22% (see page 141).

We began the implementation of our strategic workforce model and plan to give us the management information we need to make sure we have the right size, shape, and skills at the right time to deliver our strategy.

As part of our approach, we successfully ran a Graduate scheme in partnership with Ofgem, appointing three of our existing graduates to permanent positions – and recruiting five further graduates. We also appointed 50 people with a mix of skills and professions and from a wide range of backgrounds, including economists, legal professionals, communicators, project managers, accountants and others with a range of operational and business skills.

We developed a new 'In Source' delivery model for our support services. Subject to consent from HM Treasury and the Cabinet Office, we will recruit a partner to first work with us on improving our processes and then supply us with additional capacity when we have a peak in work or a project which requires skills we don't have.

Developed our delivery model for the 2019 price review

The 2019 price review will be a significant part of our work over the next three years. To make sure we deliver this work effectively and efficiently we have been carrying out some early planning for our delivery model for the price review.

We also developed our approach for using a delivery partner to provide extra support to us during the price review. And shortly after the financial year ended, we put out a notice to take soundings from the market to input into our thinking on the procurement specification and strategy. This was to allow potential partners to express their interest ahead of a formal tendering process. This will help ensure we get a good deal for customers.

Made Ofwat an even better place to work

Our annual people survey continued to show significantly improved results. For example:

- our internal advocacy score (how likely our people are to recommend Ofwat as a great place to work) was +28, compared with -31 in 2014;
- 81% of respondents agree that we are a learning organisation; and
- 82% of respondents reported they enjoyed their jobs.

We are carrying out work in a number of areas to continue to improve our performance, including improving the health and wellbeing of our people.

Engaged our people

We launched a weekly five-minute long **tinyTALK,** which is led by a different colleague each week on any topic of their choice. Colleagues have shared expertise with colleagues on subjects ranging from their professional experiences to their personal hobbies.

Improved our data management

During 2016-17 we developed a robust system where we can easily share, store and retrieve the correct information to support our people. Our EDRM (Electronic Document Records Management) system will be particularly important for us in supporting how we handle our information correctly, applying appropriate controls and security during the next price review, when the sensitivity of information increases and therefore the risk impact of an information incident increases.

Financial commentary

The financial highlights for Ofwat are summarised below.

Operating costs summary

				2016-17 £000		2015-16 £000
	Core Regulation	Open Water Programme	Thames Tideway Project	Total Core Department	Core Department	Departmental Group
Income						
Licence fees received	22,110	1,970	1,000	25,080	25,869	28,512
Other income	213	-	-	213	120	62
Credit note issued at end of year	(2,000)	-	(500)	(2,500)	(3,213)	(3,213)
	20,323	1,970	500	22,793	22,776	25,361
Expenditure						
Administration costs	(19,773)	(1,853)	(443)	(22,069)	(22,277)	(24,862)
	(19,773)	(1,853)	(443)	(22,069)	(22,277)	(24,862)
Net operating cost	550	117	57	724	499	499

Core regulation budget

Ofwat is funded by fees charged to the companies we regulate. Fees are recovered annually from appointed companies and licensees. Our fee income is subject to the constraints set out in the appointed companies' licence conditions. While our revenue funding comes directly from water companies, our budget settlement is subject to agreement with HM Treasury through the spending review process.

The core regulation operating budget set at the start of the year and included within our Main Estimate was £22.58 million.

This was funded in full by the recovery of general licence fees under licence condition N. Our budget is set to meet our expected operational costs and includes a contingency to cover any unexpected requirements. In 2016-17, we did not charge £0.5m of our contingency budget upfront to companies. At the end of the year we underspent by 13% against our core budget. The underspend mainly related to our payroll budget, which was 9% underspent against budget mainly as a result of recruitment taking longer than expected, and unrequired contingency budget.

Ofwat sets a high bar for recruitment, and filling some posts took longer than anticipated due to the competitive nature of the market from which we draw our talent. We also recast some roles, we had originally anticipated as permanent positions, as fixed term contracts. These decisions contributed to a lower level of operational payroll costs in the current financial year than we had expected.

We also held a significant contingency budget in 2016-17 that we did not in the event require due in large part to our success, working constructively with the sector, in agreeing the modifications to company licences we require to deliver PR19 in line with our Water2020 policy framework.

Our core budget for 2017-18 has been confirmed at £25.2 million.

Retail Market Opening Programme

A temporary licence condition (Condition R1) governed our work to support the opening of the retail market for businesses, charities and public sector organisations in England. This Condition allows us to raise fees to cover work on this programme and is separate in order to prevent cross-subsidisation of our work delivered under condition N of companies' licences.

In 2016-17, Ofwat collected £1.97 million in licence fees to fund work we completed internally on the Open Water programme. The underspend against budget was 3%, which related to unutilised programme contingency.

Thames Tideway project

The regulation of the Thames Tideway project is funded under a separate licence paid by Thames Water and Bazalgette Tunnel Limited, the infrastructure provider.

The programme budget for 2016-17 was estimated at £1 million. The underspend against budget was 56%. This arose because of our uncertainty over the cost profile for the programme in the initial year that the infrastructure provider was in place. The level of expenditure on this programme is in line with our cost projections for future years.

At the end of the year, we returned £0.5 million to Thames Water Utilities Limited and Bazalgette Tunnel Limited by credit note and the budget for 2017-18 has been confirmed as £0.5 million.

Capital expenditure

Capital expenditure is funded by budget cover agreed with HM Treasury, which is recorded in our Main and Supplementary Estimate. The underspend against our capital budget was 21%, relating to a supply chain delay in the delivery of planned improvements to our Information Technology Infrastructure. This will be delivered in early 2017-18.

Our core budget for 2017-18 has been confirmed at £370,000.

We have £36,000 held in capital commitments at 31 March 2016 in relation to a contract for improvements to our Information Technology Infrastructure (31 March 2015: £122,000).

Compensation payments and premature departure

During the year we utilised the provision of £54,000 we made in 2015-16 to cover the costs of a compensation payment due for a departure under voluntary exit terms in full, as detailed in note 12 to the accounts.

Cathryn Ross
Accounting Officer **15 June 2017**

Sustainability

We have adopted an operational control approach to identify which of our activities generate carbon emissions. Our carbon footprint has been calculated using the relevant requirements of the Greenhouse Gas Protocol Corporate standard and details both absolute and normalised (relative) emissions.

Our carbon emissions for the period were 256 tonnes of carbon dioxide equivalent (CO_2e). The largest source of our emissions is electricity consumption, which accounts for 125.1 tonnes of CO_2e (49% of the total). Business travel is responsible for 79.8 tonnes of CO_2e (31% of the total). We do not have any direct (Scope 1) emissions.

Table 2: Breakdown of annual greenhouse gas emissions by activity type for 2016-17

Type of emissions	Activity	Units	(tCO2e)	% of total
Indirect energy (scope 2)	Purchased electricity (kWh)	303,708.2	125.1	48.9%
	Subtotal	**303,078.2**	**125.1**	**48.9%**
Other indirect emissions (scope 3)	Business travel (miles)	809,714.3	79.8	31.2%
	Flights (miles)	61,577.0	16.4	6.4%
	Rail (miles)	727,665.2	57.2	22.3%
	Taxi (miles)	1,102.5	0.4	0.2%
	Cars (miles)	19,369.6	5.8	2.3%
	Waste and water		6.0	2.3%
	Water use (m^3)	139.6	0.1	0.1%
	Waste (tonnes)	41.4	5.8	2.3%
	Additional upstream activities		45.1	17.6%
	Electricity T&D (kWh)*		11.3	4.4%
	WTT**		33.7	13.2%
	Subtotal		**130.9**	**51.1%**
Total emissions (tCO_2e)			**256.0**	

*Transmission and distribution (T&D) emissions are those associated with grid losses (the energy loss that occurs in getting the electricity from power plant to the organisations that purchase it).

**Well-to-tank (WTT) emissions are those associated with the upstream processes of extracting, refining and transporting raw fuel to the vehicles, assets or processes under scrutiny.

Carbon emissions

Our total carbon emissions have increased by 35 tonnes of CO_2e (16%) compared to 2015-16. This is largely a result of our increase in FTE (23%) and resulting increase in business travel; emissions from rail travel have increased by 26.8 tonnes of CO_2e. Normalised emissions (tonnes of CO_2e per FTE) have decreased by 7% from 2015-16.

Table 3: Year on year analysis of greenhouse gas emissions

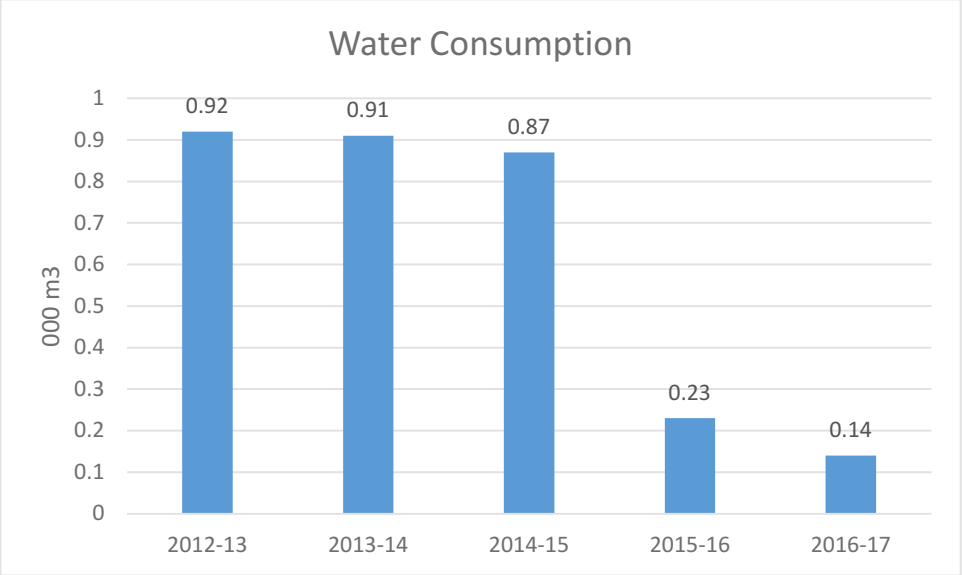
		2012-13	2013-14	2014-15	2015-16	2016-17
Type of emissions	**Activity**	**(tCO2e)**	**(tCO2e)**	**(tCO2e)**	**(tCO2e)**	**(tCO2e)**
Indirect energy (scope 2)	Purchased electricity (kWh)	233.1	210.5	225.5	142.6	125.1
	Subtotal	**233.1**	**210.5**	**225.5**	**142.6**	**125.1**
Other indirect emissions (scope 3)	Business travel (miles)	56.3	70.2	57.1	46.5	79.8
	Flights (miles)	16.1	28.8	8.7	12.5	16.4
	Rail (miles)	34.2	34.6	43.2	28.0	57.2
	Taxi (miles)	1.1	1.5	0.8	0.7	0.4
	Cars (miles)	5.0	5.3	4.5	5.2	5.8
	Waste and water	5.7	3.9	8.5	5.6	6.0
	Water use (m^3)	1.0	1.0	0.9	0.2	0.1
	Waste (tonnes)	4.7	2.9	7.6	5.4	5.8
	Additional upstream activities	62.9	59.0	64.9	42.3	45.1
	Electricity T&D (kWh)*	18.2	16.3	18.6	11.8	11.3
	WTT**	44.7	42.7	46.2	30.5	33.7
	Subtotal	**124.9**	**133.1**	**130.5**	**94.4**	**130.9**
Total emissions (tCO_2e)		**358.0**	**343.5**	**356.0**	**237.0**	**256.0**
	Average FTE across reporting period	**179.7**	**188.2**	**169.4**	**156.3**	**181.68**
	Normalised emissions (tonnes of CO2e per FTE*)	**2.0**	**1.8**	**2.1**	**1.5**	**1.4**

*Staff numbers (FTE) are used as a benchmark to monitor emissions over time.

Water

We used 140 m^3 of water in our kitchen and toilet facilities in 2016-17, equivalent to emissions of 0.15 tonnes of CO_2e. The continued reduction in our water consumption is largely attributable to the installation of water-efficient fittings in our office locations.

Figure 1: Water consumption for the past four years

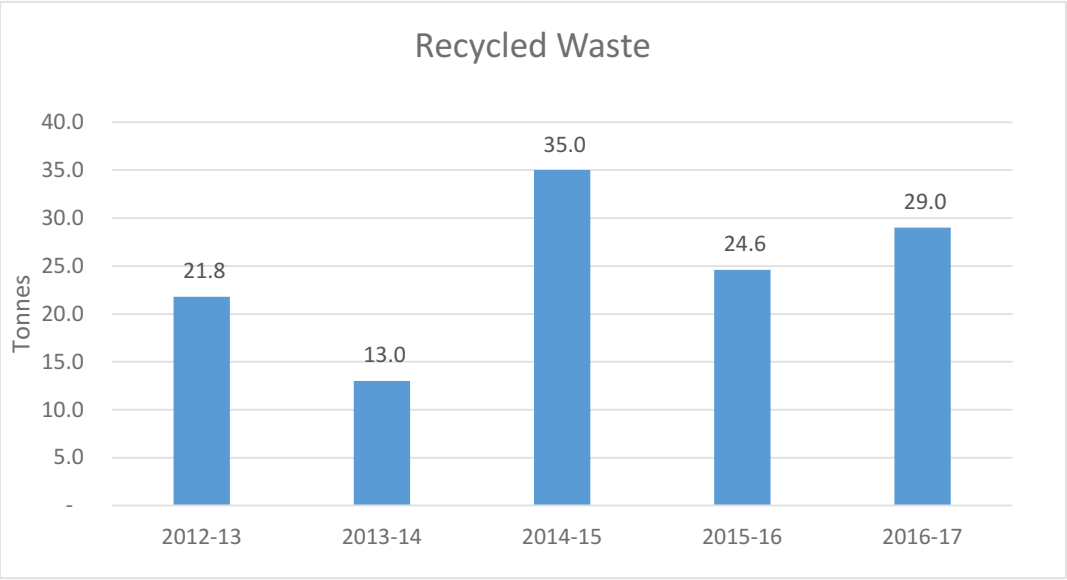


Waste

We segregate all general waste for recycling or landfill disposal. We are unable to measure landfill waste as it is disposed of via a central collection point in our multi-tenanted buildings. We have estimated that 70% of total waste is recycled.

Recycled waste amounted to 29 tonnes, equivalent to emissions of 0.61 tonnes of CO_2e in 2016-17. The spike in recycled waste in 2014-15 (Figure 2) related to the refurbishment of the Birmingham offices.

Figure 2: Recycled waste for the past four years



Part 2: Our accountability report

Corporate governance report

Directors' report

Roles and responsibilities

Ofwat is a non-Ministerial Government Department with its own resource estimate. Our Chief Executive and Accounting Officer is Cathryn Ross, and Jonson Cox is our Chairman.

Ofwat's Board recognises the importance of leadership in creating an environment where performance and risk management are fully embedded and effective. In line with the principles of the UK Corporate Governance Code, Ofwat's Board has a majority of independent non-executives with a non-executive Chairman. During 2016-17, the Board comprised seven Non-Executive Directors and four Executive Directors, including the Chief Executive.

The Board's Rules of Procedure are updated periodically and published on the Ofwat website. The Board carried out a full survey of its effectiveness in 2016-17, once the five new executive and non-executive members who joined the Board in this period were established. The Board's membership provides the necessary balance of experience and expertise, covering Ofwat's duties and strategy. The General Counsel, Jenny Block, attends and is accountable to the Board for providing legal advice.

Our Board Rules of Procedure include strict guidelines on the disclosure and management of conflicts of interest. The register of Board members' disclosable interests is published alongside the Rules of Procedure and updated regularly throughout the year and members declare interests on agenda items at the start of every Board and Committee meeting. On the rare occasion a conflict of interest arises, the Rules of Procedure ensure that the relevant Board member is not involved in decision-making on relevant items and appropriate measures are taken to ensure the integrity and impartiality of the Board's decision making. Such circumstances are noted in the minutes.

Board members' terms of appointment and committee attendance

Table 4: Attendance at Board and five sub-committee meetings from April 2016 to March 2017

Board members		Board Meetings (11) Board conference call (1)	Audit and Risk Assurance Committee Meetings (4)	Remuneration and People Committee Meetings (3)	Thames Tideway Committee Meetings (3)
Jonson Cox Chairman		**12/12**	**----**	**3/3**	**3/3**
Term started	Term 2 ends				
01/11/2012	31/10/2020				
Martin Lawrence Non-Executive Director		**10/12**	**----**	**2/3**	**----**
Term started	Term 2 ends				
01/05/2013	30/04/2020				
Mark Bayley Non-Executive Director		**10/12**	**4/4**	**----**	**2/3***

Board members		Board Meetings (11) Board conference call (1)	Audit and Risk Assurance Committee Meetings (4)	Remuneration and People Committee Meetings (3)	Thames Tideway Committee Meetings (3)
Term started	Term ends				
28/04/2016	27/04/2021				
Alison Munro Non-Executive Director		**12/12**	**4/4**	**----**	**----**
Term started	Term ends				
28/04/2016	27/04/2021				
Tim Waggott Non-Executive Director		**11/12**	**----**	**2/3**	**----**
Term started	Term ends				
28/04/2016	27/04/2021				
Catherine Waddams Non-Executive Director		**12/12**	**----**	**----**	**----**
Term started	Term 2 ends				

Board members		Board Meetings (11) Board conference call (1)	Audit and Risk Assurance Committee Meetings (4)	Remuneration and People Committee Meetings (3)	Thames Tideway Committee Meetings (3)
01/05/2013	30/04/2021				
Christine Farnish Non-Executive Director		**9/12**	**2/4**	**----**	**1/3***
Term started	Term 2 ends				
01/01/2014	30/04/2020				
Cathryn Ross Chief Executive		**12/12**	**4/4**	**3/3**	**2/3**
Aileen Armstrong Senior Director Finance and Governance		**8/12**	**----**	**----**	**----**
John Russell Senior Director Strategy and Planning		**11/12**	**----**	**----**	**----**

Board members	Board Meetings (11) Board conference call (1)	Audit and Risk Assurance Committee Meetings (4)	Remuneration and People Committee Meetings (3)	Thames Tideway Committee Meetings (3)
Richard Khaldi Senior Director Customers and Casework	**11/12**	**----**	**----**	**----**
Vanessa Howlison Independent Member - Audit and Risk Assurance Committee Term started: 01/01/2015 — Term ends: 31/12/2018	**----**	**2/4**	**----**	**----**
John Swift QC Independent Member - Casework Committee Term started — Term ends	**----**	**----**	**----**	**----**

Board members		Board Meetings (11) Board conference call (1)	Audit and Risk Assurance Committee Meetings (4)	Remuneration and People Committee Meetings (3)	Thames Tideway Committee Meetings (3)
11/2014	31/08/2017				

* Joined the Committee in October 2016
There were no meetings of the Casework Committee during 2016-17 as Ofwat did not have any open strategic cases.
There were no meetings of the Nominations and Governance Committee during the year as all Board and SLT vacancies were planned and recruited for in 2015-16.

A number of Non-Executive Directors joined the Board early in 2016-17 and two Executive Directors also joined the Board in the first half of the financial year. The terms of the new Non-Executive Directors have been staggered to provide greater continuity, particularly through the 2019 price review.

