



Water Services Regulation Authority (Ofwat)

Annual report and accounts 2013-14

For the period 1 April 2013 to 31 March 2014

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

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

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

Ordered by the House of Commons to be printed on 26 June 2014

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About this report

This document sets out our annual report and accounts for the period 1 April 2013 to 31 March 2014.

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

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

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

Further information about our work is available on our website at www.ofwat.gov.uk.

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Chairman's foreword

The year 2013-14 was an eventful one for the water sector in England and Wales, and for Ofwat. In March 2013, as the incoming Chairman, I set out an agenda of six priorities to guide the way that Ofwat would evolve its approach to ensure that the sector continues to be successful. Among these priorities were putting customers' interests at the forefront: customers' respect is hard won and easily lost, and we must never take their needs or their ability to pay for granted. We regulate an enormously important public service and maintaining customer confidence is vital to the legitimacy of all other functions, including ensuring that the sector can efficiently raise capital to finance investment in infrastructure.

I am pleased to report Ofwat's progress on many fronts in 2013-14. Over the past year, many customers continued to face significant pressure on their cost of living. A number of companies listened to our concerns and took steps to share some of the gains they have made as a result of benign economic conditions. Six of them did not take up their allowed price increases for 2014-15, while others committed to further investment.

During the summer, we engaged with the water sector to finalise our methodology

for price setting. Cathryn Ross details in her report some of the many positive changes in the approach for this price review.

Our work on Board leadership, transparency and governance during the year led to a sector-specific set of principles for the Boards of regulated companies. By 31 March 2014, all companies had submitted their governance codes to us, including their plans to reshape their Boards in the light of these principles. We were concerned about risks to customers' confidence in the sector due to the complex holding company structures of some companies. Our work with a group of investors led to a parallel set of principles for the holding companies of the privately owned companies.

It was clear from events in 2012 that Ofwat needed to broaden its engagement with the sector. This year has seen a much more extensive engagement with regulated companies, independent Non-executive Directors, Chairmen and investors. As an example, our team have carried out more than 200 meetings with investors during 2013-14 – in addition to hosting events and conference calls – to explain the changes to our regulatory framework and the 2014 price review process. This is many times the number of meetings held at a comparable time during the 2009 price review.

2013-14 was also a year of internal change and development. Regina Finn left us during the year. We were



Jonson Cox
Chairman

delighted to appoint Cathryn Ross as our incoming Chief Executive in November 2013. We also welcomed four new Non-executive Directors: Christopher Burchell, Christine Farnish, Martin Lawrence and Catherine Waddams. We appointed five new members of the Senior Leadership Team, including Richard Khaldi as an Executive Director. Sonia Brown was promoted to Chief Regulation Officer, with particular responsibility for leading the current price review. I consider the skills and experience we have in place at Board level, from the combination of existing and new members, will equip Ofwat well for the future.

This was also a year of change for the sector. The UK Government's Water Bill, which received Royal Assent in May 2014, announced some of the biggest legislative changes we have seen since privatisation, including introducing choice for all business and non-household customers in England. We welcomed these changes and consider they will further strengthen the changes we have made to our own regulatory framework in making companies more focused on their customers and on the efficiency of their businesses.

As the economic regulator of the sector in both England and Wales, we also respect the guidance of the Welsh Government. During the year, the Welsh Government set out its priorities for how the sector in Wales should develop. Shortly after the end of this reporting year, it released a draft of the Water Strategy for Wales for consultation, which sets out the long-term

direction for its water agenda. We look forward to making progress on the Welsh Government's strategy and priorities for customers in Wales.

Under Cathryn Ross' leadership the Executive and Board are taking forward the work we started in 2013 on our approach to regulating the sector. This year, we expect to complete a forward-looking strategy for Ofwat for the coming years. Cathryn has quickly recognised that Ofwat will need to change its

organisation to implement this strategy and has launched an ambitious transformation plan to ensure

Ofwat operates at the top of its game. The Senior Leadership Team and Board will all be part of the engagement with the sector as we test and refine our strategy.