Ofwat's 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 for Environment, Food and Rural Affairs.

Independent Members

To strengthen the knowledge and skills mix of committee membership, Ofwat has Independent Members who sit on our Audit and Risk Assurance and Casework Committees.

John Swift QC – Independent Member of Casework Committee.

Vanessa Howlison – Independent Member of Audit and Risk Assurance Committee, and whose other appointments include: Chief Finance Officer for Highways England.

Board effectiveness

We set out a summary of the Board's review of its effectiveness in appendix A5 on page 134.

Supplier payment performance

We achieved 90.1% against our target for paying 100% of agreed invoices within 30 days of receipt during the year. The corresponding figure for 2015-16 was 88.32%.

Whistleblowing

Ofwat's whistleblowing policy is available to all our people on our intranet. There have been no whistleblowing complaints during 2016-17. In 2017-18 we will take steps to increase awareness of our Code of Conduct which incorporates the Civil Service Code and our whistleblowing policy.

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. We have experienced no personal data incidents during 2016-17 which we considered sufficiently serious as to require the Information Commissioner to be informed, consistent with ICO guidance.

Financial instruments

We do not have borrowings; we rely for our cash requirements primarily on licence fee income, claims on the reserve and Contingency Fund repayable advances. We are not, therefore, exposed to significant liquidity risks. Further details are provided in note 8 to the accounts.

Internal audit

Grant Thornton provides Ofwat's internal audit service. This independently measures and audits 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. The 2016-17 internal audit was performed in accordance with the Public Sector Internal Audit Standards (PSIAS).

External audit

Our external auditor is the Comptroller and Auditor General (C&AG), who is appointed under statute and is required to audit our financial statements under the Government Resources and Accounts Act 2000, and report to Parliament on this examination. There was no auditor remuneration (actual or notional) for non-audit work.

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 audit service is £40,000 (2015-16: £45,000).

Cathryn Ross
Accounting Officer **15 June 2017**

Statement of Accounting Officer's responsibilities

Under the Government Resources and Accounts Act 2000 (GRAA), HM Treasury has directed Ofwat to prepare for each financial year resource accounts detailing the resources acquired, held or disposed of and the use of resources by Ofwat during the year.

The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of Ofwat, and its net resource outturn, application of resources, changes in taxpayers' equity 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 the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards (as set out in the Government Financial Reporting Manual) have been followed, and disclose and explain any material departures in the accounts;
- take personal responsibility for the annual report and accounts and the judgements required for determining that it is fair, balanced and understandable; and
- prepare the accounts on a going concern basis.

HM Treasury has appointed Cathryn Ross, Chief Executive, as Accounting Officer of Ofwat. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding Ofwat's assets, are set out in Managing Public Money published by HM Treasury.

Governance Statement

Scope of responsibility

The Accounting Officer and Ofwat Board are responsible for maintaining corporate governance that supports the achievement of Ofwat's strategy, 'Trust in Water', while safeguarding public funds and departmental assets. This is in accordance with the responsibilities set out in 'Managing Public Money'. The Accounting Officer is accountable to Parliament for all aspects of Ofwat's work. This includes the management of risk and opportunity.

As a non-Ministerial Government Department, Ofwat's duties are laid down by legislation, in particular the Water Industry Act 1991, as amended.

The purpose of the governance framework

Ofwat adheres to the principles of the Code of Practice on Corporate Governance ('Corporate Governance in central government departments: code of good practice').[1] Ofwat complies with the Code, other than in some areas where our composition as a Non-Ministerial Government Department means certain provisions are not applicable. For example, our Director of Finance is not a member of the Board but attends for all relevant items.

The governance statement sets out:

- a review of Ofwat's effectiveness in 2016-17;
- a summary of the key elements of our governance framework; and
- the Accounting Officer's statement.

[1] https://www.gov.uk/government/publications/corporate-governance-code-for-central-government-departments

Ofwat's effectiveness

Achievements in 2016-17

Our progress in delivering our ambitious strategy, 'Trust in water', has continued at pace. We have reported earlier on how each of our programmes and projects has moved us closer to the delivery of our shared vision of trust and confidence in water and wastewater services, and has seen us implement our regulatory model. But I want to draw out some of the achievements of the last year and reflect on what this signals about the effectiveness of our contribution over the year and the risks and opportunities ahead.

The last year was the second year of the control period governed by our 2014 price review determinations. It saw continued improvements in delivery for customers across the sector in line with those determinations. Average bills have fallen by 1% (including inflation) from their level at the end of the last control period, and marking a significant step towards the 5% in real terms bill reductions that we will see in the period 2015-2020 as a result of PR14. We also saw some companies earning rewards for establishing new frontiers in performance, which will enable us better to challenge the sector as a whole in future.

We have also made significant strides in putting in place the framework needed to enable and incentivise the sector to continue to deliver more for less for its customers in future.

We published our policy framework for the next price review, which will see us further improve the effectiveness of our regulation in securing a good deal for customers. It does this, in particular, by enabling improvements in efficiency and resilience through the use of markets to give companies greater optionality in how they procure for water resources and the treatment and disposal of bioresources. It will also drive improvements in efficiency and innovation through the use of market testing in respect of network projects. We were particularly pleased during this year with the constructive and collaborative way companies in the sector worked with us to secure the modifications needed to their licences to implement this framework.

We have worked effectively with our Open Water partners, Defra and MOSL, and with the sector, to open the retail market for business charity and public sector customers in England to competition. This gives business customers the choice of retailer they have long sought, and will deliver improvements in service and spur innovation. But, while it is a competitive market, it will not be an unregulated market. And we laid the ground work in the last year for our continued oversight of the

market, enabling us to ensure the market works as effectively as it can, and we are able to protect customers as necessary.

Improving our oversight of the sector was an important theme elsewhere in our work over the last year. We have paid particular attention to issues of resilience – operational, corporate and financial. We have intervened to protect customers when operational resilience has been called into question, for example, in response to the Thames trunk mains bursts this winter. Our work on the company monitoring framework has given us better insight into the quality of companies' information. We have continued to monitor companies' compliance with our principles of board leadership, transparency and governance. We have also stepped up our oversight of companies' financial resilience, publishing a new financial monitoring report.

Together these achievements make a massive contribution to the delivery of our strategy – enabling and incentivising the sector to deliver more for less, and ensuring we have effective oversight so that we are able to step in where we need to in order to protect customers.

In parallel with these externally facing achievements, we are pleased to report that we have made further strides in making Ofwat a great place to work.

Recognising that our programme and project based operating model, introduced just over two years ago, is still relatively new, we focused this year on clarifying the role of our Strategic Resource Managers and Resource Managers, who manage our people, and supporting those who perform these important roles through training opportunities and opportunities to share learning. Following our restructuring in 2014-15 recruitment continued to be a priority for us in the last year as we complement our existing skills and expertise with people who bring additional skills and experience in key areas. Our recruitment has been successful, with 50 people joining the office, and Ofwat proving an attractive employer. However, the time taken to secure new people and bring them on board was longer than we had expected, which is why underspend on payroll in the last year was the main driver of our underspend overall.

Recognising that we are now more familiar with programme and project based working, towards the end of the year, we were able to take a more streamlined and proportionate approach to developing our business plan for 2017-18. This year we also took the decision to proceed with a new model for our support services provision, based on in-sourcing, to ensure the levels of agility and resilience we will need to continue to protect customers effectively in a sector that is becoming more dynamic.

The forward looking risk and opportunities environment

Our strategic priorities for the coming year include: delivering a step change in customer services, improving resilience, maintaining affordability and driving efficiency; improving information and transparency in the sector to hold companies to account; supporting the development and investability of markets to deliver more for less; securing stakeholder engagement and support for change; ensuring Ofwat has the skills, experience, systems, processes and culture to deliver.

Reflecting on these priorities, we see both risks and opportunities in the year ahead.

The newly competitive business customer market in England represents a fantastic opportunity to drive service improvement and innovation. This is not only for those customers who now have a choice of retailer, but also, through our regulation, for those who do not – including those in Wales where the Welsh Government has decided not to open the retail market to competition. We need to enable and track the development of new frontiers in customer service in the competitive market, and create a regulatory framework that enables us to challenge monopoly companies using new information about what is achievable and about what customers want. But there are risks here too.

Firstly, we need to ensure that customers have trust in the market and are confident in engaging with it. In addition, we need to ensure that our regulation of the market supports, rather than stifles, competition so that customer choice drives the improvements we expect.

This is why a critical workstream within our Market Outcomes and Enforcement programme is communications and engagement, and why we have retained the Open Water brand to use as a separate channel for communicating directly with customers. This takes Ofwat into new territory. And in seeking to maximise informed, empowered customer engagement in a competitive market, it forces us to address one of the most vexed issues facing regulators today. It is imperative that we learn from the experience of others, and also that we capture the learning from our own experience, both from what works and what does not.

A further necessary condition for customers to maintain and build trust and confidence in the newly competitive retail market in England is to know that they will be treated fairly, that redress will be provided when things go wrong, and that appropriate action will be taken when companies fail to comply with the rules. Our role in monitoring behaviour in the market is key here. Our new monitoring framework aims to capture this, both in terms of supplier behaviour and customer insight. Again, we will need to learn and adapt as we go. We also need to ensure we

are ready and able to act when we get intelligence that things are going wrong. In that respect, we are paying particular attention to the role of third party intermediaries (TPIs) in the new market and ensuring that while the benefits that these companies can bring are harnessed, we are alert to any risks that they may equally present, having regard to the problems with some TPIs in other markets. As we have no formal regulatory powers to act directly in relation to them, we set great store by the enforceable obligations we have placed on retailers through the customer protection code of practice, and the clear expectation on them that they will give effect to these obligations in their dealings with TPIs too.

We must also seize the opportunity from the competitive retail market to bring new challenge to bear on monopoly companies providing wholesale services. I have been pleased at the level of enthusiasm from new retailers to engage with our 2019 price review, and we will build their contribution into our methodology. We will also use the information that is revealed through casework, for example through challenges brought by retailers to wholesale charges or terms and conditions, to make our monopoly regulation more effective.

In parallel with the risks and opportunities from the business retail market in England, we must continue our work towards PR19. Although the groundwork has been laid, there remains a great deal to do to finalise our methodology, which we will be publishing for consultation in July 2017.

In addition, through this year we will continue to keep a close eye on resilience issues. Following from the Thames Water mains bursts last winter and our targeted review of asset health, we need to understand more about companies' information, systems and processes for risk based asset management planning. And we must maintain a focus on resilience in the round, too – placing appropriate emphasis on customer participation, recovery and response from disruption as well as on the ability of assets to withstand it. This is an important dialogue to have with the sector now, given that the monopoly companies are already putting together business plans, and our expectation that spending driven by resilience will – like all aspects of business plans – need to be well evidenced and supported by customer engagement.

Developing and growing our capability internally continues to be a focus for us this year, especially as we move into the regulation of a competitive retail market and towards PR19. Our Business Transformation Programme, which developed, implemented and supported a new operating model for our office over the last three years, has been closed down and this year its successor programme, Fit for the Future, focusses on completing and embedding our change programme. This includes changes to our internal IT systems, including moving to the Cloud,

introduction of an electronic document and records management system, and developing systems that will enable monopoly companies to upload their PR19 business plans directly into our system. It also includes a review of our governance processes, so that they properly support our agile programme and project based ways of working. It further and crucially includes work to ensure we have the right skills and experience across the office. We will continue with a programme of learning and development targeted at developing specific skills, and we will continue to recruit where we need to complement our existing people. But we do this recognising that the skills and experience we need are specialist and highly sought-after by a wide range of employers, and the risk posed by continuing civil service pay constraints on our ability to retain and secure these skills is increasing.

In the coming year we have two additional specific pieces of work to do that are critical in ensuring our effectiveness. The first is the successful procurement of an in-sourcing partner to help us to deliver the level of agility and resilience that we need in our support services. We are not under-estimating this challenge, which will entail significant changes to our internal processes. The second is specifying and securing the delivery partnership arrangements we will need to deliver PR19.

We will also continue to invest this year in the health and wellbeing of our people. We have made progress on this over the last year, but we recognise that our people are telling us that workload and stress are issues in some parts of the organisation. This means we need to do more to help people to identify and manage stress in themselves and their colleagues. But it also amplifies the need to maintain our focus on planning and prioritisation, especially in the face of a more dynamic sector that will bring greater demands on us in coming years.

We also face a new UK Government in this year, and we will need to consider any changes to the strategic and policy landscape that this brings. In particular, it will fall to the incoming Government to finalise the UK's Strategic Policy Statement[2], with which we must act in accordance. We expect to work closely with the incoming UK Government on this. We will also continue to work closely with the Welsh Government as it finalises its equivalent policy statement[3], with which we must act in accordance in Wales. We also expect to continue our work with the Welsh Government beyond its Strategic Policy Statement, on our regulatory framework in

[2] In relation to Ofwat's regulation relating to appointment areas wholly or mainly in England.
[3] In relation to Ofwat's regulation relating to appointment areas wholly or mainly in Wales.

Wales, which will include working with wider stakeholders in Wales too, for example through the Wales Water Forum.

The UK's exit from the European Union will also bring changes. The legislative and institutional framework within which the water and waste water sector operates is very largely a UK one: even though the sector is affected by environmental and water quality law with its origins in the EU, the framework for economic regulation is largely set out in domestic, rather than EU, legislation. With the Water Act 2014 in place, we have the basis we need for reforms in the sector that will bring improvements in service, efficiency and resilience. But the inevitable wider uncertainties arising from the process of exit from the EU mean that the stability and predictability that independent economic regulation brings to the sector will be especially important.

Reviewing Ofwat's effectiveness

The Accounting Officer and Board are responsible for reviewing the effectiveness of our performance management and internal control system, informed by the internal and external audit and the operation of the internal control framework. The Board and Audit and Risk Assurance Committee have advised the Accounting Officer about the implications of her review of the effectiveness of the system of internal control throughout the year. The Non-Executive Directors also provide the Accounting Officer with an independent view of our performance.

Ofwat's strategy provides the basis for our annual priorities, which are set out and consulted on in the forward programme each year. This forward programme drives programme and project plans and, ultimately, each of our people's objectives. Directors, project managers and team leaders regularly review progress on programme and project plans. The Senior Leadership Team and Board review progress across our portfolio each quarter.

Our resource requirements are assessed regularly in the context of our rolling business plan and annual operational plan. During 2016-17, we further embedded programme budgeting by moving to more agile and strategically aligned resource management through formal quarterly reviews of budgets and allocation of our people across our portfolio. This helped to mitigate risks associated with workloads and the challenge of balancing these with the resources available to us. We also intend to use this system of quarterly portfolio reporting to manage more effectively our use of contingency budgets to minimise the risks associated with an underspend against budget.

Our internal auditors in 2016-17, Grant Thornton, reviewed and advised on our portfolio management; and reviewed our financial systems and payroll, our information management (including our management of market sensitive information), and our recruitment control processes. Grant Thornton also supported our submission of assurance to the Secretary of State on business retail market opening on two occasions in 2016-17, and on our management of Value Added Tax. Two additional audits were presented to the June 2017 meeting of the Audit and Risk Assurance Committee (ARAC) on stakeholder management and information rights, including a review of Ofwat's Departmental Security Health Check compliance return.

Key elements of Ofwat's governance framework

The Board

The Chairman and non-executive Directors have played a full part in Board business by attending and contributing to Board and Board committee meetings. The Board met in Wales in June 2016, using the occasion to meet informally with key Welsh stakeholders. Minutes of the Board's meetings are published on the Ofwat website.

Committees of the Board

The Board has five standing committees, each of which is chaired by a Non-Executive Director. The Chair of each committee reports to the Board after each meeting.

Audit and Risk Assurance Committee

The purpose of the Audit and Risk Assurance Committee (ARAC) is to support the Board in its responsibilities for managing issues of risk, control, governance and associated assurance. It does this by reviewing the sources of assurance in place to meet the Board's and Accounting Officer's assurance needs, considering whether they are sufficiently comprehensive and complete, reviewing the reliability and integrity of these assurances, and providing an opinion on how well the Board and Accounting Officer are supported in decision making and discharging their accountability obligations. The Committee acts only in an advisory capacity to the Board and has no executive powers.

In 2016-17 the Committee was chaired by Alison Munro. To strengthen oversight, our Audit and Risk Assurance Committee includes an Independent Member, Vanessa Howlison, who is neither a Board member nor an Ofwat employee.

The Committee met four times during 2016-17. In June 2017, the Committee submitted its annual report to the Board along with its recommendation to approve the annual accounts. In addition to its review of the annual report and accounts, matters discussed by the Committee in 2016-17 included:

- recommendations to the Board on Ofwat's anti-fraud and bribery policy;
- a follow up to a deep dive review of financial controls undertaken in December 2015;
- strategic risk and opportunity management reviews on Ofwat's reputation and credibility risk and corporate governance and organisational capability risk, covering two of our ten strategic risk and opportunities. Four strategic risks were reviewed during 2015/16;
- the refreshed strategic risk and opportunities strategy;
- programme closure reports in relation to our Business Transformation Programme and Casework Programme;
- improvements in our system of information asset management and awareness and training;
- regular reviews of our progress in implementing actions arising from internal and external audit and other reviews; and
- Ofwat's governance framework refresh.

The internal audit plan for 2016-17 was agreed by ARAC at its March 2016 meeting. All of the scheduled internal audit reviews were completed, subject to the Committee's approval, with findings providing moderate assurance and above. Overall for the 2016-17 financial year, Grant Thornton have provided 'moderate' assurance of Ofwat's systems of internal control.

Remuneration and People Committee

The role of the Remuneration and People Committee is to oversee the implementation of the People Strategy and to consider matters relating to the pay and conditions of employment of Ofwat's staff. During 2016-17 the Committee was chaired by Martin Lawrence. During 2016-17 the Committee focused on strategic workforce planning and resourcing and pay issues.

Casework Committee

In July 2013, the Board established the Casework Committee to make certain final decisions in strategic cases. John Swift QC is an independent member of the Committee. During the year there were no strategic cases requiring the Committee's involvement.

Thames Tideway Committee

The purpose of the Committee is to make certain decisions and to provide challenge, support and advice in relation to the Thames Tideway Tunnel programme. During 2016-17 Jonson Cox chaired the Committee, which met on three occasions. During the year the Committee made the following decisions:

- delegation to Keith Mason, Senior Responsible Officer for the Thames Tideway Tunnel programme, for deciding to approve or not the stage 1 variation of works submitted by Tideway to enable the integration of Thames Water's Counters Creek Flood Alleviation Scheme with the tunnel;
- approval of changes to the incentive arrangements in the alliance agreement between Thames Water, Tideway and the main works contractors and delegation of final sign off of Ofwat's approval to Keith Mason; and
- waiver of Tideway's procurement obligations in respect of specific software contracts and delegation to Cathryn Ross, Chief Executive, to grant procurement waivers to Tideway in situations of extreme urgency.

Nominations and Governance Committee

In July 2013, the Board established a Nominations and Governance Committee. The Committee is chaired by Jonson Cox other than when it is dealing with matters relating to the chairmanship of the Board. The Committee's role is to:

- review, and make recommendations on, the structure, size, and composition of the Board (including identifying and nominating for approval candidates to fill certain Board vacancies);
- review succession planning for the Board, the members of the Senior Leadership Team and other senior roles;
- be engaged in the appointment of any member of the Senior Leadership Team; and;
- monitor and make recommendations to the Board on Board governance issues.

As all board and SLT vacancies were planned and recruited for last year, this committee did not meet during 2016-17.

Senior Leadership Team

The Senior Leadership Team (SLT) comprises the executive members of the Board, Senior Directors and the General Counsel. SLT meets frequently and advises on key decisions relating to the management of Ofwat, its portfolio of programmes and its

resources, subject to the overall direction, reserved powers and oversight of the Board.

Its focus is strategic across Ofwat's portfolio, including horizon scanning and the scrutiny of strategic risk and opportunities. It also focusses on ensuring that we have the right people, systems, processes and internal policies to support the delivery of our strategy. It plays a key leadership role in the organisation, particularly in terms of overseeing and exemplifying our values, behaviours and culture. Progress is fed back to each Board meeting in the Chief Executive's report.

In 2015-16 we restructured SLT to create three new posts in the light of the leadership required to deliver Trust in Water and to provide a sufficiently resilient leadership structure, in particular in time for the 2019 Price Review. Those posts were successfully filled in 2016-17 and I was delighted to welcome David Black, Aileen Armstrong and John Russell to the team.

Risk management

Our risk management framework is based on HM Treasury standard guidance in the Orange Book. In January 2017, the Board held its annual strategic risk and opportunities review. This resulted in minor changes to our strategic risks and opportunities, and no changes to our risk appetite.

In line with the principles of the Code, the Board, Audit and Risk Assurance Committee and Senior Leadership Team regularly review the strategic risk and opportunities register. In addition, the Audit and Risk Assurance Committee receives risk review presentations from the owners of each strategic risk and opportunity and programme Senior Responsible Officers, and senior director overviews on a rolling basis. Risk and opportunity management is embedded into all of Ofwat's programmes and their component projects.

Retail market opening governance controls

The Retail Market Opening programme was set up within Ofwat to progress the preparatory work for the opening of the business retail market in England, which opened in April 2017.

Given the time-critical nature of the programme, an assurance framework was agreed in July 2015 between Ofwat, MOSL and Defra. This provided assurance to the Secretary of State at regular intervals on both market and company readiness to support decision-making in the run up to market opening. A series of letters of

assurance were submitted to the Secretary of State at key intervals. Ofwat's delivery of its own milestones was subject to independent assurance by our Internal Auditors.

Accountability

Ofwat's Annual Report and Accounts is sent to Defra, which lays copies of it before each House of Parliament. From April 2017, we are also required to send Ofwat's Annual Report and Accounts to the Welsh government, which lays copies before the National Assembly for Wales. The Board is responsible for ensuring that proper records are maintained, which disclose with reasonable accuracy, at any time, the financial position of Ofwat. In addition, the Board is responsible for safeguarding Ofwat's assets and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

How Ofwat manages the public funds it receives, in line with HM Treasury guidance, is set out in Managing Public Money. We are also developing a Framework Document with Defra following the Public Accounts Committee review of Arm's Length Bodies. Both Defra and Ofwat are seeking to ensure that the development of the framework will ensure Ofwat maintains its independence within the remit set by statute.

Information assurance

Ofwat holds a range of information, the majority of which is policy and commercial information with a small number of personal information assets. We have an Information Risk Policy (IRP) and related procedures in place to ensure that such assets are properly safeguarded and associated risks are well managed, including with respect to our dealings with third party supplies.

We have a Senior Information Risk Owner, Departmental Security Officer and IT Security Officer, and Information Asset Owners for all of our programmes and pools. We have quarterly meetings of our Security and Information Assurance Group (SIAG) which provides governance of our security, information risk and information assurance measures. SIAG has met four times during 2016-17.

To raise staff awareness we are running a security campaign which started in September 2016 covering physical, personal and information security. As a result of the increased awareness of security issues we have seen a slight increase in the number of reported security issues, most of which were minor, in the second half of the year. All reported issues have been discussed with our Audit and Risk Assurance Committee, and lessons learned have been used to strengthen our internal policies

and procedures. None of the reported issues required reporting to the Information Commissioner's Office.

Our Departmental Security Health Check return, key elements of which are subject to internal audit, demonstrates we have robust systems and processes in place to manage our information and security whilst recognising that there are some areas for improvement that we will be taking forward during the next financial year.

During 2016-17 we have built on our Business Continuity Plan through reciprocal arrangements with other public sector organisations.

Quality Assurance of Analytical Models

In the last year Ofwat has made significant strides to develop its quality assurance framework for analytical models.

In 2016-17, nineteen members of staff were trained in the use of the FAST modelling standard. This is in addition to the twelve members of staff who were trained in 2015-16. Further training will be provided during 2017-18 to new recruits who will be involved in analytical and modelling work.

During 2016-17, Ofwat has developed, with assistance from Grant Thornton, guidance and processes for the internal quality assurance of Excel spreadsheet models. This material draws on sources such as the HM Treasury Aqua Book, academic research on spreadsheet risk, recommendations from the Institute of Chartered Accountants in England and Wales (ICAEW) and modelling industry best practice. Training material on this guidance has been developed and training will be delivered to relevant staff on how to use this guidance during 2017-18.

A register of Ofwat's business critical models has been developed and will be continually updated and reviewed during 2017-18.

Data quality

Ofwat receives a wide range of financial and other data both to facilitate its oversight of the performance of Ofwat's functions and to inform its regulatory decisions. The Board considers that this information is generally of good quality and Ofwat continually seeks new ways to present management information in a clear way. During 2017-18, Ofwat intends to improve the usefulness of its monitoring of Ofwat's efficiency in delivering its strategic priorities.

Accounting Officer's statement

As Accounting Officer, I am personally responsible and accountable to Parliament for Ofwat as an organisation, its management, use of public money and stewardship of public assets. My review of the effectiveness of the system of internal control was informed by assurance statements from Senior Responsible Officers for all of our programmes and the Strategic Resource Managers who lead our resource pools. My review drew on independent assurance from our internal and external auditors and the Audit and Risk Assurance Committee and the assurance reports and reviews undertaken to inform our returns to government, for example with respect to our Departmental Security Health Check.

Based on my review of this evidence, I am assured that Ofwat has a strong system of internal control to support the delivery of our strategy. That said, I am not complacent, and in line with our value of learning, there are areas where further action is being taken to reinforce our internal systems, particularly in relation to the management of information and data. In this respect in particular we are conscious of the changing external risk environment. We will continue to take action as necessary to enhance our internal arrangements to ensure that we are able to manage these risks effectively in the coming year.

Other than making refinements to our internal processes and controls, our governance arrangements will remain in place for 2017-18 and we do not intend a wholesale review of such arrangements.

Cathryn Ross
Accounting Officer **15 June 2017**

Remuneration and staff report

Remuneration report

Senior Leadership Team

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

Senior Leadership Team member	Position
Cathryn Ross*°	Chief Executive
John Russell*°	Senior Director, Strategy and Planning (from 25 July 2016)
Richard Khaldi*°	Senior Director, Customers and Casework
Aileen Armstrong*°	Senior Director of Finance and Governance (from 16 May 2016)
David Black°	Senior Director, Water 2020
Keith Mason°	Senior Director, Thames Tideway
Claire Forbes	Senior Director, Corporate Communications
Jenny Block°	General Counsel (from 5 September 2016)
Beverley Messinger	Senior Director, Business Improvement (until 2 October 2016)
Elizabeth Hillman°	General Counsel (until 14 July 2016)

*Denotes Board member
°Denotes member of the Senior Civil Service

Service contracts

The Constitutional Reform and Governance Act 2010 requires Civil Service appointments to be made on merit on the basis of fair and open competition. The Recruitment Principles published by the Civil Service Commission specify the circumstances when appointments may be made otherwise.

Unless otherwise stated below, the officials covered by this report hold appointments which are open-ended. Early termination, other than for misconduct, would result in the individual receiving compensation as set out in the Civil Service Compensation Scheme. The notice period does not exceed six months for any member of the Senior Leadership Team.

More information about the work of the Civil Service Commission can be found at www.civilservicecommission.org.uk.

With the exception of non-Senior Civil Servants, Senior Leadership Team members' remuneration is set out in their contracts and subject to annual review in line with awards recommended by the Senior Salaries Review Body (SSRB).

Each permanent member of the Senior Leadership Team (with the exception of non-Senior Civil Servants) participates in a bonus scheme, which is in line with the SSRB's recommendations. The bonus is paid based on the individual's performance. Bonus payments are non-consolidated and non-pensionable.

Permanent members of the Senior Leadership Team who are not part of the Senior Civil Service are remunerated in line with Ofwat's staff remuneration policy.

Register of interests

Ofwat maintains a register of interests to help identify and address potential conflicts of interest in advance of Board discussions. Where potential conflicts exist, they are recorded in the Board minutes, along with any appropriate action taken to address them. The register of interests can be found within our Board Rules of Procedure, available on our website.

For the 2016-17 financial year, Ofwat's 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.

Staff remuneration policy

The Remuneration and People Committee approves the approach to annual pay awards. Our salaries are set on the basis of recruiting and retaining high-calibre staff within the framework of controlling public sector expenditure and pay set by the Government.

A non-consolidated bonus may be awarded to staff or teams whose performance is exceptional. Bonus budgets are delegated to resource pools. Bonus nominations are considered by a panel, and the consistency and fairness of the process is overseen by the Director, People in conjunction with a small group of representatives from the Office and Joint Negotiating Committee. The annual bonus budget is determined as part of the annual Pay Remit approved by the Permanent Secretary for Defra.

Non-Executive Directors' remuneration policy

The Chairman and Non-Executive Directors are remunerated in line with Cabinet Office guidance.

Senior managers' remuneration

The following information was subject to audit.

Single total figure of remuneration	Salary (£000)		Bonus payments (£000)		Benefits in kind (to nearest £100)		Pensions benefits (to nearest £1,000)		Total (£000)	
	2016-17	2015-16	2016-17	2015-16	2016-17	2015-16	2016-17	2015-16	2016-17	2015-16
Cathryn Ross Chief Executive	160-165	160-165	-	15-20	9,700	7,200	63,000	78,000	235-240	265-270
John Russell Senior Director, Strategy and Planning (from 25 July 2016)	80-85 (full year equivalent 120-125)	-	-	-	-	-	216,000	-	295-300	-
Richard Khaldi Senior Director, Customers and Casework	120-125	120-125	15-20	-	11,300	4,900	48,000	47,000	190-195	170-175
Aileem Armstrong Senior Director, Finance and Governance (from 16 May 2016)	60-65 (full year equivalent 120-125)	-	-	-	5,100	-	159,000	-	220-225	-
David Black* Senior Director, Water 2020	120-125	120-125	15-20	-	3,200	1,300	48,000	47,000	185-190	165-170
Keith Mason Senior Director, Thames Tideway	115-120	115-120	-	-	-	-	24,000	29,000	140-145	145-150
Claire Forbes** Senior Director, Corporate Communications	85-90 (full year equivalent 100-105)	95-100 (full year equivalent 100-105)	-	-	2,800	1,300	34,000	37,000	120-125	135-140
Jenny Block General Counsel (from 5 September 2016)	65-70 (full year equivalent 120-125)	-	-	-	3,000	-	27,000	-	95-100	-
Beverley Messinger Senior Director, Business Improvement (until 3 October 2016)	60-65 (full year equivalent 120-125)	120-125	-	-	4,000	4,200	24,000	48,000	85-90	170-175
Elizabeth Hillman** General Counsel (until 14 July 2016)	30-35 (full year equivalent 120-125)	110-115 (full year equivalent 120-125)	-	-	1,000	1,300	-	-	35-40	115-120

*David Black held a temporary Senior Director role from 23 March 2015, and was part of the Senior Leadership Team from that date. The salary disclosed above includes his remuneration for the role of Director of Economics in 2015-16. Following a competitive recruitment process, he was awarded the permanent role of Senior Director, Water 2020 with effect from 1 March 2016.
**For Elizabeth Hillman and Claire Forbes the difference between actual remuneration and full year equivalent includes the impact of periods of leave during 2015-16 and 2016-17.

Third party payments*

The following information was subject to audit.

	2016-17 Payment £000	2015-16 Payment £000
Capita Resourcing Ltd T/A Veredus Nick Gammage, Interim Director of Communications (28 May 2015 - 31 March 2016)	-	120-125

*Civil Service Pension rights are not applicable to members of the Senior Leadership Team while contracted through a third party.

Non-Executive Director's remuneration

The following information was subject to audit.

	Salary (£000)		Benefits in kind (to nearest £100)		Total (£000)	
	2016-17	2015-16	2016-17	2015-16	2016-17	2015-16
Jonson Cox Chairman	115-120	115-120	1,900	4,500	120-125	120-125
Martin Lawrence Non-executive Director	15-20	15-20	1,000	300	20-25	15-20
Christine Farnish Non-executive Director	15-20	15-20	-	100	15-20	15-20
Catherine Waddams Non-executive Director	15-20	15-20	700	300	15-20	20-25
Alison Munro Non-executive Director (from 28 April 2016)	15-20 (full year equivalent 15-20)	-	300	-	15-20 (full year equivalent 15-20)	-
Mark Bayley Non-executive Director (from 28 April 2016)	15-20 (full year equivalent 15-20)	-	200	-	15-20 (full year equivalent 15-20)	-
Tim Waggott Non-executive Director (from 28 April 2016)	15-20 (full year equivalent 15-20)	-	1,000	-	15-20 (full year equivalent 15-20)	-
Robin Paynter Bryant Non-executive Director (until 23 January 2016)	-	5-10 (full year equivalent 10-15)	-	600	-	5-10 (full year equivalent 10-15)
Wendy Barnes Non-executive Director (until 31 March 2016)	-	15-20	200	1,800	0-5	20-25
Christopher Burchell Non-executive Director (until 30 April 2016)	0-5 (full year equivalent 15-20)	15-20	-	200	0-5 (full year equivalent 15-20)	15-20

Independent Members' remuneration

The following information was subject to audit.

	2016-17		2015-16	
	Salary (£000)	Benefits in kind (to nearest £100)	Salary (£000)	Benefits in kind (to nearest £100)
John Swift* Independent Member	0-5	-	15-20	-
Vanessa Howlison** Independent Member	-	-	-	-

*John Swift is remunerated per attendance at committee meetings.
**Vanessa Howlison does not receive remuneration from Ofwat in respect of her appointment, but was granted time by Highways England to attend these meetings.

Salary

Salary includes gross salary, overtime, and any allowance that is subject to UK taxation. This report is based on accrued payments made by Ofwat as 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 included subsistence and travel arrangements.

Bonuses

Senior Civil Service bonuses are based on performance levels, assessed as part of the appraisal process. In line with other government departments, Ofwat must follow a set distribution in assessing the performance of its Senior Civil Servants, with only the top 25% of its Senior Civil Servants eligible to receive bonuses. In 2016-17 this meant that only 2 Senior Civil Servants were eligible for bonuses. All other bonuses are awarded in line with our staff remuneration policy.

The Senior Manager bonuses reported in 2016-17 relate to performance in 2015-16 and the comparative bonuses reported for 2015-16 relate to performance in 2014-15.

Pay multiples

The following information was subject to audit.

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.

The banded remuneration of the highest-paid director in Ofwat in the financial year 2016-17 was £170,000 to £175,000 (2015-16: £185,000 to £190,000). This was 3.6 times (2015-16: 4.2 times) the median remuneration of the workforce, which was £48,697 (2015-16: £45,000). The decrease in remuneration ratio is primarily driven by the increase in the median salary due to the increase in our workforce and rebalancing the skills mix of the organisation (16% increase in average FTE during the year).

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

Senior managers' pension benefits*

The following information was subject to audit.

	Accrued pension at age 65 at 31 March 2017 and related lump sum £000	Real increase in pension and related lump sum at age 65 £000	CETV at 31 March 2017 £000	CETV at 31 March 2016 £000	Real increase in CETV £000
Cathryn Ross Chief Executive	35-40 lump sum: 80-85	2.5-5.0 lump sum: (2.5) - 0	504	452	23
John Russell Senior Director, Strategy and Planning (from 25 July 2016)	25-30 lump sum: 75-80	7.5-10.0 lump sum: 22.5-25.0	435	286	141
Richard Khaldi** Senior Director, Customers and Casework	20-25 lump sum: -	17.5-20.0 lump sum: -	236	56	16
Aileen Armstong Senior Director, Finance and Governance (from 16 May 2016)	20-25 lump sum: 60-65	5.0-7.5 lump sum: 17.5-20.0	353	240	100
David Black Senior Director, Water 2020	10-15 lump sum: -	2.5-5.0 lump sum: -	121	91	19
Keith Mason Senior Director, Thames Tideway	30-35 lump sum: 100-105	0.0-2.5 lump sum: 2.5-5.0	806	744	24
Claire Forbes Senior Director, Corporate Communications	5-10 lump sum: -	0.0-2.5 lump sum: -	79	57	14
Jenny Block General Counsel (from 5 September 2016)	0-5 lump sum: -	0.0-2.5 lump sum: -	18	-	13
Beverley Messinger Senior Director, Operations (until 2 October 2016)	5-10 lump sum: -	0.0-2.5 lump sum: -	96	81	12

*CETV: Cash Equivalent Transfer Value; the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time.

** Increase in pension includes a transfer in brought by the member during the reporting year.

Pension liabilities

The main pension scheme for Ofwat staff is the Principal Civil Service Pension Scheme (PCSPS). 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.

A full provision has been made in the accounts for liabilities arising in respect of the 'by-analogy' pension schemes for both former Directors General, as required by HM Treasury (note 13). 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.

Civil Service Pensions

Pension benefits are provided through the Civil Service pension arrangements. From 1 April 2015 a new pension scheme for civil servants was introduced – the Civil Servants and Others Pension Scheme or **alpha**, which provides benefits on a career average basis with a normal pension age equal to the member's State Pension Age (or 65 if higher). From that date all newly appointed civil servants and the majority of those already in service joined **alpha**. Prior to that date, civil servants participated in the Principal Civil Service Pension Scheme (PCSPS). The PCSPS has four sections: three providing benefits on a final salary basis (**classic**, **premium** or **classic plus**) with a normal pension age of 60; and one providing benefits on a whole career basis (**nuvos**) with a normal pension age of 65.

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**, **nuvos** and **alpha** are increased annually in line with Pensions Increase legislation. Existing members of the PCSPS who were within 10 years of their normal pension age on 1 April 2012 remained in the PCSPS after 1 April 2015. Those who were between 10 years and 13 years and 5 months from their normal pension age on 1 April 2012 will switch into **alpha** sometime between 1 June 2015 and 1 February 2022. All members who switch to **alpha** have their PCSPS benefits 'banked', with those with earlier benefits in one of the final salary sections of the PCSPS having those benefits based on their final salary when they leave **alpha**. (The pension figures quoted for officials show pension earned in PCSPS or **alpha** – as appropriate. Where the official has benefits in both the PCSPS and **alpha** the figure quoted is the combined value of their benefits in the two schemes.) Members joining from October 2002 may opt for either the appropriate defined benefit

arrangement or a 'money purchase' stakeholder pension with an employer contribution (**partnership** pension account).