Finally, I would like to place on record my sincere thanks, on behalf of all members of the Board, to everyone in Ofwat and our partner organisations for the efforts of the past year. We have made progress but there is still more to do. I look forward to further progress over the coming year in placing water customers firmly at the heart of everything we do now and for the future to ensure the continuing success of this vital public service.

**A number of companies
took steps to share
some of the gains
they have made**



Chief Executive's report

This is my first annual report and accounts since my appointment as Chief Executive in November 2013. As a former Senior Director of Ofwat, I am not a newcomer to this sector. But, having been away for a few years, I have a fresh perspective of where this sector has come from – and, crucially, where it has to go next.

It is now 25 years since this sector was privatised. Most people will recognise the improvements in services in that time.

The sector needs to evolve if it is to continue to deliver to customers and the environment

But the sector needs to evolve if it is to continue to deliver to customers and the environment.

These are essential public services and their future depends on maintaining the trust and confidence of customers. Stable, independent economic regulation has a crucial role to play in making that happen. And that means we also need to evolve so that we are always at the cutting edge in facilitating and incentivising the sector's delivery of the outcomes that customers and society care about. Change is never easy and there have been some bumps along the road, but I am amazed at what has been achieved.

Our 2014 price review is an excellent example of our new approach to regulation. Our final methodology for setting

companies' price controls for 2015-20, which we published in July 2013, has:

- encouraged companies to focus more on listening to their customers and delivering the things that really matter to them;
- given the sector space to innovate in products and customer service; and
- allowed us to focus our regulatory interventions on where they are really needed and – crucially – allowed us to step back where we are assured that companies' business plans reflected:

- good information and sufficient evidence;
- extensive engagement with customers and environmental and quality regulators;
- where Boards have been fully engaged; and
- where the outturns are in line with our expectations on costs and the cost of capital.

We were particularly pleased that the business plans that companies sent us in December 2013 demonstrated that they had made a real step change in planning and delivering their businesses to focus on their customers.

But the 2014 price review is just the start. We need to continue to evolve the way we regulate. That is why, during the year, we began to develop our new strategy for regulating the sector. Among other things, our strategy will:

- recognise that water and wastewater are essential public services and put the customer at the centre of everything we do;
- reflect the needs of everyone who benefits from water and wastewater services, including current and future customers, and wider society;
- address the relationship between water and wastewater services and the wider environment;
- understand that, although the regulated water companies have a crucial role to play in delivering what customers need and want, other companies and organisations also have important roles and effects upon, and within, the sector;
- recognise the need for certain standards to be set and maintained – for example, in public health, environmental protection and core levels of service – and Ofwat's role in their delivery;
- focus on Ofwat's role in ensuring effective relationships between water companies, investors and customers;
- continue to harness the benefits of competition and market forces where appropriate to drive efficiencies and give better outcomes for all customers; and
- continue to see Ofwat supporting conditions under which efficient companies can finance their water and wastewater businesses.

We have already had some excellent discussions about our strategy with the many groups and organisations that play an important role in the water sector. And I would like to thank them for the excellent



Cathryn Ross
Chief Executive

response we have received. This engagement will help us determine a strategy that will provide a robust basis for our regulation in years to come.

At the same time, we have also been working hard to ensure that Ofwat – as an organisation – is really at the top of its game. Alongside developing our strategy, we have put in place a business transformation programme to help us deliver our work more effectively and efficiently. This will ensure that what we do, the type of organisation we are and the way we work all give us the confidence and capabilities to deliver against an ambitious strategy.

Finally, I would like to echo and amplify Jonson's thanks to Ofwat's staff and stakeholders for their work during the year. There may be significant challenges on the horizon, but our achievements during 2013-14 gives us a good start to securing the best possible outcomes for customers and the environment now and over the long term.

Our year at a glance

Protecting customers

During the year, we:

- started work on a new strategy, which will continue to place customers at the centre of our work, and drive the sector to deliver the best outcomes for customers – including the environment – now and over the long term;
- challenged monopoly companies to consider whether they need to take up their allowed price increases and rejected an extra increase in the bills of Thames Water's customers; and
- delivered a 2014 price review methodology that gives customers a stronger voice.