Employee contributions are salary-related and range between 3% and 8.05% of pensionable earnings for members of **classic** (and members of alpha who were members of **classic** immediately before joining **alpha**) and between 4.6% and 8.05% for members of **premium**, **classic plus**, **nuvos** and all other members of **alpha**. 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 is payable on retirement. For **premium**, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike **classic**, there is no automatic lump sum. **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 his 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 uprated in line with Pensions Increase legislation. Benefits in **alpha** build up in a similar way to **nuvos**, except that the accrual rate is 2.32%. 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 8% and 14.75% (depending on the age of the member) into a stakeholder pension product chosen by the employee from a panel of 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 0.5% 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**, 65 for members of **nuvos**, and the higher of 65 or State Pension Age for members of **alpha**. (The pension figures quoted for officials show pension earned in PCSPS or alpha – as appropriate. Where the official has benefits in both the PCSPS and alpha the figure quoted is the combined value of their benefits in the two schemes, but note that part of that pension may be payable from different ages as set out above.)

Further details about the Civil Service pension arrangements can be found at the website www.civilservicepensionscheme.org.uk.

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 that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies.

The figures include the value of any pension benefit in another scheme or arrangement which the member 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 in accordance with The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008 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 that is 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.

Staff report

Table 5: Analysis of Ofwat's staff costs for 2016-17

				2016-17 £000	2015-16 £000
	Permanently employed staff	Others	Non-exec directors	Total	Total
Wages and salaries	9,695	472	235	10,402	8,262
Social security costs	1,072	-	25	1,097	757
Other pension costs	2,098	-	-	2,098	1,689
Other staff costs	(10)	-	-	(10)	133
Sub Total	**12,855**	**472**	**260**	**13,587**	**10,841**
Less recoveries in respect of outward secondments	(157)	-	-	(157)	(64)
Total net costs	**12,698**	**472**	**260**	**13,431**	**10,777**

Other staff costs include the cost of agency workers. Other expenditure incurred in respect of specialist contractors and interim managers are disclosed as contingent labour expenditure in note 4 to the accounts.

Pension contributions

The PCSPS and the Civil Servant and Other Pension Scheme (CSOPS) – also known as **alpha** – are unfunded multi-employer defined benefit schemes. Ofwat is unable to identify its share of the underlying assets and liabilities. The scheme's actuary valued the scheme as at 31 March 2012. Details can be found in the resource accounts of the Cabinet Office: Civil Superannuation at www.civilservicepensionscheme.org.uk.

For 2016-17, employers' contributions of £2,051,631 were payable to the PCSPS (2015-16: £1,652,698) at one of four rates between 20% and 24.5% (2015-16: 20% and 24.5%) of pensionable pay, based on salary bands. The scheme's actuary usually reviews employer contributions every four years, following a full scheme valuation. The contribution rates are set to meet the cost of the benefits accruing during 2016-17 to be paid when the member retires, 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 £27,441 (2015-16: £39,740) were paid to one or more of the panel of three appointed stakeholder pension providers. Employers' contributions are age-related and range from 8% to 14.75% (2015-16: 3% to 12.5% until 30 September 2015, 8% to 14.75% from 1 October 2015) of pensionable pay. Employers also match employee contributions up to 3% of pensionable earnings. In addition, employer contributions of £921: 0.5%

(2015-16: £1,423: 0.8% until 30 September 2015, 0.5% from 1 October 2015) of pensionable pay were payable to the PCSPS to cover future lump sum benefits payable upon the death in service or ill-health retirement of these employees.

Contributions due to the **partnership** pension providers at the balance sheet date were £1,668 (2015-16: £3,394). Contributions prepaid at that date were £nil (2015-16: £nil).

Table 6: Average number of full-time equivalents

	2016-17 number				2015-16 number
	Permanently employed staff	Others	Non-exec directors	Total	Total
Business Transformation	19.77	0.21	0.12	20.10	17.38
Casework	18.46	-	0.13	18.59	16.24
Compliance and Assurance	35.24	1.42	0.12	36.78	30.89
Finance and Governance	15.26	-	0.13	15.39	13.45
Strategy and Planning	18.68	2.13	0.12	20.93	17.12
Water 2020	48.77	1.42	0.13	50.32	44.93
Retail Market Opening	13.35	0.96	0.13	14.44	11.79
Thames Tideway Project Regulation	5.01	-	0.12	5.13	4.49
Total	**174.54**	**6.14**	**1.00**	**181.68**	**156.29**

Civil Service and other compensation scheme exits

No redundancy or other departures under the Civil Service and other compensation scheme were agreed in 2016-17.

Departure costs in the previous year 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 were accounted for in the year the obligation arose. Where the department agreed early retirements, the additional costs were met by the department and not by the Civil Service pension scheme. All packages awarded in excess of £95,000 received Cabinet Office approval.

Table 7: Analysis of Civil Service and other compensation exits by exit package total cost band

			Core Department 2016-17	Core Department 2015-16
Exit package 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	-	-	-	-
£10,000 - £25,000	-	-	-	-
£25,001 - £50,000	-	-	-	-
£50,001 - £100,000	-	-	-	1
£100,001 - £150,000	-	-	-	-
£150,001 - £200,000	-	-	-	1
Total number of exit packages	**-**	**-**	**-**	**2**
Total resource cost (£000)	**-**	**-**	**-**	**206**

Off-payroll engagements

Following the Review of Tax Arrangements of Public Sector Appointees, published by the Chief Secretary to the Treasury on 23 May 2012, Ofwat is required to publish information about our highly paid and/or senior off-payroll engagements.

All of Ofwat's existing off-payroll engagements have during the term of their contract been subject to a risk-based assessment to determine whether we should seek assurance that the individual is paying the right amount of tax. Where necessary, that assurance has been sought and, in all cases, it has been received.

Table 8: Off-payroll engagements for more than £220 per day and lasting for longer than six months, as of 31 March 2017

	Core Department Number of arrangements
Existing at 31 March 2017	2
existed for less than one year at the time of reporting	2

Table 9: New off-payroll engagements, or those that reached six months in duration, between 1 April 2016 and 31 March 2017, for more than £220 per day and that last for longer than six months

	Core Department 1 April 2016 to 31 March 2017
Number of new engagements for more than £220 per day and that last longer than 6 months	7
Number of new engagements which include contractual clauses giving the department the right to request assurance in relation to income tax and National Insurance obligations	7
The number for whom assurance has been requested	7
The number for whom assurance has been requested and received	7
The number for whom assurance has been requested and not received	-
The number that have been terminated as a result of assurance not being received	-

Table 10: Off-payroll engagements of Board members and/or senior officials with significant financial responsibility between 1 April 2016 and 31 March 2017

	Core Department Number of arrangements
Number of off-payroll engagements of Board members and/or senior officials with significant financial responsibility during the financial year	-
Total number of individuals, both on payroll and off-payroll, deemed "Board members and/or senior officials with significant financial responsibility" during the financial year	18

Consultancy expenditure

Ofwat's expenditure on other consultancy services in 2016-17 was £3.7m (2015-16: £4.93m) per note 4 of the accounts. The reduction in consultancy expenditure represents our planned reduction in professional service support which is in line with our regulatory cycle of work. We have also been able to reduce our reliance on external support during the year by recruiting more people with the specialist skills we require to deliver our strategy.

Sickness absence

Our policy is to reduce employee absence and we rely on early intervention by our people mangers conducting a return to work interview after each period of absence to mitigate and manage this effectively. People managers are supported by systems which help to identify when trigger points have been reached to allow them to consider whether further support or action is required. Our trigger points are:

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

CiC 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 and also monitored by the Remuneration and People Committee.

Table 11: Sickness absence statistics (reported to the Ofwat Board quarterly)

	2016-17			2015-16		
	Short term	Long term	Total	Short term	Long term	Total
Days lost	467	571	1,038	295	618	913
Average working days lost per person			6.6			5.4

A long-term absence is any absence running over a consecutive period of 21 working days or more. Ofwat's sickness absence figures are below the Civil Service average of 7.1 working days lost per person. The increase in average days lost per person is mainly attributable to a small number of long term sickness absences during 2016-17.

Employee involvement

We turned our ambition to become a learning organisation into reality during 2016-17 as we launched a major development programme for our Resource Managers and Strategic Resource Managers which included the development and adoption of a clear set of responsibilities in a 'Role Expectations' document.

For the second year we devolved a portion of the learning and development budget to our resource pools so that they could identify and deliver learning needs relevant to their technical and professional requirements, and ensuring their learning met the needs of our strategy and the requirements of our key programmes of work.

We further developed our 'giving and receiving feedback' workshops, and by the end of 2016-17 over 180 people had completed the session, with further 'feedback booster' sessions. As part of the feedback process, and wider project lessons learned, we rolled out short 'growth mindset' taster sessions, attended by over 100 people to date, to help explore positive and developmental ways of working and learning.

By the end of 2016-17 we refreshed our in-house learning area called Darwin, which was named following an internal competition for names and then votes by the office for the most popular, to create learning zones catering for numerous learning styles. Darwin has played host to a variety of learning activities including the Resource Manager bootcamps, growth mindset sessions, giving and receiving feedback workshops, brown bag lunches, project team and resource pool 'away days' and our newly launched 'Ofwat Essentials' learning including our introduction to the water industry, and environment and resilience courses.

Equal opportunities policy

We recruit staff on merit through fair and open competition, in line with the Civil Service recruitment principles governed by the Civil Service Commission. This ensures fair and open competition, 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 Commission to ensure that we comply with the guidance set out in the recruitment principles.

During the year, we carried out 42 separate recruitments, which in some cases sought more than one member of staff.

Staff composition

Details of Ofwat's staff composition by gender and ethnic group is available in appendix A10, on page 140.

Cathryn Ross
Accounting Officer **15 June 2017**

Parliamentary accountability and audit report

Statement of Parliamentary Supply

for the 12 months ended 31 March 2017

The following information was subject to audit.

Table 12: Summary of resource and capital outturn 2016-17

								2016-17	2015-16
		Estimate			Outturn			Voted outturn compared with Estimate: saving/ (excess)	Outturn
	Note	Voted	Non-voted	Total	Voted	Non-voted	Total		Total
Departmental Expenditure Limit									
- Resource	SOPS1.1	130	-	130	(724)	-	(724)	854	(499)
- Capital	SOPS1.2	360	-	360	288	-	288	72	261
Annually Managed Expenditure									
- Resource		-	-	-	-	-	-	-	-
- Capital		-	-	-	-	-	-	-	-
Total Budget		**490**	**-**	**490**	**(436)**	**-**	(436)	**926**	**(238)**
Total Resource		130	-	130	(724)	-	(724)	854	(499)
Total Capital		360	-	360	288	-	288	72	261
Total		**490**	**-**	**490**	**(436)**	**-**	(436)	**926**	**(238)**

The variance between outturn and estimate on our resource departmental expenditure limit (DEL) mainly relates to under spend on our payroll budget in relation to recruitments taking longer than anticipated and unrequired contingency budget.

Capital DEL represents Parliamentary supply provided to Ofwat for capital items. The variance between capital DEL outturn and estimate arose because of a supply chain delay in the delivery of planned improvements to our Information Technology Infrastructure. These improvements will now take place in 2017-18.

Further details of the main variances between Ofwat's budgets and outturn can be found in the financial commentary on page 27.

Table 13: Net cash requirement 2016-17

£000		2016-17			2015-16
	Note	Estimate	Outturn	Outturn compared with Estimate: saving/ (excess)	Outturn
	SOPS3	**3,002**	**1,209**	**1,793**	**63**

The variance between outturn and estimated net cash requirement is £1.8 million. Licence fees received in the period were enough to cover the previous year's working capital balances as a result of budget efficiencies achieved. As a result there was no need to draw cash from the Consolidated Fund during the year.

Table 14: Administrative costs 2016-17

£000	2016-17	2016-17		2015-16
	Estimate	Outturn		Outturn
	130	**(724)**		**(499)**

The £130,000 estimate represents Parliamentary supply provided to Ofwat in relation to the retired Directors General pension scheme, for which we cannot charge the industry. The variance between outturn and estimate relates to income received in excess of expenditure during the period.

Figures outlined in bold are voted totals subject to Parliamentary control. Any breach of the administration budget will also result in an excess vote, although this is not a separate voted limit.

The notes on pages 88 to 104 form part of these accounts.

SOPS1: net outturn

for the 12 months ended 31 March 2017

The following information was subject to audit.

SOPS1.1: Analysis of net resource outturn by section

£000	2016-17										2015-16
	Outturn							Estimate			
	Administration			Programme							
	Gross	Income	Net	Gross	Income	Net	Total	Net total	Net total compare to Estimate	Net total compared to Estimate, adjusted for virements	Total
Spending in Departmental Expenditure Limit Voted:											
A	22,069	(22,793)	(724)	-	-	-	(724)	130	854	854	(499)
Total	**22,069**	**(22,793)**	**(724)**	-	-	-	**(724)**	**130**	**854**	**854**	**(499)**

SOPS1.2: Analysis of capital outturn by section

£000	2016-17						2015-16
	Outturn			Estimate			
	Administration						
	Gross	Income	Net	Net total	Net total compare to Estimate	Net total compared to Estimate, adjusted for virements	Total
Spending in Departmental Expenditure Limit Voted:							
A	288	-	288	360	72	72	261
Total	**288**	**-**	**288**	**360**	**72**	**72**	**261**

The notes on pages 88 to 104 form part of these accounts.

Ofwat is not required to produce ‘SOPS2: Reconciliation of outturn to net operating expenditure’.

SOPS3: Reconciliation of net resource outturn to net cash requirement

for the 12 months ended 31 March 2017

The following information was subject to audit.

SOPS 3.1: Reconciliation of net resource outturn to net cash requirement

		2016-17 £000		
	Note	Estimate	Outturn	Net total outturn compared with estimate; saving (excess)
Resource Outturn	SOPS1.1	130	(724)	854
Capital Outturn	SOPS1.2	360	288	72
Accruals to cash adjustments:		2,512	1,645	867
of which:				
Adjustments to remove non-cash items:				
Depreciation	4	(359)	(217)	(142)
New provisions and adjustments to previous provisions	4	(130)	(90)	(40)
Other non-cash items	4	(78)	(40)	(38)
Adjustments to reflect movements in working balances:				
Increase/(decrease) in receivables	10	-	(66)	66
(Increase)/decrease in payables	11	2,873	1,765	1,108
Use of provisions	12, 13.1	206	293	(87)
Net cash requirement		**3,002**	**1,209**	**1,793**

The notes on pages 88 to 104 form part of these accounts.

SOPS4: Income payable to the Consolidated Fund

for the 12 months ended 31 March 2017

The following information was subject to audit.

SOPS4.1: Analysis of income payable to the Consolidated Fund

	Note	2016-17 £000 Outturn Income	2016-17 £000 Outturn Receipts	2015-16 £000 Outturn Income	2015-16 £000 Outturn Receipts
Excess cash surrenderable to the Consolidated Fund	9	293	293	576	576
Other amounts collectable on behalf of the Consolidated Fund		293 -	293 -	576 -	576 -
Total income payable to the Consolidated Fund		**293**	**293**	**576**	**576**

The notes on pages 88 to 104 form part of these accounts.

Other areas of Parliamentary Accountability

Ofwat does not have anything to report for 2016-17 in respect of:

- Losses and special payments
- Fees and charges disclosures
- Remote contingency liabilities
- Long-term expenditure trends

The notes on pages 88 to 104 form part of these accounts.

Cathryn Ross
Accounting Officer **15 June 2017**

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 Regulation Authority (Ofwat) for the year ended 31 March 2017 under the Government Resources and Accounts Act 2000. The financial statements comprise: the Department's Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity; and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the Statement of Parliamentary Supply and the related notes, and the information in the Remuneration and Staff Report and the Parliamentary Accountability Disclosures that is described in those reports and disclosures 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 and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. 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 2017 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 2017 and of the Department's net operating cost 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.

Opinion on other matters

In my opinion:

- the parts of the Remuneration and Staff Report and the Parliamentary Accountability disclosures to be audited have been properly prepared in accordance with HM Treasury directions made under the Government Resources and Accounts Act 2000; and

- the information given in the Performance Report and Accountability Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

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 parts of the Remuneration and Staff Report and the Parliamentary Accountability disclosures 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.

Report

I have no observations to make on these financial statements.

Sir Amyas C E Morse **22 June 2017**
Comptroller and Auditor General
National Audit Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Part 3: Financial statements

Consolidated statement of comprehensive net expenditure

for the 12 months ended 31 March 2017

	Note	2016-17 £000 Core Department	2015-16 £000 Core Department	2015-16 £000 Departmental Group
Licence fees		(22,580)	(22,656)	(25,299)
Miscellaneous		(213)	(120)	(62)
Total operating income		(22,793)	(22,776)	(25,361)
Staff costs	3	13,587	10,841	10,841
Purchase of goods and services	4	7,324	9,926	12,500
Rental costs	4	811	789	800
Depreciation and impairment charges	4	217	510	510
Other non cash	4	130	211	211
Total operating expenditure		22,069	22,277	24,862
Net income for the year ended 31 March 2017		(724)	(499)	(499)
Other comprehensive net expenditure				
Items which will not be reclassified to net operating costs:				
Actuarial (gain)/loss on pension scheme liabilities	13	335	(130)	(130)
Comprehensive net expenditure for the year ended 31 March 2017		**(389)**	**(629)**	**(629)**

The notes on pages 88 to 104 form part of these accounts.

Consolidated statement of financial position

for the 12 months ended 31 March 2017

	Note	31 March 2017 £000 Core Department		31 March 2016 £000 Core Department		Departmental Group
Non-current assets:						
Property, plant and equipment	5	849		720		720
Intangible assets	6	28		86		86
Trade & other receivables	10	1		2		2
Total non-current assets			878		808	808
Current assets:						
Trade & other receivables	10	621		686		686
Cash and cash equivalents	9	293		576		576
Total current assets			914		1,262	1,262
Total assets			1,792		2,070	2,070
Current liabilities:						
Trade and other payables	11	(6,354)		(8,401)		(8,401)
Provisions	12	(15)		(114)		(114)
Total current liabilities			(6,369)		(8,515)	(8,515)
Total assets less current liabilities			(4,577)		(6,445)	(6,445)
Non-current liabilities:						
Provisions	12	-		(16)		(16)
Pension liabilities	13.1	(2,919)		(2,672)		(2,672)
Other payables	11	-		(1)		(1)
Total non-current liabilities			(2,919)		(2,689)	(2,689)
Total assets less total liabilities			**(7,496)**		**(9,134)**	**(9,134)**
Taxpayers' equity and other reserves:						
General Fund			(7,496)		(9,134)	(9,134)
Revaluation Reserve			-		-	-
Total equity			**(7,496)**		**(9,134)**	**(9,134)**

Cathryn Ross
Accounting Officer

15 June 2017

The notes on pages 88 to 104 form part of these accounts.