Company accountability

As part of our work to ensure that companies are accountable to their customers, we:

- encouraged regulated companies and their owners to improve their Board leadership, transparency and governance;
- delivered a 2014 price review methodology that encouraged companies to take ownership of their business plans; and
- made sure that where monopoly companies identified issues with their performance during 2012-13, that they got back on track.

Improving monopolies

Over the period covered by this report, we have continued to:

- encourage monopoly companies to continue to improve their customer service;
- encourage each monopoly company to develop a high-quality plan for 2015-20 and in the longer term; and
- produced a 2014 price review methodology that has delivered real benefits to customers in identifying substantial cost efficiencies, a lower cost of capital, and more than £2 billion of net benefits associated with setting separate retail controls and encouraging water trading.



WATER WORKS

If one "Utility" is owned rent is 4 times amount shown on dice.

If both "Utilities" are owned rent is 10 times amount shown on dice.

Mortgage Value £75.

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Promoting competition

During the year, we:

- granted nine new appointment variations that will deliver a range of benefits to more than 9,000 household customers;
- contributed to preparations to allow all non-household customers in England to choose their supplier from April 2017; and
- delivered a 2014 price review methodology that should help prepare monopoly companies for the introduction of more competition in England.

Better regulation

As part of our commitment to the better regulation principles of proportionality, accountability, consistency, transparency and targeting, we:

- made rapid progress on implementing a programme to transform Ofwat into a leaner, more focused and more efficient and effective organisation;
- contributed to the launch of the UK Regulators Network, along with eight other regulators – and joined the UK Competition Network, with the Competition and Markets Authority (CMA) and other concurrent regulators; and
- delivered a 2014 price review methodology that reflects better regulation principles in many aspects of our approach.

Sustainable development

Our work on sustainability during the year included:

- challenging the processes companies used to prepare their 25-year water resources management plans in order to check they are following rules for preparing good plans, such as incorporating customers' views;
- encouraging companies to trade water where this the most efficient option for meeting demand; and
- producing a 2014 price review methodology that encouraged companies to consider long-term sustainable options for delivering services.

Our Board



Jonson Cox
Chairman



Cathryn Ross
Chief Executive



Wendy Barnes
Non-executive
Director



Penny Boys
Non-executive
Director



Christopher Burchell
Non-executive
Director



Christine Farnish
Non-executive
Director



Martin Lawrence
Non-executive
Director



Robin Paynter Bryant
Non-executive
Director



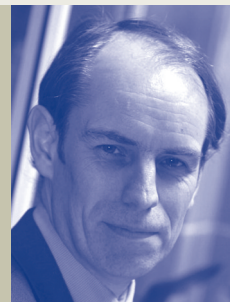
Catherine Waddams
Non-executive
Director



Sonia Brown
Chief Regulation
Officer



Richard Khaldi
Senior Director of
Customers and
Casework



Keith Mason
Senior Director of
Finance and
Networks

Part 1

Annual
report



Protecting customers

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

Taking action now

Despite recent improvements in the general economy, many customers across England and Wales continue to face difficult economic circumstances.

So in October 2013, we called on all monopoly companies to consider whether they needed to take up the rises in prices they were allowed in 2014-15. And in February 2014, we were pleased to welcome the announcement that Affinity Water, Anglian Water, Southern Water, United Utilities, Wessex Water and Yorkshire Water all committed to benefit customers by reducing their allowed bill increases in 2014-15. From 1 April 2014, the average household water and wastewater bill across England and Wales will increase by £8, or 2% – a rise below the Retail Price Index (RPI) rate of inflation.

Also, in November 2013 we announced our decision to turn down Thames Water's application for an additional price increase for 2014-15. This followed its application for an 'interim determination of price limits' (IDoK), which allows companies to ask us to reset their price limits between price reviews as long as certain criteria are met. Thames Water wanted to increase the bills of more than five million of its customers by an extra £29, or 8%, on average. Having assessed the evidence that the company submitted, we found that it had not done enough to justify its

proposed increase. Thames Water decided not to appeal our decision to the Competition Commission.

At the same time as we considered Thames Water's application, in September 2013 we announced that we were looking at the extent to which the company has benefited from wider economic circumstances beyond its control, and whether it could return these gains to customers through an established regulatory process to reset its price limits (the 'substantial favourable effect' mechanism). After considering responses to a short, technical consultation – and Thames Water's acceptance that its investors could absorb cost increases that have occurred in 2010-15 – in February 2014, we decided not to issue a substantial favourable effect notice on the company.

Planning for the future

The continued pressure on household incomes means that the legitimacy to customers of their water and wastewater services – and the bills they pay – will be even more important in future.

In July 2013, we confirmed our plans to give customers a stronger voice in the way prices and

2013-14 highlights

Many customers continue to face difficult economic circumstances

Protecting customers

services are decided. This was part of our final methodology for how we will set the price and service packages ('price controls') the monopoly water and sewerage and water only companies in England and Wales must deliver in each of the five years between 2015 and 2020. Some of the key approaches we used in our methodology to give customers a stronger voice include the following.

- Companies had to develop their business plans by talking to and listening with their customers. This included developing the outcomes – and the rewards and penalties companies receive for delivering or not delivering them ('outcome delivery incentives') – that customers want during 2015-20.
- Each company had to set up an independent customer challenge group (CCG) – a group of customer representatives – to make sure it engaged properly with its customers.
- We used the CCGs' reports – and our own customer advisory panel – to help inform our decisions on the quality of companies' business plans.

Placing customers at the centre of price setting is just one way we are seeking to increase companies' focus on their customers. Good quality information can help customers lower their bills, secure better quality services, and also sustain affordable investment. So in May 2013, we published our final decisions on changes so that companies provide better information to their customers. Our new, principles-led framework takes a risk-based approach that gives companies the freedom to be more innovative and more

responsive to customers' rapidly changing information needs. But with this freedom comes more responsibility for delivery – developments that companies and consumer groups welcomed.

Large infrastructure projects can have a sustained impact on the level of customers' bills. During the year, we continued to review progress on Thames Water's 'Thames Tideway' project, which involves building a large sewer tunnel beneath London. Our work included challenging and reviewing the company's processes for managing risks and estimating the costs of the tunnel to ensure that customers receive value for money. We also worked with Defra, HM Treasury, Infrastructure UK and Thames Water to develop a financing model for the project.

As the economic regulator we have a big role to play in ensuring customers get value for money and the services they want. During the year, we began work on a new strategy, which will, among other things:

- continue to place customers at the centre of our work; and
- help us drive the sector to deliver the best outcomes for customers – including the environment – now and over the long term.

Our initial work has included engaging with the sector and other stakeholders to develop a shared vision on the direction of the sector and Ofwat's future role. We will report on the outcome of this in next year's annual report.



Company accountability

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

Taking action now

In September 2013, we reported that companies received about 12,000 fewer complaints in 2012-13. This was the fifth year in a row that complaints had fallen.

Companies reported that they generally delivered good levels of service to most customers in 2012-13. Yet there are areas they need to improve – in particular, sewer flooding and pollution incidents.

Each company is required to maintain its water and sewerage treatment works, and underground networks of water mains and sewers (its 'assets') to a certain standard so that it can provide reliable services to customers over the long term. We call this 'stable serviceability'. When a company is

not maintaining its assets effectively, there will be a rise in the number of incidents such

as burst water mains or overflowing sewers. So it is important they get it right.

Companies that had less than stable ('marginal') serviceability in 2012-13 are seeking to restore assets to stable serviceability. We will review their progress as part of the 2014 price review (PR14). This includes clawing back

money for customers where companies have not restored their performance.

In 2013-14, we also followed up companies that had identified issues with their environmental performance to ensure they got back on track. If companies fail to deliver the agreed environmental performance, we and the Environment Agency will consider together what action we each need to take to protect the environment and customers' interests.