Consolidated statement of cash flow

for the 12 months ended 31 March 2017

	Note	2016-17 £000 Core Department	2015-16 £000 Core Department	2015-16 £000 Departmental Group
Cash flows from operating activities				
Net operating income		724	499	499
Adjustments for non-cash transactions	4	347	721	721
(Increase)/decrease in trade and other receivables	10	66	30	8
Increase/(decrease) in trade payables	11	(2,048)	(2,914)	(4,067)
Less movements in payables relating to items not passing through the Comprehensive Statement of Net Expenditure		209	3,170	3,170
Use of provisions	12, 13.1	(293)	(1,320)	(1,360)
Net cash outflow from operating activities		**(995)**	**186**	**(1,029)**
Cash flows from investing activities				
Purchase of property, plant and equipment		(288)	(279)	(279)
Purchase of intangible assets		-	(2)	(2)
Net movement in capital receivables (payables)		73	29	29
Net cash outflow from investing activities		**(215)**	**(252)**	**(252)**
Cash flows from financing activities				
From the Consolidated Fund (Supply) - current year		1,502	639	639
Capital element of payments in respect of finance leases		1	3	3
Net financing		**1,503**	**642**	**642**
Net increase/(decrease) in cash and cash equivalents in the period before adjustment for receipts and payments to the Consolidated Fund		293	576	(639)
Receipts due to the Consolidated Fund which are outside the scope of the Departments activities		-	-	-
Payment of amounts due to the Consolidated Fund		(576)	(3,778)	(3,778)
Net increase/(decrease) in cash and cash equivalents in the period after adjustment for receipts and payments to the Consolidated Fund		**(283)**	**(3,202)**	**(4,417)**
Cash and cash equivalents at the beginning of the period	9	**576**	**3,778**	**4,993**
Cash and cash equivalents at the end of the period	9	**293**	**576**	**576**

The notes on pages 88 to 104 form part of these accounts.

Consolidated statement of changes in taxpayers' equity

for the 12 months ended 31 March 2017

	Note	Core Department General Fund £000	Core Department Revaluation Reserve £000	Core Department Total Reserves £000	Departmental Group General Fund £000	Departmental Group Revaluation Reserve £000	Departmental Group Total Reserves £000
Balance at 1 April 2015		(9,873)	2	(9,871)	(9,873)	2	(9,871)
Changes in taxpayers' equity for 2015-16							
Net Parliamentary Funding		639	-	639	639	-	639
Comprehensive Net Expenditure for the year		631	(2)	629	631	(2)	629
Notional Auditors' Remuneration	4	45	-	45	45	-	45
Amounts issued from consolidated fund but not spent at year end	9	(576)	-	(576)	(576)	-	(576)
Balance at 31 March 2016		**(9,134)**	-	**(9,134)**	**(9,134)**	-	**(9,134)**
Changes in taxpayers' equity for 2016-17							
Net Parliamentary Funding		1,502	-	1,502	1,502	-	1,502
Comprehensive Net Expenditure for the year		389	-	389	389	-	389
Notional Auditors' Remuneration	4	40	-	40	40	-	40
Amounts issued from consolidated fund but not spent at year end	9	(293)	-	(293)	(293)	-	(293)
Balance at 31 March 2017		**(7,496)**	-	**(7,496)**	**(7,496)**	-	**(7,496)**

The notes on pages 88 to 104 form part of these accounts.

Notes to the departmental accounts

1. Statement of accounting policies

These financial statements have been prepared in accordance with the 2016-17 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, we have selected the policy we judge to be most appropriate to our particular circumstances for the purposes of giving a true and fair view. 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.

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 Basis of consolidation

Open Water Market Limited ceased trading on 31 August 2015, and was recorded as dissolved by Companies House on 19 July 2016. The Amendment Order presented to Parliament in 2016-17 confirmed that this entity is no longer within Ofwat's departmental boundary for 2016-17.These accounts comprise of the consolidation of the core department and Open Water Market Limited in the comparative figures for the previous financial period, as defined in the FReM, being those entities listed in the Designation and Amendment Orders presented to Parliament in 2015-16.

The department and all entities included in the consolidation for 2015-16 were domiciled in the UK. Transactions and balances between the included entities were eliminated on consolidation.

1.3 Property, plant and equipment

Items of property, plant and equipment have been stated at fair value using depreciated historic cost as a proxy and they are subject to an annual impairment review.

An annual verification exercise is completed to ensure that the assets are present and in working condition. Any damaged equipment that is beyond economical repair is disposed of. Items include furniture and fittings, office machinery and telecommunications equipment, leasehold improvements and ICT equipment.

All individual items must exceed a capitalisation threshold of £2,500 for inclusion as property, plant and equipment. Where items operate co-dependently with one another and are unable to operate individually, they are treated as a single asset. Ofwat policy is to pool purchases of property, plant and equipment assets when the total purchase value is in excess of £500,000 for capitalisation purposes.

Depreciation is provided at rates calculated to provide for the write down of an item of property, plant or equipment by equal instalments over its estimated useful life. Property, plant and equipment lives are in the following range.

Table 15: Estimated useful lives of property, plant and equipment classes

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

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

1.4 Intangible assets

Intangible assets include separable software licences, such as those for the finance system. They are separable, in that the ICT equipment will operate without them. All individual items must exceed a capitalisation threshold of £2,500 for inclusion as an intangible asset.

Operating software is included with the cost of the tangible asset it supports. Software licences and bespoke software are amortised over the term of the licence or the useful economic life from the date the asset is brought into service, whichever is shorter.

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

1.5 Financing

Ofwat is primarily resourced by licence fees. Licence fees are charged to companies that Ofwat regulates in the water and wastewater sectors. The licence fees levied for Ofwat's core work are subject to a cap governed by Condition N of statutory undertakers' Instruments of Appointment under the Water Industry Act 1991. Additional licence fees are payable by certain companies for specific work on the Thames Tideway Tunnel project and with respect to the Open Water programme, each of which had its own cap in this financial year, and a small licence fee is paid by water supply licensees.

1.6 Operating income

Since Ofwat's costs are primarily recovered through the licence fees and invoiced in advance based on estimated costs, any licence fee income that exceeds the level of operating costs is surrendered to the Consolidated Fund.

1.7 Cash

Cash is primarily generated through licence fees. At the end of a financial year, any cash remaining in Ofwat's bank account (Government Banking Service) is paid over to the Consolidated Fund (see SOPS4). As Ofwat does not receive income from companies at the start of the financial year, a sum is borrowed from the Contingencies Fund and repaid later.

1.8 Trade receivables

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

1.9 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 final legal notice is served.

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

1.10 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).

1.11 Pensions

The majority of past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS). Ofwat recognises the expected cost of this scheme 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.

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 International Accounting Standard (IAS) 19.

1.12 Value-added tax

Most of Ofwat's activities are outside the scope of value added tax (VAT). 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.

1.13 Provisions

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. The discount rate for pension liabilities changed from 1.37% real per annum to 0.24% real per annum net of CPI with effect from 31 March 2017.

1.14 Contingent liabilities

As well as 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 is noted separately. Contingent liabilities that are not required to be disclosed by IAS37 are stated at the amounts reported to Parliament.

1.15 Going concern

The statement of financial position at 31 March 2017 shows negative taxpayers' equity of £7.5 million. In common with other government departments, the future financing of liabilities will 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 believe that future approvals will not be forthcoming. Accordingly, we consider it appropriate to adopt a going concern basis for the preparation of these financial statements.

Under the Government Resources and Accounts Act 2000, no money may be drawn from the Consolidated Fund except what is required for the service of the specified year or retained in excess of that need. All unspent monies, including those derived from our income, are to be surrendered to the Fund.

Ofwat's budget for 2017-18 was agreed via our Main Estimate, presented to the House of Commons on 19 April 2017.

1.16 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 unused leave entitlements at the end of the financial year.

1.17 Accounting estimates

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

1.18 Operating costs

Ofwat operates a time recording system, capturing staff hours against our programmes. The percentage of staff time per programme is apportioned against payroll costs.

2. Statement of operating costs by programme

Description of Programme:	2016-17 £000	2015-16 £000
Business Transformation	2,584	3,966
Casework	1,591	1,419
Compliance and Assurance	5,295	4,233
Finance and Governance	1,776	1,297
Strategy and Planning	1,630	1,619
Water 2020	6,897	5,673
Retail Market Opening	1,853	3,217
Thames Tideway Project Regulation	443	853
Open Water Market Limited	-	2,585
Total Expenditure	22,069	24,862
Total Income	(22,793)	(25,361)
Net income	**(724)**	**(499)**

3. Staff costs

	2016-17 £000	2015-16 £000	
	Core Departmental Outturn	Core Department Outturn	Departmental Group Outturn
Staff costs:			
Wages and salaries	10,402	8,262	8,262
Social security costs	1,097	757	757
Other pension costs	2,098	1,689	1,689
Other staff costs	(10)	133	133
Total	**13,587**	**10,841**	**10,841**

4. Expenditure

	2016-17 £000	2015-16 £000	
	Core Department Outturn	Core Department Outturn	Departmental Group Outturn
Purchase of goods and services:			
Consultancy services	3,699	4,932	7,000
Contingent labour	984	2,317	2,804
Training	323	180	180
Travel and subsistence	515	415	415
Taxation charges	30	21	21
Rates	170	224	224
Information Technology	410	599	607
Other hire and maintenance	18	16	16
Seminars, meetings and conferences	70	39	49
Publications, books and periodicals	107	118	123
Telecommunications	322	189	189
Recruitment costs	217	275	275
Office Consumables	80	219	219
Accommodation expenses	75	148	149
Internal Audit fees	40	77	77
External Audit fees	-	1	13
Records management	133	17	17
Other	131	139	122
	7,324	**9,926**	**12,500**
Rentals under operating leases:			
Accommodation	767	745	756
Office equipment	44	44	44
	811	**789**	**800**
Non cash items:			
Depreciation	160	178	178
Amortisation	57	83	83
Loss on disposal of assets	-	20	20
Addition/(release) of provision	(3)	(7)	(7)
Restructuring provisions	-	54	54
Other finance costs	93	99	99
External Auditors' remuneration	40	45	45
Impairment of assets	-	249	249
	347	**721**	**721**
Total	**8,482**	**11,436**	**14,021**

We have reduced our reliance on interim staff (contingency labour) during the year by recruiting people with the specialist skills we require to deliver our strategy in the future and we have invested in the development of our people. This is in line with ongoing work in the development of our Strategic Workforce Plan to ensure we have the right people, with the right skills available at the right time. Whilst expenditure on internal audit reduced during the year, 95% of our internal audit programme was completed as planned. The reduction in expenditure relates to the timing of the final review which was not completed until May 2017.

5. Property, plant and equipment

Open Water Market Limited did not hold any non-current assets. These notes to the accounts relate to the core department only for the comparative year. Property, plant and equipment consists of furniture and fittings, office machinery and telecommunications, leasehold improvements and ICT equipment.

	£000 Payments on Account	£000 Furniture & Fittings	£000 Office machinery & Telecomms	£000 Leasehold Improvements	£000 Information Technology	£000 Total
Cost or valuation						
At 1 April 2016	12	91	53	688	506	1,350
Additions	-	28	-	222	38	288
Disposals	-	-	(35)	-	-	(35)
Reclassifications	(12)	-	-	12	-	-
At 31 March 2017	**-**	**119**	**18**	**922**	**544**	**1,603**
Depreciation						
At 1 April 2016	-	17	45	139	429	630
Charged in year	-	11	7	103	39	160
Disposals	-	-	(35)	-	-	(35)
Impairments	-	-	-	(1)	-	(1)
At 31 March 2017	**-**	**28**	**17**	**241**	**468**	**754**
Carrying amount at 31 March 2017	**-**	**91**	**1**	**681**	**76**	**849**
Carrying amount at 31 March 2016	**12**	**74**	**8**	**549**	**77**	**720**
Asset Financing:						
Owned	-	91	-	681	76	848
Finance Leased	-	-	1	-	-	1
Carrying amount at 31 March 2017	**-**	**91**	**1**	**681**	**76**	**849**

	£000	£000	£000	£000	£000	£000
	Payments on Account	Furniture & Fittings	Office machinery & Telecomms	Leasehold Improvements	Information Technology	Total
Cost or valuation						
At 1 April 2015	161	65	71	821	1,637	2,755
Additions	12	-	-	254	13	279
Disposals	-	(40)	(18)	(152)	(1,192)	(1,402)
Impairments	-	-	-	(282)	-	(282)
Reclassifications	(161)	66	-	47	48	-
At 31 March 2016	**12**	**91**	**53**	**688**	**506**	**1,350**
Depreciation						
At 1 April 2015	-	32	54	259	1,557	1,902
Charged in year	-	8	9	97	64	178
Disposals	-	(23)	(18)	(149)	(1,192)	(1,382)
Impairments	-	-	-	(68)	-	(68)
At 31 March 2016	-	**17**	**45**	**139**	**429**	**630**
Carrying amount at 31 March 2016	**12**	**74**	**8**	**549**	**77**	**720**
Carrying amount at 31 March 2015	**161**	**33**	**17**	**562**	**80**	**853**
Asset Financing:						
Owned	12	74	6	549	77	718
Finance Leased	-	-	2	-	-	2
Carrying amount at 31 March 2016	**12**	**74**	**8**	**549**	**77**	**720**

6. Intangible assets

Open Water Market Limited did not hold any intangible assets. These notes to the accounts relate to the core department only for the comparative year. Intangible assets consist of purchased software licences.

	£000 Purchased software licences	£000 Total
Cost or valuation		
At 1 April 2016	417	417
Additions	-	-
At 31 March 2017	**417**	**417**
Amortisation		
At 1 April 2016	331	331
Charged in year	58	58
At 31 March 2017	**389**	**389**
Carrying amount at 31 March 2017	**28**	**28**
Carrying amount at 31 March 2016	**86**	**86**

	£000 Purchased software licences	£000 Assets Under Development	£000 Total
Cost or valuation			
At 1 April 2015	481	69	550
Additions	2	(69)	(67)
Reclassifications	69	-	69
Disposals	(51)	-	(51)
Revaluation	(84)	-	(84)
At 31 March 2016	**417**	**-**	**417**
Amortisation			
At 1 April 2015	348	-	348
Charged in year	83	-	83
Disposals	(51)	-	(51)
Revaluation	(49)	-	(49)
At 31 March 2016	**331**	**-**	**331**
Carrying amount at 31 March 2016	**86**	**-**	**86**
Carrying amount at 31 March 2015	**133**	**69**	**202**

7. Capital and other commitments

7.1 Operating leases

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

	2016-17 £000 Core Department	2015-16 £000 Core Department
Obligations under operating leases comprise:		
Buildings		
Not later than one year	878	847
Later than one year and not later than five years	3,513	3,531
Later than five years	472	1,425
Total	**4,864**	**5,803**
Other		
Not later than one year	42	42
Later than one year and not later than five years	14	56
Later than five years	-	-
Total	**56**	**98**

7.2 Capital commitments

	2016-17 £000 Core Department	2015-16 £000 Core Department
Contracted capital commitments at 31 March not otherwise included in these financial statements		
Property, plant and equipment	36	122
Total	**36**	**122**

8. Financial instruments

Ofwat is not exposed to the same degree of financial risk as 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 organisation in undertaking its activities.

8.1 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 significant liquidity risks.

8.2 Interest rates and foreign currency risks

All material deposits are held at the Government Banking Service and all material assets and liabilities are denominated in sterling, so Ofwat is not exposed to significant interest rate risk or foreign currency risk.

8.3 Fair values

There is no material difference between the book values and the fair values of the departmental group's financial assets and liabilities at 31 March 2017.

9. Cash and cash equivalents

	2016-17 £000	2015-16 £000	
	Core Department	Core Department	Departmental Group
Balance at 1 April 2016	576	3,778	4,993
Net change in cash and cash equivalent balances	(283)	(3,202)	(4,417)
Balance at 31 March 2017	**293**	**576**	**576**
The following balances at 31 December 2016 were held at:			
Government Banking Services (GBS)	293	576	576
Commercial banks and cash in hand	-	-	-
Total	**293**	**576**	**576**

Any cash held at 31 March 2017 by the core department must be surrendered to the Consolidated Fund per note 1.7.

10. Trade receivables and other current assets

	2016-17 £000	2015-16 £000	
	Core Department	Core Department	Departmental Group
Amounts falling due within one year			
Trade receivables	49	162	162
Deposits and advances	33	28	28
HM Revenue and Customs (VAT)	225	238	238
Prepayments and accrued income	314	258	258
Total	**621**	**686**	**686**
Amounts falling due after more than one year:			
Prepayments and accrued income	1	2	2
Total	**1**	**2**	**2**

11. Trade payables and other current liabilities

	2016-17 £000	2015-16 £000	
	Core Department	Core Department	Departmental Group
Amounts falling due within one year			
Trade payables	3,056	4,737	4,737
Other payables	242	204	204
Other taxation and social security	334	275	275
Accruals	2,295	2,517	2,517
Deferred income	133	91	91
Current part of finance leases	1	1	1
Excess cash due to be paid to the Consolidated Fund	293	576	576
Total	**6,354**	**8,401**	**8,401**
Amounts falling due after more than one year			
Finance leases	-	1	1
Total	**-**	**1**	**1**

Payables have reduced in the year due to a lower level of licence fee returned to water companies at 31 March 2017 compared with the previous year.

12. Provisions for liabilities and charges

	2016-17 £000 Core Department		2015-16 £000 Departmental Group	
	Restructure costs	Total	Core Department Total	Total
Balance at 1 April 2016	130	130	1,222	1,262
Provided in the year	-	-	54	54
Provisions utilised in the year	(112)	(112)	(1,139)	(1,179)
Provisions not required written back	(3)	(3)	(7)	(7)
Balance at 31 March 2017	**15**	**15**	**130**	**130**

Analysis by type	2016-17 £000 Core Department		2015-16 £000 Departmental Group	
	Restructure costs	Total	Core Department Total	Total
Amounts falling due within one year	15	15	114	114
	15	**15**	**114**	**114**
Amounts falling due after more than one year	-	-	16	16
	-	-	**16**	**16**
Total	**15**	**15**	**130**	**130**

Analysis of expected timing of discounted flows	2016-17 £000 Core Department		2015-16 £000 Departmental Group	
	Restructure costs	Total	Core Department Total	Total
Not later than one year	15	15	114	114
Later than one year and not later than five years	-	-	16	16
Later than five years	-	-	-	-
Balance at 31 March 2017	**15**	**15**	**130**	**130**

13. Pensions liabilities

13.1 Pension liabilities

Open Water Market Limited did not operate a pension scheme. This note to the accounts relates to the core department only for the comparative year.

	2016-17 £000 Core Department	2015-16 £000 Core Department
Balance at 1 April 2016	2,672	2,884
Analysis of the amount charged to the Statement of Comprehensive Net Expenditure		
Interest costs	93	99
Benefits paid		
Benefits paid	(181)	(181)
Analysis of the amount recognised in the Statement of Changes in Taxpayers' Equity		
Experience (gain)/loss	13	(20)
Actuarial (gain)/loss	322	(110)
Balance at 31 March 2017	**2,919**	**2,672**

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 2017.

The demographic assumptions are consistent with those used elsewhere in central government for resource accounting purposes and with those adopted in previous years. The main demographic assumptions are as follows.

- Mortality improvements to 2014 are based on historic population experience for those years. Improvements since 2014 are based on improvements underlying 2014-based UK principal population projections by the Office for National Statistics.
- All members are assumed to have a spouse or eligible partner from the date their pension is assumed to be paid. Male members are assumed to be three years older than their partners and female members are assumed to be two years younger than their partners.

The main financial assumptions used to assess liabilities at 31 March 2017 are as follows.

- The gross discount rate is assumed to be 2.8% a year (31 March 2016: 3.6%).
- The consumer price index (CPI) is assumed to be 2.55% (31 March 2016: 2.2%).
- Net (of CPI) discount rate is assumed to 0.24% (31 March 2016: 1.37%).

A cumulative actuarial loss of £2.3 million has been incurred by the scheme since 1 April 2004.

13.2 Sensitivity analysis of main actuarial assumptions

The sensitivity analysis of the main actuarial assumptions indicates the following.

- Increasing the discount rate by 0.5% would result in a corresponding decrease in liabilities of approximately 5%, or £142,000.
- Increasing the CPI inflation assumption by 0.5% would result in a corresponding increase in liabilities of approximately 6.0%, or £160,000.
- Increasing assumed life expectancies in retirement to equal those of people one year younger would result in a corresponding increase in liabilities of approximately 5.0%, or £150,000.

The opposite changes in assumptions will produce approximately equal and opposite changes in the liability. Similarly, doubling the changes in the assumptions will produce approximately double the changes in the liability.

The sensitivities show the change in each assumption in isolation. In practice, such assumptions rarely change in isolation and, given the interdependencies between them, their impacts may offset each other to some extent.

13.3 Analysis of actuarial loss

	2016-17 £000 Core Department	2015-16 £000 Core Department	2014-15 £000 Core Department
Experience (gains)/losses arising on the scheme liabilities	13	(20)	4
Changes in assumptions underlying the present value of scheme liabilities	322	(110)	157
Per Statement of Changes in Taxpayers' Equity	335	(130)	161

13.4 History of experience losses

	2016-17 Core Department	2015-16 Core Department	2014-15 Core Department	2013-14 Core Department	2012-13 Core Department
Experience (gains)/losses arising on the scheme liabilities					
Amount (£000)	13	(20)	4	61	24
Percentage of the present value of the scheme liabilities	0.4%	(0.7)%	0.1%	2.2%	0.9%
Total amount recognised in Statement of Taxpayers' Equity					
Amount (£000)	335	(130)	161	204	99
Percentage of the present value of the scheme liabilities	11.5%	(4.9)%	5.6%	7.3%	3.7%

14. Contingent liabilities disclosed under IAS37

On occasion, Ofwat may be subject to formal legal challenge including by way of judicial review of its decisions.

We have received a complaint regarding a party's intention to implement a particular code. The complainant has asked Ofwat to intervene to prevent the implementation of the code and threatens us with legal action (including judicial review for a failure to act) if we do not do so. We will be replying to the complaint in due course.

15. Related party transactions

15.1 Defra/CCWater

Ofwat collects licence fees in respect of CCWater's operating costs under licence condition N. Ofwat transferred £5.1 million to Defra in respect of CCWater's operating costs in 2016-17.

15.2 Civil Aviation Authority (CAA)/UK Regulators Network (UKRN)

Ofwat received £9.6k from the CAA in respect of services provided by Keith Mason during the year under a secondment agreement between the two departments.

Ofwat received £133k from the CAA on behalf of the UKRN in relation to the provision of services by Ofwat employees loaned to the UKRN under a secondment agreement and contributions to joint UKRN collaboration projects.

15.3 Office of Communications/ UK Regulators Network (UKRN)

Ofwat received £76k from the CAA on behalf of the UKRN in relation to the provision of services by Ofwat employees loaned to the UKRN under a secondment agreement. (2015-16: £59k)

15.4 Jonson Cox Chairman/Cory Environmental Management Ltd (Cory)

Cory paid Ofwat £12k for the provision of shared secretariat services for Jonson Cox during the year. (2015-16: £6k)

15.5 Other

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

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

16. Events after the reporting period

The Accounting Officer authorised these financial statements for issue on the date of the Comptroller and Auditor General's audit certificate. The financial statements do not reflect events after this date.

Part 4: Appendices

A1 Progress on projects described in 'Ofwat's forward programme 2016-17'

Below we highlight our progress against the projects we outlined in 'Ofwat's forward programme 2016-17'.

What we said	Status
April to June 2016	
Publish Ofwat's five-year business plan for 2016-17 to 2020-21.	Met
Publish final guidance and engage the water sector on our approach to competition law and, in particular, the challenges of the new retail market for eligible business, charity and public sector customers in England.	Met
Open the application process for businesses to apply to become licensed as Water Supply and Sewerage Licensees (WSSLs) for the newly competitive retail market for eligible business, charity and public sector customers in England – and for individual customers to supply themselves with retail services.	Met
Engage the sector and others on work to modernise water companies' licences.	Met
Publish the customer protection code of practice setting out the minimum standards of behaviour towards customers in the new market – and consult on the consequential changes to companies' Instruments of Appointment from market opening.	Met
Publish our decisions on the design of the regulatory framework for wholesale markets and the 2019 price review (PR19) – and engage with the sector on licence reform needed to give effect to our decisions.	Met
Publish the final method and table requirements for carrying out our review of each monopoly company's price control for business retail services in England and Wales.	Met
Publish a policy statement on customer engagement for PR19, setting out conclusions on the principles consulted on in our December 2015 document.	Met
Complete the first phase of our delivery model for PR19.	Met
Consult on rules for monopoly companies in charging for new connections.	Met
Publish a rulebook setting out how the Infrastructure Provider's licence will work.	Changed. We considered that a one page infographic was a better tool to communicate the licence
Launch our new employer brand, resourcing and attraction strategy.	Met

What we said	Status
Design and begin to implement our learning and development offer for employees	Met
Complete changes to our London accommodation to reduce the space we occupy.	Met
Publish Ofwat's annual report and accounts 2015-16.	Met
July to September 2016	
Publish our initial and final findings of our review of the benefits of extending choice of water and wastewater retail services supplier to residential customers in England.	Met
Publish our draft decisions ('draft determinations') of each monopoly company's price control for retail services in England and Wales.	Met
Produce a scoping document for the code for self-lay agreements, as set out in the Water Act 2014	Met
Publish revised regulatory accounting guidance to reflect good practice and to reveal information to support the regulation and development of markets.	Met
Conduct a targeted review related to market participants' readiness for the opening of the retail market for eligible business, charity and public sector customers of companies whose areas are wholly or mainly in England – to support Ofwat's assurance of market participants' readiness.	Met
Publish Ofwat's quarterly dashboard.	Delayed until 2017-18
Hold an event with stakeholders to explain the Infrastructure Provider's licence and the regulatory framework for the Thames Tideway Tunnel.	Changed. We considered that a one page infographic was a better tool to communicate the licence
Implement our strategic workforce plan and model to drive our resourcing and inform our delivery model for PR19.	Met
Establish a customer panel to help make sure we build the customer perspective more effectively into all our work.	Met
Publish rules for monopoly companies in charging for wholesale water and wastewater services.	Met
October to December 2016	
Begin sector-wide engagement on handling and managing customer data.	Met
Begin sector-wide engagement on identifying and taking account of the needs of the future customer.	Changed. Engaged the sector on customer participation.
Publish our assessment of sector performance against the latest Water UK-led water sector assessment framework ('dashboard').	Met
Publish Ofwat's draft forward programme for 2017-18.	Met
Publish Ofwat's quarterly dashboard.	Delayed until 2017-18

What we said	Status
Assess monopoly companies against the company monitoring framework – after they have published their annual performance information for 2015-16.	Met
Publish our first full commentary on water sector financial resilience.	Met
Formally consult on the main market codes – the Wholesale–Retail Code and Market Arrangements Code.	Met
Set up the enduring Market Codes Panel.	Met
Send the UK Government an interim letter of assurance on Ofwat's and market participants' readiness for the market to open.	Met
Publish further consultations to take forward work to implement the regulatory framework for wholesale markets and PR19.	Met
Following engagement with the sector, consult under section 13 of the Water Industry Act 1991 to change monopoly companies' licences to reflect our decisions on the regulatory framework for wholesale markets and PR19.	Met
Publish our final decisions ('final determinations') of each monopoly company's price control for business retail services in England and Wales.	Met
Publish rules for monopoly companies in charging for new connections.	Met
Review our approach to telecommunications to support our flexible approach to working and deliver improved value for money.	Met
Implement our new human resources system.	Delayed until 2017-18
Move more of our IT services to a Cloud-based system and investigate sharing services.	Met
January to March 2017	
Publish Ofwat's final forward programme for 2017-18.	Met
Publish Ofwat's quarterly dashboard.	Delayed until 2017-18
Implement a new database of customer enquiries and disputes received by Ofwat to help identify trends and issues that may need investigation or action.	Delayed until 2017-18
Review the sector's markets and consider whether further intervention, potentially through a formal market study, would improve customer outcomes in a target water and wastewater market.	Met
Initiate and carry out a targeted review of a service area.	Met
Consult on revised board leadership, transparency and governance principles.	Delayed until 2017-18
Send the UK Government a final letter of assurance on Ofwat's and market participants' readiness for the market to open.	Met
Complete the implementation of our management development programme.	Met
Start planning the systems needed to support PR19.	Met

A2 Performance against stated levels of service

Every year, we respond to enquiries and complaints from members of the public and our stakeholders, including phone calls and written correspondence. We also investigate disputes between customers and their water companies where Ofwat has powers to do so.

We set out below our performance for 2016-17 in responding to enquiries, complaints and disputes, against the standards of service we aim to achieve.

We have changed the way we report our performance this year. This is to make it clearer and better demonstrate our performance against the standards of service that we have committed to.

We have a number of performance measures that we monitor as we aim to improve our performance. We continue to keep all aspects of our performance under review.

General enquiries

Ofwat receives a variety of general enquiries by telephone and written communication. These include, for example, enquiries about Ofwat's role in price reviews; requests for publications; and requests for information about the process for applying to us for a new retail or New Appointment and Variation (**NAV**) licence.

Table 16: Performance against our service standard for general enquiries

Metric	What is measured	Number received	Target 2016-17	Actual 2016-17
General Enquiries	The proportion of enquiries responded to within ten working days of receipt	716	95%	97%

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 respond to any written request, normally within 20 working days. There are some exceptions to this deadline; we are able to take more time to consider the public interest in the disclosure of information. We set out our performance in the table below.

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.

Table 17: Performance against standard for FOIA and EIR requests

Metric	What is measured	Number of requests[1]	Target 2016-17	Actual 2016-17
FOIA and EIR requests	Information requests responded to within deadline	158	100%	98.6%

[1] Ten requests were closed due to no clarification being received, or were withdrawn

Disputes and complaints about water and wastewater services

The majority of complaints we receive fall outside of Ofwat's remit. The Consumer Council for Water (**CCWater**) is the statutory consumer body for customers in the water sector. It deals with most customer service complaints that water companies themselves cannot resolve directly with the customer.

Where customers are still dissatisfied following CCWater's efforts to resolve their complaint, in some cases they have the right to refer their complaint to the Water Redress Scheme (**WATRS**). WATRS is the independent adjudicator for disputes between customers and water and wastewater companies. It is designed to provide an independent, impartial and easy to use alternative to going to court or a tribunal. WATRS is able to consider disputes where Ofwat does not have legal powers to consider the matter.

Ofwat has legal powers to consider a specific set of disputes. The most common areas in which we have powers to consider complaints and disputes include:

- complaints about regulatory policy;

- allegations of breach of certain statutory duties by a company;
- water supply and sewer connection charges;
- requisitioning of water mains, sewers and lateral drains;
- terms and conditions of adoption agreements for self-laid mains or sewers;
- sewer transfer appeals;
- water company refusal to install a water meter;
- guaranteed standards scheme (**GSS**) payments;
- trade effluent appeals; and
- how a water company has consulted customers affected by their pipe-laying in streets and across private land.

When we receive details of a dispute or complaint from a customer, we carry out an initial assessment to decide whether:

- it falls within our jurisdiction; or
- we should investigate and open a formal case.

We set out the cases we closed in this initial assessment phase below.

Table 18: Performance against our service standard for responding to complaints where Ofwat has no role

Metric	What is measured	Number Received	Target 2016-17	Actual 2016-17
Complaints – Ofwat has no role	The proportion of complaints where Ofwat has no role responded to within ten working days of receipt	741	95%	97%

Table 19: Performance against our service standard for completing an initial assessment where Ofwat has or may have a role

Metric	What is measured	Number Received	Target 2016-17	Actual 2016-17
Initial Assessment – Ofwat has or may have a role	Proportion of responses following our initial assessment provided within 10 working days of receipt	181	95%	94%

Investigations we carry out

We aim to investigate as quickly and thoroughly as possible. Where we investigate a dispute or complaint, we have service standards within which we aim to complete all

of our non-strategic cases. These service standards range from six months to 24 months depending on the type of investigation. Further details can be found on our website.

During 2016-17, we have put an increased emphasis on trying to work with customers and water companies to resolve issues before they become formal investigations. This has often helped customers to get a quicker resolution to their complaint. It has also reduced the number of formal investigations we are asked to do. It does, however, mean that those investigations we are asked to take forward are often on new or particularly complex issues on which our investigation will set a new precedent. This can sometimes affect the time it takes us to resolve them.

In the absence of an informal resolution where we have opened formal investigations, we recognise that during 2016-17 the percentage of cases we closed within the service standard we seek to achieve was significantly lower than we and our customers would like. We are working towards making sure that we are closing all of our cases within our service standard timeframes during in 2017-18.

Table 20: Cases closed within our service standards

Metric	What is measured	Number received	Actual 2016-17
Cases	Proportion of our non-strategic cases closed within our service standard timeframes (including those cases closed prior to final decision/determination due to informal resolution or withdrawal by the parties).	21	48%

Internal reviews

If anyone is unhappy with how we have handled their dispute or complaint, we carry out an internal review to determine whether we handled it correctly.

Where a stakeholder is unhappy with how we have handled a complaint or case, they can ask us to review what we did. Our internal complaints policy sets out how we review complaints.

We were not asked to carry out any internal reviews in 2016-17.

Complaints to the Parliamentary and Health Service Ombudsman

If a complainant is still dissatisfied with our handling of their complaint, they can ask the Parliamentary and Health Service Ombudsman (PHSO) to investigate.

No complaints were referred to the PHSO during 2016-17.

Licensing

New appointees (**NAVs**) are companies that have successfully applied for a licence (an "appointment") to replace the existing water and or sewerage company for a particular geographic area. If a company already has an appointment elsewhere and applies to serve a particular site, we vary its existing appointment to cover the new site rather than grant it a new appointment.

We aim to assess and grant new appointments and variations within 110 workings days of receiving a completed application. We aim to undertake an initial check of applications to ensure they are complete within 15 working days of receipt. During 2016-17, we fully processed far fewer NAV applications than we would have liked within our target of 110 working days. This was in part due to us not generally using our ability formally to "stop the clock" on applications where we were waiting for the submission of additional information required from the applicant. During 2017-18, we aim to improve the time in which we process applications and to make better use of "stop the clock" to ensure the measure of this metric truly reflects the stages of the application process that rely on us.

Table 21: New Appointment and Variations (NAVs) processed within our service standards

Metric	What is measured	Number of applications received	Completed within our service standard
NAV licence applications	Proportion of applications for which we complete our initial check within 15 working days of receipt	10	90%
	Proportion of applications fully processed within 110 working days of receipt	7	43%

From April 2017, 1.2 million eligible business, charity and public sector customers in England can choose their water and wastewater retailer. These retailers must apply

for and be granted a water supply and/or sewerage licence (**WSSL**). As part of the licence application process we consider whether the applicant has the appropriate level of competency to hold the type of WSSL requested. We do this by assessing a number of key areas, including managerial, financial and technical competencies.

We aim to process WSSL applications within 60 working days of receiving a completed application. This service standard is extended to 90 working days if there is a need to modify a standard licence condition. We also seek to undertake our initial checks on WSSL applications (i.e. to ensure they have all the required information for us to undertake our full assessment) within five working days. During 2016-17 we completed 61% of our initial checks within our target of five working days. Learning from our experience of the first year during which we have processed WSSL applications, during 2017-18 we will be considering how our performance on initial checks can be further improved.

Table 22: Water and Sewerage Supply Licences (WSSLs) processed within our service standards

Metric (KPIs)	Details of what is being measured	Number of applications received	Completed within our service standard
WSSL applications	Proportion of WSSL applications for which we complete our initial check within 5 working days of receipt	31	61%
	Proportion of applications fully processed within 60/90 working days of receipt	25	92%

A3 How our work aligns with the UK and Welsh Governments' priorities and guidance

Under the Water Industry Act 1991, the Secretary of State for Environment, Food and Rural Affairs and the Welsh Government have powers to issue statements setting out strategic priorities and objectives for us. We are required to act in accordance with these statements when discharging relevant legal functions. Until the new statements have been issued in final form, we must act in accordance with both Governments' previous statutory guidance to us on social and environmental matters.

Guidance from the Welsh Government

In December 2013, following consultation, the Welsh Government laid before the Assembly new social and environmental guidance (SEG) for us. This included the priority areas they expect us to consider while carrying out our work. In February 2014, the SEG was confirmed by the Assembly. It includes an expectation that we will feed back on our management of these overarching priorities as part of our annual reporting process consistent with the requirements of the WIA91.

We have written to Welsh Ministers to explain how we have done this. We also summarise the actions we have taken below.

The Welsh Government has recently consulted on its new 'Strategic Priorities and Objectives Statement to Ofwat'. We expect to report progress against these priorities for 2017-18.

Priority and contribution

1. Regulatory proposals: assess impacts of regulatory changes on consumers and investors

Our work throughout the year has built on the successes of our 2014 price review.

Reflecting the policy of the Welsh Government not to extend business retail competition further to companies wholly or mainly in Wales, our PR16 final determination of business retail price controls provides continuing price control protection for business customers of companies operating wholly or mainly in Wales.

In May 2016, we published our regulatory approach for water and wastewater services in England and Wales. This sets our policy direction in relation to future price limits and the potential for greater use of wholesale markets to deliver efficiencies and improved resilience.

- The framework is ground-breaking for the sector and provides a solid and early basis for companies to develop their business planning. A clear and early framework, based on effective engagement, alongside providing regulatory capital value protection for efficient expenditure up to 31 March 2020, has demonstrably maintained investor confidence in the sector.
- Our decision document sets out how we will facilitate long-term planning and innovation in the sector, consistent with the sustainable development objective. Dialogue through the Welsh Water Forum and Welsh PR19 Forum informed our approach and continues to inform the development of our more detailed methodology.
- As part of our decisions on future price limits and markets in May 2016, we published our expectations for monopoly companies in engaging with their customers during the 2019 price review (PR19). Our policy significantly strengthens customers' role in the way services are delivered and in deciding companies' price and service levels.
- We will be stepping away from the use of the Retail Price Index (RPI) measure of inflation and moving towards a more robust and legitimate measure of inflation in price controls. Our options are the Consumer Price Index (CPI) − or the Consumer Price Index including owner-occupiers' housing costs (CPIH) measure.

The package of key policy decisions set out in our May 2016 regulatory approach can now be implemented through PR19 by virtue of a series of changes to monopoly company licences ('Water 2020 licence changes'). The Water 2020 licence changes reflected an 18 month process of close and constructive engagement with companies on our future regulatory framework and the modifications themselves. All companies agreed the Water 2020 licence changes following a consultation under section 13 of the Water Industry Act 1991, which allows us to modify the conditions of licences with the agreement of the companies concerned.