As well as their obligations to customers and the environment, the companies also have other obligations – including under competition law.

During the year, we continued our investigation into whether Anglian Water abused its dominant position – and infringed the Competition Act 1998 – in relation to pricing for providing water and wastewater services to the 'Fairfield' development site at Milton Keynes, which is in the company's supply area.

We also continued to investigate Bristol Water for potentially abusing its dominant position in the contestable market of providing new water connections through the price and other terms it offers for its services to independent providers ('self-lay organisations'). We will provide an update on both cases in next year's annual report.

Companies received about 12,000 fewer complaints in 2012-13

Company accountability

Planning for the future

Each company has a licence that sets out the conditions under which it is allowed to operate in the water sector in England and Wales. But they also have other obligations.

Water, wastewater and drainage services are essential public services. Most people across England and Wales cannot choose their supplier and must pay to receive services from private monopoly companies. This means that customers' expectations of these companies are high in terms of:

- how well they plan and deliver services ('leadership');
- how open they are about what they do and how they perform ('transparency'); and
- how well they govern what they do ('governance').

Companies that perform well in these areas will help build customers' trust and confidence in the services they receive ('customer legitimacy'). This is vital if customers are to continue to pay their bills and finance the services on which everyone relies.

Our PR14 methodology gives companies' Boards greater ownership of – and responsibility for – how well they deliver for customers and the environment in the long term. While we provided help and support to companies, under our approach, they each took full responsibility for planning their business and listening to their customers, and not simply tick regulatory boxes.

To further encourage companies and their owners to maintain legitimacy, during 2013-14 we:

- developed a set of principles with companies and other stakeholders that represent our minimum expectations for regulated companies in terms of Board leadership, transparency and governance; and
- worked with a group of water company investors to develop the minimum standards we think should apply to the owners of water companies ('holding companies').

Customer legitimacy is vital if customers are to continue to pay their bills

By adopting these principles as a minimum, companies will show that they fully understand and meet the responsibilities of providing an essential public service. Each company has developed its own codes voluntarily by 1 April 2014 – and we expect them to fully meet our principles by 1 April 2015. We have also asked owners to implement our principles by 1 April 2015. We will report on the outcome of this work in next year's annual report.



Improving monopolies

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

Taking action now

In September 2013, we announced that customers contacting their water and sewerage or water only company in 2012-13 received an improved service from them.

We asked 16,000 customers to give us their view on how well their water company did on a scale of 1 to 5 (where '5' indicates they were very satisfied). The average result for all companies in 2012-13 was 4.44. This is the second consecutive year that companies' performance on this measure has improved.

We introduced the level of customer satisfaction in April 2010 as a way of getting companies to improve how they treat customers. It forms part of our service incentive mechanism (SIM), a regulatory tool that focuses on customer experience.

Planning for the future

One of the tools we use to ensure monopoly companies deliver to customers is the five-yearly price review. And in 2014-15, we will set price controls for each of the five years from 2015 to 2020.

In July 2013, we published our final methodology for how we will set price controls in 2014-15. Independent analysis

from PwC showed that changes we have made to our PR14 methodology could bring more than £2 billion in benefits to customers, as well as substantial cost and financing efficiencies. This includes:

- empowering customers today by giving them a stronger voice in how companies deliver services, and how much they pay for them;
- protecting the needs of future customers by ensuring companies plan how they will deliver secure and sustainable supplies over the long term;
- encouraging companies to produce high-quality business plans based on their legal obligations and effective customer engagement – and giving them greater ownership for delivering those plans;
- challenging companies to keep costs low and deliver improved value to customers and the environment;
- ensuring that the balance between risk and reward is sufficiently aligned with customers' best interests;
- maintaining the stability and transparency that investors value and which will encourage them to continue to finance long-term investment; and
- revealing new information from companies to improve how we set price

Changes we have made to our methodology could bring more than £2 billion in benefits to customers

2013-14 highlights

Improving monopolies

controls in future and continue to protect customers' interests.