We continue to work closely with the Consumer Council for Water (CCWater). We engage with them to understand how their research will inform the impact of regulatory changes on customers. The Welsh Water Forum and Welsh PR19 Forum also provide opportunities to better understand the impact of regulatory changes on customers in Wales using the insight provided by CCWater Wales and the Customer Challenge Groups (CCGs) set up by companies in Wales. The CCGs form an important part of our approach to ensuring that company plans are based on high

quality customer engagement, including impacts on future bills, affordability and resilience. They will provide independent challenge to companies and independent assurance to us on the quality of a company's customer engagement; and the degree to which this is reflected in its business plan.

2. Environmental and statutory obligations: facilitate compliance with domestic and European legislation/ 8. Drinking water quality: ensure compliance with drinking water quality obligations

The 2014 price review took effect on 1 April 2015. It reflected companies' licences and our commitment to comply with domestic and European legislation.

The sector has now published the Discover Water dashboard which publicises the progress of the sector. The measures included on the dashboard provide a wide range of coverage which includes compliance with environmental and drinking water quality obligations. Customers and stakeholders in Wales, for example, are now able to compare transparently the performance of Welsh Water, Dee Valley Water and Severn Trent Water with each other and with the performance of other companies in England.

In 2015-16 Dee Valley Water and Welsh Water both performed around the industry average on drinking water compliance. Dŵr Cymru Welsh Water performed around the industry average on environmental performance. We work closely with the Drinking Water Inspectorate and Natural Resources Wales respectively to monitor company delivery against their statutory obligations and performance commitments to customers in both of these service areas.

The regulatory framework put in place by the 2014 price review gave companies what they needed to deliver on their statutory obligations and responsibilities. In addition PR14 introduced an outcomes-focused approach to encourage companies to go further to deliver more of what their customers want such as the quality and reliability of their water supply, how well companies look after their local environment and how good their customer service is. After speaking and listening to their customers, Welsh Water, Dee Valley Water and other water companies made pledges to improve outcomes through performance commitments, many of which were backed by financial rewards and penalties. Companies will only receive rewards for going beyond their statutory obligations, and will receive penalties if their performance drops below the high standards demanded by their customers.

3. Sustainable development: contribute to the Welsh Government's sustainable development objectives

Our work this year has protected customers, the environment and wider society and contributed to the Welsh Government's sustainable development objectives. We engage with Natural Resources Wales to ensure that our regulatory approach contributes to sustainable development, including through the Welsh Water Forum.

The sector has now published Discover Water, a website which brings together a range of information about companies and water and wastewater services in a user-friendly and interactive way. The measures included on the dashboard provide a wide range of coverage of aspects relevant to sustainable development. The transparency of the range of performance of companies across England and Wales also contributes to sustainable development, by highlighting areas of poor performance and enabling companies to learn from good practice. Customers and stakeholders in Wales, for example, are now able to compare transparently the performance of Welsh Water, Dee Valley Water and Severn Trent Water, with each other and with the performance of other companies in England.

In July 2016, we published an update to our 2011 climate change adaptation report. The report reflected the changes to our regulatory model which challenges companies to take ownership of the long-term challenges they face by innovating to address them. Our regulatory model places the emphasis on companies also understanding how climate change might impact on the services customers and wider society value, as well as their wider obligations, and taking responsibility for appropriate action.

Our outcomes approach plays a key role in this company-led approach and marks a significant departure from previous price reviews. Companies have identified a wide range of outcomes that are relevant to sustainable development, and we will ensure they report on what progress is made against them. For example, in addition to fully complying with their abstraction licences, Dŵr Cymru Welsh Water increased their renewable energy generation, maintained leakage below their target and increased the volume of surface water removed from the sewerage system through the use of more sustainable approaches. Dee Valley Water maintained leakage below their target and reduced the average duration of supply interruptions.

To build on PR14, we engaged with stakeholders to inform our policies on customer engagement, Customer Challenge Groups, long-term performance commitments and common outcomes (including leakage and asset condition) in preparation for the next price review (PR19).

Our company performance monitoring and our forthcoming PR19 methodology will enable and encourage companies to manage risk and secure resilient systems and services, including ecosystems and financial and corporate systems. Consistent with our approach to outcomes, and our approach to resilience (building on our December 2015 position statement), our approach emphasises socio-economic and environmental matters alongside our other duties. These include contributing to the achievement of sustainable development, and will underpin companies' contribution to the Welsh Government's Wellbeing Goals.

4. Affordability: take account of affordability issues in Wales

Customers are central to our work. We have continued to protect customers' interests, reflecting the vital nature of water and wastewater services. As we describe against other priorities, maintaining affordability is one of our key strategic priorities for the coming year. It is also central to our Water 2020 methodology. As well as taking account of affordability issues specifically in Wales, we used evidence from Wales to inform our research and approach in England. Average bill levels are higher in Wales than in England, which is one factor that contributes to water affordability issues in Wales. We monitor whether Welsh Water is meeting its commitment to increase the social tariffs and other affordability measures it provides to meet this priority of the Welsh Government.

We have continued discussions with companies and stakeholders following the publication last year of our reports on affordability and vulnerability. We require companies to report on their performance in helping customers struggling to pay their bills in their annual reports, including where they have specific performance commitments set as part of PR14. Through the industry body, Water UK, we encouraged water companies to work closely with energy companies to share good practice in supporting vulnerable customers. We also participated in the production of a cross-sector vulnerability leaflet through the UK Regulators Network (UKRN).

We are working with Ofgem through the UKRN to identify the potential benefits, opportunities and challenges associated with data sharing. Our work builds on the existing good practice by companies and the previous work of regulators. Our aim is to facilitate the targeted, appropriate and proportionate exchange and distribution of information about consumers' vulnerable circumstances across electricity, gas and water. We will report on our progress next year.

5. Efficiency and cost-effective solutions: drive innovation within the boundaries set by the Welsh Government to ensure improvements in efficiency

Companies must publish relevant information that customers and other stakeholders can trust and understand. Our company monitoring framework challenges the 17 largest monopoly companies to provide accurate information and explanations about their performance, and consult with their customers and stakeholders on their priorities.

We use the information that companies publish to monitor different aspects of their services, and take targeted action where this is appropriate

The regulatory framework put in place by the 2014 price review adopted a 'total expenditure' or 'totex' approach with a focus on outcomes. This moved away from our previous focus specifically on capital (capex) or operating (opex) expenditure, which tended to incentivise capex solutions rather than – potentially more innovative – opex solutions. This move helped companies develop more sustainable and innovative approaches in discussion with their customers. These included innovation in catchment management to safeguard drinking water and offset nutrient diffuse pollution, reducing the need to invest in costly, energy-intensive water and wastewater treatment. Innovation in catchment management approaches which recognises the value of community and partnership involvement is an important part of the Water Strategy for Wales.

Our Water 2020 regulatory approach published in May 2016, represented great strides in enabling water companies to deliver a step change in efficiency and improving resilience through better use of wholesale markets in bioresources and water resources. In this document we made clear the elements of our reforms that applied to Wales, consistent with the policy position of the Welsh Government.

Our thinking on the development of markets in these areas has been informed by water resources and bioresources working groups with stakeholders, including Dŵr Cymru Welsh Water, Dee Valley Water and Natural Resources Wales. This fed into our publication in April 2017 of our water resources and bioresources market information consultation document. Our work in this area will stimulate efficient trading of both water resources and bioresources, which will help to address issues such as water scarcity – which is a serious issue in parts of Wales – reduce the cost of water resources and potentially develop even more low-carbon energy production.

Our Water2020 regulatory framework also includes proposals to improve efficiency by increasing competition for large, mainly infrastructure schemes of over £100

million whole-life totex. This will encourage water companies to consider 'direct procurement for customers', using third parties to design, build, finance, and operate large schemes, where this reduces costs for customers.

6. Resilience and joined up outcome-based solutions: enable resilience against natural and other hazards

In 2016-17 we aimed to ensure that companies demonstrated resilience in the round, protecting current and future customers, and the environment.

For example, we have carried out extensive engagement and preparation to support our role as a statutory consultee on company Water Resource Management Plans (WRMPs). We published guidance for WRMPs jointly with Natural Resources Wales, Defra, and the Environment Agency. This provides clarity to the sector on our expectations to consider a wide range of options on water supply such as demand management, reducing leakage and water resource sharing, where this reduces costs for customers.

Water resources management and planning form a key part of water company business activities. We expect companies to integrate the development of their WRMPs into their mainstream business planning. We are working closely together with governments and water regulators in both Wales and England to ensure that water resources planning outcomes, including long term, strategic and resilient solutions, are reflected through the price review process.

During 2016-17 we initiated a targeted review on company asset health and resilience, which we will publish as part of our continuing work to ensure that companies are delivering resilience in the round – both in their current activities and for the long-term in their PR19 plans.

Through this work we continue to recognise that companies have to provide the required standards of service to customers in a sustainable and resilient way, and that their operational planning must account for longer-term issues and external challenges such as climate change. Our casework also has due regard to companies' longer-term responsibilities– such as sewer flooding and water supply infrastructure development, for example – reflecting the approach in the Wales Water Strategy.

7. Research and evidence-based decisions and policy making: take account of research and costs in making decisions

We engaged stakeholders openly as we developed our key revised policies in 2016-17. We sought input via consultations and meetings with sector representatives, and acted in accordance with guidance on social and environmental matters from the Welsh Government. Where we judged that significant issues may require a wider audience, we published draft determinations for comment. We used the latest available information on costs and research, and sought updated information when we considered it necessary. We published all our final determinations, providing clear information about how we considered the evidence and why we reached our final decision.

We expect companies to publish annual performance reports, to make more information available to customers and other stakeholders – and we expect companies to explain their performance. Our approach to decision making often begins with asking for more information from water companies and/or other stakeholders to inform our decisions. This could be on specific issues (such as a particular dispute referred to us), or to consider wider strategic or sectoral issues (such as the market review of the NAV market we commissioned in 2016-17, or targeted reviews of particular cross-sector issues).

Evidence-based decision-making is at the core of our regulatory model. For example, where we made significant proposals or decisions, we published impact assessments to take account of the costs and benefits, including for our Water 2020 regulatory approach, where our cost benefit analysis aligned to the specific proposals for Wales. In our casework we also determined a series of complaints of varying complexity that were formally referred to us for resolution, including cases arising from Welsh companies. Each of these cases required us to gather and analyse a range of information and evidence from the parties to the dispute in order to inform our final evidence-based decision.

To inform our consideration of disputes about connections costs, we commissioned an update to the independent comparison of water supply connections costs. Transparency of this information helps to improve the service provided by companies and stakeholders' understanding of how we determine these types of dispute. The continued publication by Water UK of levels of performance in developer services also helps us to challenge poor performing companies to improve their customer service, leveraging the power of this reputational incentive.

The merger between Severn Trent Water and Dee Valley Water was the first under the revised special merger regime. We provided advice on the impact on our ability

to make comparisons between water companies to the Competition and Markets Authority in the three weeks from phase 1 enquiry launch to decision. The underlying evidence informs our advice includes an assessment of the impact on both cost and service benchmarking.

9. Integrated water management solutions: encourage sustainable and innovative water management solutions/ 10. Future resource management: encourage integrated long term planning and solutions

We are taking an active role as statutory consultees on company Water Resource Management Plans, which require companies to consider climate change projections in assessing supply-demand deficits over a period of at least 25 years.

Along with other elements of our PR19 timetable, the water resource management plan processes and timetable were aligned through engagement with the Welsh Government and Natural Resources Wales. Our regulatory framework is designed to allow companies to work flexibly to support the delivery of priorities identified in the State of Natural Resources Report (SoNaRR) and Area Statements through the National Environment Programme process. By providing certainty on our PR19 timetable at an early stage, companies will be able to consider these priorities in their business plans.

Our Water 2020 regulatory approach published in May 2016 set out:

- how to better focus the sector on the long term how the needs of future customers can best be reflected in our regulation; and
- how supporting markets (for example, in relation to water resources and bio resources) can be best used to inform, enable and encourage more sustainable, efficient approaches in the best interests of customers, the environment and wider society.

We also set out our expectations for how companies undertake customer engagement and participation for the PR19 review. Taken together, through these expectations we are driving long-term planning in the sector to benefit future generations. This includes consideration of all pressures on current and future expenditure and on the resilience of services and systems – including ecosystems and financial and corporate systems. Our work to create the right regulatory framework will enable and encourage service providers to put resilience in the round at the heart of their business planning.

Guidance from the Secretary of State for Environment, Food and Rural Affairs

In May 2013, following consultation, the UK Government issued us with a strategic policy statement (SPS), including revised social and environmental guidance which we are obliged to act in accordance with. It sets out ten priority areas the UK Government expects us to consider while carrying out our work.

The SPS requires:

- us to report how we have reflected these priorities in our regulatory decisions regularly to the Secretary of State;
- our Chairman to agree a reporting timetable with the Secretary of State – and review it every year;
- us to summarise what we have done to deliver the priorities in our annual report and accounts; and
- us to summarise how we propose to further the delivery of the priorities in our forward work programme each year.

As well as reporting against the ten priorities in our annual report and accounts, we have in the past published specific reports each year on agreed priorities. We have agreed with the UK Government that we will prepare these additional reports for 2016-17 in addition to our annual report and accounts. The UK Government has recently consulted on a new SPS. We expect to report against the priorities in the new SPS for 2017-18.

Below, we summarise what action we have taken to support the delivery of the ten priorities in the current SPS.

Priority and contribution

1. Impacts of regulatory changes on sector investment prospects/ 3. Impacts of the regulatory framework on sector investment profile

Our 2014 price review took effect on 1 April 2015. It reflects our commitment to maintaining regulatory stability in key areas.

In May 2016, we published our Water 2020 regulatory approach for water and wastewater services in England and Wales. The Water 2020 regulatory framework is ground-breaking for the sector and provides a solid and early basis for companies to develop their business planning. A clear and early framework, based on effective engagement, alongside providing regulatory capital value protection for efficient

expenditure up to 31 March 2020, has demonstrably maintained investor confidence in the sector.

Our work on regulatory capital value protection, and on the transition mechanism for the proposed change in indexation from RPI to CPI, has helped address investor concerns and maintained confidence in the sector – as has our engagement with investors.

Our Water 2020 regulatory framework also includes proposals to improve efficiency by increasing competition for large, mainly infrastructure schemes of over £100 million whole-life totex. This will encourage water companies to consider 'direct procurement for customers', using third parties to design, build, finance, and operate large schemes, where this reduces costs for customers. Our work also provided clarity on our approach to risk allocation between companies and customers across the Water 2020 regulatory framework.

To allow us to implement some of the key policy changes set out in the Water 2020 regulatory framework, we agreed a number of licence changes with water companies. These licence changes reflected an 18 month process of close and constructive engagement with companies on our Water 2020 regulatory framework, and on the modifications themselves.

During the year, we continued to work alongside the UK Government, Tideway and Thames Water to deliver value for money for customers on the 25 km Thames Tideway Tunnel. Unprecedented in scale, size and complexity in the water sector in England and Wales, the project will deal with the problem of the amount of untreated sewage going into the River Thames. Our work included (among other things):

- ensuring continued value for money for customers;
- challenging Thames and Tideway on costs and variations to the project; and
- working with Thames Water and Tideway within our own remit to deliver project outcomes.

2. Proportionality of the regulatory framework

Our strategy, 'Trust in water', demonstrates the key principle of proportionate and targeted regulation. Through our regulatory model we are seeking to create an incentive framework that aligns the interests of company management and investors with those of customers. We maintain an active role in monitoring how companies perform within this framework. Where companies respond to this framework, and deliver more for their customers and society with less, and where they do so with transparency and a high quality of assurance, we take a less intrusive approach. But where companies do not act in line with this framework, where they are not

transparent and where their assurance fails short, we step in to ensure that customers remain protected and companies are properly held to account.

This year, we have undertaken our first company monitoring framework (CMF) annual assessment, a key element of our approach in this respect. We carried out a series of assessments covering a range of information, including the company annual performance reports, to test whether or not customers could have confidence in the performance information and explanations that companies were providing.

In our CMF, the companies we gave a top 'self-assurance' rating to were leading edge companies, which met the high standards of assurance that stakeholders expect. As well as providing clear, transparent and accurate data, we expected companies to present their information that stakeholders can engage with. We were looking for companies who can demonstrate a successful and positive approach to stakeholder engagement, including in their approach to developing their assurance plans where appropriate. This approach is proportionate as transparency about company structures, procedures and decision-making processes is another important area of focus that helps companies to earn their stakeholders' trust and confidence. Where companies did not meet these standards, we gave a 'prescribed assurance' rating and expect them to carry out additional assurance and to work more closely with Ofwat.

Companies are responsible for publishing information on their own performance against their commitments. In addition to the CMF, which incentivises accuracy, transparency and engagement, we monitor performance using this published information. We have set out a range of proportionate tools for targeted action, and conducted two targeted reviews during the year in order to focus our work on the highest risks – in this case, our targeted review of market readiness across the sector; and our targeted review of asset health and resilience. This approach allows us to intervene in a way which is proportionate to the risk to customers.

Another example of our targeted and proportionate approach to regulation during 2016-17 was on tax. Water companies' lack of transparency about their regulated company corporation tax charge made comparisons with the PR09 Final Determination difficult. Following the PR14 Final Determination, we introduced changes requiring companies to make additional disclosures on corporation tax within their annual performance report. We then commissioned an independent report which has reviewed our changes and makes further recommendations, which we consulted on and implemented.

Up front clarity on regulatory frameworks, where appropriate, reduces regulatory burdens and improves proportionality. As an example, the merger between Severn Trent and Dee Valley was the first under the revised special merger regime – we

provided advice on the impact on our ability to make comparisons between water companies to the Competition and Markets Authority in the three weeks from phase 1 enquiry launch to decision.

Our Water 2020 regulatory framework for wholesale markets and the 2019 price review reduces the overall regulatory burden by removing more prescriptive price and service regulation from parts of water and wastewater service delivery, where appropriate, and replacing it with more risk-based, assurance focused regulation and a greater use of markets.

4. Contribution to the UK Government's sustainable development objectives

Our work this year has protected customers, the environment and wider society and contributed to the UK Government's sustainable development objectives.

For example, we have worked with the sector as it develops an assessment framework, which will contribute to the UK Government's sustainable development objectives. The sector has now published 'Discover Water', a website which brings together a range of information about companies and water and wastewater services in a user-friendly and interactive way.

Through horizon scanning and working collaboratively with the sector, we have identified:

- barriers and opportunities to the delivery of sustainable development objectives; and
- barriers to long-term planning or innovation as a result of our regulatory approach.

This analysis informs our future work programmes, and in particular for 2016-17 the development of our methodology for the 2019 price review.

We have also developed charging rules for new connections to come into force from April 2018. Enabling a clear and customer-centric charging framework will be key to ensuring trust and confidence in the sector and our new charging rules will support new developments and facilitate the adoption of more sustainable solutions. We want to ensure that charges send sensible, cost-reflective signals on which suppliers and buyers can make choices that will enable and encourage efficiency. Stakeholders have concerns with the current arrangements – for example, that charges are too complex, unpredictable and unfair.

Our new approach marks a significant change from the past and one we expect to deliver major benefits to developers and other customers. Our work on the charging rules reflected the UK Government's charging guidance that, while companies can innovate and reform their new connection charging, there should be no overall change to the balance of charges.

5. Impacts of the regulatory approach on the sector's preparation for long-term challenges, such as climate change/ 6. Impacts of the regulatory approach on company innovation, such as catchment management

In July 2016, we published an update to our 2011 climate change adaptation report. The report reflected the changes to our regulatory model so companies take ownership of the long-term challenges they face by innovating to address them. Our regulatory model also places the emphasis on companies understanding how climate change might impact on the services customers and wider society value, as well as their wider obligations, and taking responsibility for appropriate action.

The outcomes approach introduced in PR14 plays a key role in this company-led approach and marks a significant departure from previous price reviews. Companies have identified a wide range of outcomes that are relevant to mitigating climate risk, and we will ensure they report on what progress is made against them. These include catchment management initiatives, leakage reduction, reduction in carbon impact and renewable energy generation commitments.

To build on PR14, we engaged with stakeholders to inform our policies on customer engagement, Customer Challenge Groups, long-term performance commitments and common outcomes (including leakage and asset condition) in preparation for the next price review (PR19). But our understanding of the resilience of the sector to climate change was not restricted to data gathered by Ofwat. We also engaged with Water UK on the long-term planning framework, and Water Resources South East and Water Resources East Anglia to consider water resource planning at a regional level.

We are also taking an active role as a statutory consultee on company Water Resource Management Plans. This requires companies to consider climate change projections in assessing supply-demand deficits over a period of at least 25 years.

7. Impacts of the regulatory approach on sector resilience and sustainable water resource management

Our work this year has focused on companies demonstrating resilience in the round, protecting current and future customers, and the environment.

Resilience is vital for customers' trust and confidence in the water sector. We have challenged the sector to develop outcome metrics for resilience that allow the overall performance of the sector on resilience to be measured and incentivised.

For example, we have carried out extensive engagement and preparation to support our role as a statutory consultee on company Water Resource Management Plans. We published guidance for WRMPs jointly with Defra, the Environment Agency and Natural Resources Wales. This provides clarity to the sector on our expectations to consider a wide range of options on water supply such as demand management, reducing leakage and water resource sharing, where this reduces the costs for customers.

Water resources management and planning form a key part of water companies' business activities. We expect companies to integrate the development of their WRMPs into their mainstream business planning. We are working closely together with governments and water regulators in both England and Wales to ensure that water resources planning outcomes, including long term, strategic and resilient solutions are reflected through the price review process.

During 2016-17, we initiated a targeted review on company asset health and resilience, which we will publish as part of our continuing work to ensure that companies are delivering resilience in the round – both in their current activities and for the long-term in their PR19 plans.

Resilience in the round is more than just operational resilience. We published our first 'monitoring financial resilience' report in November, which compared companies on key indicators of financial stability. This also reported on long-term viability statements that companies were required to publish for the first time this year. These set out the risks the companies had considered and the approaches they had used in assessing long-term viability. Companies also had to report on their compliance with our Board leadership, transparency and governance principles – and we assessed this as part of our 'company monitoring framework' assessment.

8. Sufficiency of company action to help customers struggling to pay bills

The single most important role for companies to help customers struggling to pay their bills is to be as efficient as possible. Through our Water 2020 regulatory framework for wholesale markets and the 2019 price review we are making better use of markets through the sector to enable efficiency and innovation. We are complementing this with a regulatory framework that will really challenge monopoly companies to do more for less.

We also recognise that, from time to time, customers may find themselves in vulnerable circumstances, including situations where their vulnerability means that they are struggling to pay their bills.

We have made continued progress with companies and stakeholders following the publication last year of our reports on affordability and vulnerability. We require companies to report on their performance in helping customers struggling to pay their bills in their annual reports, including where they have specific performance commitments set as part of PR14. Through Water UK we encouraged water companies to work closely with energy companies to share good practice on support to vulnerable customers. We also participated in the production of a cross-sector vulnerability leaflet through the UK Regulators Network (UKRN). All companies offer social tariffs and are taking steps to increase the number of eligible customers that they reach.

We are working with Ofgem through the UKRN to identify the potential benefits, opportunities and challenges associated with data sharing. Our work builds on the existing good practice by companies and the previous work of regulators. Our aim is to facilitate the targeted, appropriate and proportionate exchange and distribution of information about consumers' vulnerable circumstances across electricity, gas and water. We will report on our progress next year.

Our report for the UK Government on the potential costs and benefits of residential retail competition highlighted a need for companies to provide more help to customers struggling to pay their bills. We worked closely with CCWater to design our customer research, which revealed that more than half of customers have characteristics that could make them vulnerable. We have found that emerging technology in other sectors helps customers to pay their bills and access tailored services. Through our work we raised companies' awareness of opportunities to use technology to benefit all their customers better than they do today.

9. Progress on competition, to ensure this is in step with the Water White Paper and UK Government boundaries

We engaged constructively with Defra and UK government officials to ensure that the regulatory framework facilitates competition for water and wastewater retail services to business customers. We have also ensured that the framework is equipped for the reform of water and wastewater value chains for companies wholly or mainly in England, consistent with the provisions of the Water Act 2014.

For example, our preparatory work as part of the Open Water programme supported the largest competitive retail market in the world opening on time on 1 April 2017.

During the year, we consulted on, developed and implemented a number of the key arrangements to ensure the new retail market opened as planned. These included

- Opening the application process for retail supply licences
- Processing retail licence applications
- Consulting on and formally designating the main documents ('codes') setting out the way the market works.

Co-ordination of this process with government, the market operator and companies was key, and we assisted this through providing guidance on the framework to participants.

We also made a smooth transition from our role in setting up the market to our role as its regulator. Taking account of the experiences of introducing competition in other utility markets in the UK, we put in in place a framework for effective competition with a robust market monitoring framework to ensure we understand how the market is developing and when or where we might need to intervene. The framework includes a Customer Protection Code of Practice, and voluntary codes of practice for Third Party Intermediaries (TPIs), such as brokers or price comparison websites, operating in the market.

A further example of our work to protect customers whilst promoting the market was our final determination of business retail price controls. Our business retail price controls provide additional protections for customers until competition becomes effective.

We also updated our guidance on how we approach the application of the Competition Act 1998 (CA98) to the water and wastewater sector in England and Wales. Our aim is to provide more clarity on how the competition law prohibitions may apply in the sector.

Our Water 2020 regulatory approach published in May 2016, represented great strides in enabling water companies to deliver a step change in efficiency and improving resilience through better use of wholesale markets in bioresources and water resources. Following extensive consultation and engagement the reforms to support new markets in bioresources and water trading, could together provide benefits worth £1.6 billion over 30 years.

Water resources and bioresources working groups with stakeholders helped to develop and inform our thinking, feeding into our publication in April 2017 of our market information consultation and direction document. Our work in this area will stimulate efficient trading of both water resources and bioresources, which will help

to address issues such as water scarcity, reduce the cost of water resources and potentially develop even more low-carbon energy production.

We also proposed that large, mainly infrastructure schemes of over £100 million whole-life totex will be opened up to competition. A 'direct procurement' approach will require water companies to secure services from a third party for such a project.

We prepared a report for the UK Government exploring the potential costs and benefits of residential retail competition. This included a range of scenarios to illustrate the potential benefits, and areas to explore further. It is now for the UK Government to decide whether and how to introduce competition.

10. Effectiveness of the 2014 price review in delivering outcomes sought by customers and other stakeholders

We are now building on the success of the 2014 price review through our ongoing monitoring of company delivery of outcomes and using this to inform the future development of our regulatory framework.

During 2016-17 we published our first report monitoring the overall services delivered by the appointed monopoly water and wastewater companies that deliver services to customers. The aim of this report is to provide information to interested stakeholders on the relative performance of the monopoly companies that we regulate. Customers and other stakeholders can use this information to challenge companies on their performance and encourage them to deliver better services for all. This complements company annual reports and the development of the Discover Water website.

We use the information that companies publish to monitor different aspects of their services. An example of our work includes the determinations we made for the 3 companies with in-period Outcome Delivery Incentives (ODIs). These incentives focus companies' attention on delivering what matters for their customers and act as a balance to companies' financing and cost efficiency incentives. They also compensate customers for poor performance below companies' stretching performance commitments during the price control period rather than simply at the end.

In November 2016 we consulted on how we can build on the PR14 outcomes approach to make companies' performance commitments more stretching (with higher service levels), how ODIs can be strengthened, how we can better reflect resilience in outcomes and how performance commitments can be made more transparent to customers.

We provided early clarity on our expectations that companies will go further to understand the needs of their customers. We set out our expectations in a policy statement that companies will be responsible for carrying out direct local engagement with their customers to understand their priorities, needs and requirements, which should then drive decision making and the development of business plans.

Customer Challenge Groups (CCG) will provide independent challenge to companies and provide independent assurance to us on the quality of a company's customer engagement; and the degree to which this is reflected in its business plan.

A4 List of impact assessments carried out during 2016-17

Water 2020: Regulatory framework for wholesale framework for wholesale markets and the 2019 price review, 25 May 2016

Appendix 4: Draft Impact Assessment for New Connections charging rules, 27 July 2016

Costs and benefits of introducing competition to residential customers in England, September 2016

Water 2020: Final Impact Assessment for New Connections charging rules, Appendix 6: Final impact assessment, 8 December 2016

A5 Review of Board effectiveness

We conducted a Board evaluation during the final quarter of 2016-17. Our Board members completed an assessment questionnaire on Board effectiveness.

The principal finding of the evaluation was that the Board was operating well, with the identification of potential improvements that could be made to continuous learning for board members.

Our Board discussed responses to the assessment questionnaire at their meetings in April and June 2017.

Our Audit and Risk Assurance Committee (ARAC) also conducted an evaluation of:

- its effectiveness against the requirements of the UK Corporate Governance Code; and
- its own work against the Committee's terms of reference.

ARAC and our Board received a report of the results in June 2017.

We intend to conduct an assessment of our Remuneration Committee in the first quarter of 2017-18.

It is the intention of the Board to continue to review its performance and that of its Board Members regularly.

A6 Progress in reducing regulatory burdens

Background

The UK Government introduced the Regulatory Enforcement and Sanctions Act 2008 for the purpose of delivering 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 below.

Report on progress

Programme	How we intend to reduce regulatory burdens
Strategy and Planning	The programme helped us embed our strategy and maximise the benefits we deliver across our portfolio of programmes. This has also helped improve our value for money and reduce the financial burden on companies. See 'Performance summary' on pages 8 to 13.
Casework	We assess the relative merits, costs and potential benefits of issues where we have discretion to investigate. Taking into account the full range of regulatory and 'non-regulatory' options available allows us to determine the appropriate and proportionate approach required – in relation to the context and potential customer detriment that a particular issue poses – to achieve the best overall outcome. For example, see 'Reduced harm and detriment to customers by resolving complaints, disputes and company failures' on page 22 – and 'A2 Performance against stated levels of service' on page 108.
Finance and Governance	Our risk-based approach to monitoring and intervention means that we use a variety of tools that are proportionate to the different risks that customers face. Our informal tools focus on highlighting performance and allowing companies to manage and respond themselves, rather than needing to intervene formally where appropriate. For example, see 'Checked how well monopoly companies are delivering against the promises they made to their customers' on page 17.
Retail Market Opening	The sole focus of the programme was to ensure that the appropriate arrangements were in place to open up the business retail market in England to competition by April 2017. Our work targeted areas of particular risk or uncertainty and ensured the arrangements we put in place were

Programme	How we intend to reduce regulatory burdens
	proportionate. See 'Implemented choice for business, charity and public sector customers in England by 1 April 2017' on page 15.
Water 2020	Following consultation, we are implementing changes to the regulatory framework for wholesale markets and the 2019 price review. There is the opportunity for new arrangements to reduce the overall regulatory burden by removing more prescriptive price and service regulation from parts of water and wastewater service delivery where appropriate and replacing it with either: • more risk-based, assurance focused regulation; or • a greater use of markets. See 'Secured a better long-term deal for customers through new markets in bioresources and water trading' on page 14.
Thames Tideway	We have adapted our regulatory approach to be more appropriate to the specific issues associated with the Thames Tideway Tunnel. We have ensured that in those limited cases where we need to be prescriptive, requirements are proportionate. See 'Encouraged innovative delivery and financing models for large infrastructure projects' on page 25.
Business Transformation	These programmes have helped improve the way we work and deliver value for money. The aim has been to ensure that we delivered best value from licence fees and help reduce the financial burden on companies. See '5. To ensure that Ofwat has the skills, experience, systems, processes and culture that support our new strategy' on pages 25 and 27.
Compliance and Assurance	

A7 Directions given by the Secretary of State under section 27(3) of the Water Industry Act 1991

None

A8 Final and provisional orders made and penalties imposed

None.

A9 Reference of cases or issues to the Competition and Markets Authority

None.

A10 Staff composition 2016-17

Staff recruitment (by gender and ethnic group)

	2016-17			2015-16			2014-15		
Level and salary range	Full-time equivalent staff appointed	Proportion of women (%)	Proportion from ethnic minorities (%)	Full-time equivalent staff appointed	Proportion of women (%)	Proportion from ethnic minorities (%)	Full-time equivalent staff appointed	Proportion of women (%)	Proportion from ethnic minorities (%)
Band 1 – £15,623 to £22,220	0	0	0	0	0	0	0	0	0
Band 2 – £22,221 to £31,448	5	40	60	13	62	23	8	63	13
Band 3 – £31,449 to £47,146	18	50	16	23	39	1	6	33	17
Band 4 – £47,147 to £72,114	19	57	21	20	35	10	5	80	60
Band 5 – £72,115 to £108,171	8	62	12	6	0	0	3	33	0
Total	50	54	22	62	38	8	22	55	23

All figures rounded to the nearest whole number.

Staff in post

Type	31 March 2017	31 March 2016	31 March 2015
Employed staff head count	190	171	147
Agency staff and consultants head count	13	34	7

Employed staff information

Area	31 March 2017	31 March 2016	31 March 2015
Full-time equivalent staff	161	157	136
Proportion of women (%)	47	45	70
Proportion from ethnic minorities (%)	17	14	30
Proportion disabled (%)	1	1	1
Members of the Senior Civil Service	9	8	8**
Number of fixed-term and casual contracts	31	17	11
Number of staff working part-time	31	26	20
Staff turnover (%)	9	11*	10*

*Does not include end of fixed-term contracts, death in service or leavers via voluntary exit or voluntary redundancy.
**Restated in 2015-16.

Staff training attendance (by ethnic group)

Ethnic group	2016-17		2015-16[1]		2014-15[1]	
	Number of training days[2]	%[3]	Number of training days[2]	%[3]	Number of training days[2]	%[3]
White	–	–	–	–	–	–

Other ethnic groups	-	-	–	–	–	–
Unknown	1,673	100	1,361	100	132.5	100
Total number of training days	1,673	100	1,361	100	132.5	100

1. We did not collect information on training days by ethnic group in 2014-15 and 2015-16.
2. Rounded up.
3. Rounded to the nearest whole number.

Staff by gender

Area	31 March 2017	31 March 2016	31 March 2015
Employed staff head count	190	171	147
Number of women	90	78	67
Number of men	100	93	80

Senior Directors by gender

Area	31 March 2017	31 March 2016	31 March 2015
Employed head count	9	6	7
Number of women	3	3	5
Number of men	6	3	2

Members of Senior Civil Service by gender

Area	31 March 2017	31 March 2016	31 March 2015
Employed head count	8	8	7
Number of women	3	2	3
Number of men	5	6	4

A11 Ofwat's compliance with the public sector equality duty

Background

The public sector equality duty (section 149 of the Equality Act 2010) requires public bodies to consider the needs of different groups of individuals when carrying out their day-to-day work. It requires public bodies, in carrying out their work, to have due regard to the need to:

- eliminate discrimination;
- advance equality of opportunity; and
- foster good relations between different people.

The equality duty is supported by specific duties set out in regulations. The specific duties require public bodies, such as Ofwat, to publish relevant, proportionate information demonstrating compliance with the equality duty and to set specific equality objectives.

External

As an economic regulator, Ofwat rarely works directly with individuals but carries out its functions through the way we regulate water companies. So our work to promote equality is largely through our general regulatory approach. We seek to ensure these approaches do not have unintended or disproportionate impacts.

On pages 114 to 132, we summarise the actions we have taken in 2016-17 in relation to the UK Government's strategic policy statement to us, including its social and environmental guidance, and the Welsh Government's social and environmental guidance.

In 2015-16 we published reports on customer affordability and vulnerability, which recommended how companies could respond to these issues and how we as the regulator, and customers themselves, should evaluate companies' behaviour. Building on these reports, in 2016-17 we joined forces with Ofgem and UKRN to identify the potential benefits, opportunities and challenges that may arise from data sharing across water and energy, including sharing information on customers' vulnerability.

As an organisation, we help advance equality of opportunity through access to information. For example, we make publications available in large print and braille formats on request. Our website complies with government guidance on accessibility, including a responsive design which adapts itself to a range of devices. We continue to provide transcripts or subtitles for multimedia content.

We also have a Welsh language scheme and use a scoring system to objectively identify which material needs to be published in Welsh or bilingually. When someone writes to us in Welsh, we reply in Welsh. We will also, if practicable, reply in the same language to correspondence we receive in languages other than Welsh or English.

Our branding guidelines cover our use of things like fonts, colours and logos. It takes into account the needs of people with disabilities such as dyslexia and colour vision deficiency (‘colour blindness’).

Internal

In 2013, we put in place a People Strategy, setting out strong people management practices to make us an employer of choice: one that is attractive to existing employees and prospective candidates because our work, culture, environment and rewards make it a great place to be. We also want a working environment that, among other things, provides a welcoming culture, free from discrimination, and that values diversity and different opinions.

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 our recruitment activity is subject to audit by the Civil Service Commission to ensure that we comply with the guidance in the Civil Service recruitment principles.

By the end of March 2017, diversity e-learning had been undertaken by 98% of our staff. This is part of our commitment to ensure our staff understand and fulfil their obligations under the Equality Act, thereby contributing to a welcoming and diverse working environment.

One of our equality objectives is to put our values at the forefront of everything we do. In 2015-16 we introduced a new set of values and in 2016-17 we have focused on embedding these values. Our values are core to our people management practices such as recruitment, reward and recognition schemes and induction of new staff. In July 2016 employees signed-up to our values at our staff event.

One way we measure our performance is by our staff survey results. Our 2017 People Survey results indicated that our people are more likely to think that we put our values at the forefront of our work (69%) compared to 2015 (57%). This means we are very close to achieving our target and that we are continuing to see an improved trend as we embed our values in everything we do.

Table 22: Equality objectives for 2014-18

Objectives	Measured by	Due date
To put our values at the forefront of everything we do.	There are year-on-year improvements against our key performance indicators. Turnover measures show increases in movement for career progression. At least 70% of our people think colleagues demonstrate our values. There is an improvement in our staff survey responses.	Mostly achieved. Revised to end of 2018 (from 2016).
To provide a working environment that is welcoming, diverse, and supports effective working.	We are recognised as an employer of choice and people seek out opportunities to work here. At least 80% of our people are willing to recommend Ofwat to friends as a good place to work. At least 80% of our people are proud to say they work at Ofwat. We fare well against benchmarked organisations.	By the end of 2018

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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