Based on our methodology, in December 2013, each water and sewerage and water only company in England and

Wales submitted five-year business plans to us.

We then carried out a series of tests on

companies' plans to rate their quality and highlight any areas of risk (our 'risk-based review'). This included looking at:

- each company's proposed key deliverables for consumers, including current and future customers and the environment, and the incentives associated with delivering them;
- the costs, for both wholesale and retail businesses, associated with delivering each company's proposed outcomes;
- how each company's proposals balance risk and the rewards for bearing those risks between consumers, including current and future customers and the environment, and the company and its investors; and
- the impact of each company's proposals on customers' bills, and its ability to finance its functions.

We published the full outcome for all companies shortly after the end of the reporting year.

Overall, we were delighted that the quality of companies' business plans was

significantly better than at the same stage at previous price reviews. We saw evidence of a real change from them with, among other things:

- Boards taking real ownership and accountability for business plans;
- companies going to great lengths to engage with their customers and other stakeholders and to develop business plans that reflected their priorities; and
- more innovative approaches for delivering services to improve resilience and long-term sustainability (see page 26).

The business plans of two companies – South West Water and Affinity Water – really stood out. Both demonstrated that they would deliver outcomes that customers wanted, at bill levels they can afford. So in March 2014, we invited these companies to qualify for 'enhanced status' – subject to them accepting our guidance on risk and reward (see page 29). Both companies accepted, so will now be rewarded with:

- less scrutiny of their business plans;
- financial benefits; and
- earlier decisions on their price controls.

Other non-enhanced companies will follow a different timetable for setting their price controls.

We will make our decisions on all companies' price controls during 2014-15, and will report on this in next year's annual report.

The quality of companies' business plans was significantly better than at previous price reviews



Promoting competition

We make sure that where markets for water and wastewater services exist they operate efficiently and effectively, and deliver benefits to customers and the environment. We also make recommendations to the UK and Welsh Governments where we consider there would be benefits to customers from making changes to markets or introducing further competition.

2013-14 highlights

Taking action now

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

We granted nine appointment variations during 2013-14. More than 9,000 household customers will be supplied at the sites we approved. Customers benefited in the following ways.

- Three of the nine appointment variations offered a discount on the charges they would have paid to their previous supplier. At one of these sites, the new appointee uses rainwater harvesting and recycling to provide a non-drinking water supply. This enables customers, for example, to wash their cars with cheaper water.
- At six of the nine sites, developers are being supplied with water, sewerage, gas and electricity infrastructure by a

single company. So, they only have to deal with one supplier. It also means that the infrastructure is installed together, which can be quicker and cheaper.

- At one of the sites, the developer chose the company it preferred to supply the site.

Water supply licensing is another means by which non-household customers can choose their supplier. During the year, we granted one water supply licence (WSL) to Source For Business Ltd and we revoked Satec's licence. We have seen an increase in the number of applications for WSLs and expressions of interest to apply.

Planning for the future

In June 2013, we welcomed the publication by the UK Government of its Water Bill. The Bill – which received UK Parliamentary approval ('Royal Assent') in May 2014 – will:

- allow all non-household customers in England to choose their supplier for customer-facing ('retail') water and wastewater services by April 2017; and
- introduce competition in England into less customer-facing ('wholesale' or 'upstream') water and wastewater services after 2019.

Promoting competition

Establishing an effective retail market is a complex task that takes a lot of planning. So in 2012, the UK Government established a group of key stakeholders, including us (the 'High Level Group'), to help prepare for a new retail market and other market reforms. The High Level Group (HLG) established the 'Open Water' programme to deliver this work.

In 2013-14, we contributed to the work of the HLG and Open Water. For example, we provided input to Open Water's draft market blueprint, which set out initial plans for the high-level design of the retail market arrangements. We also supported the water sector in setting up a company limited by guarantee – Open Water Market Limited (OWML) – funded by licensed monopoly water and sewerage and water only companies to ensure Open Water's work can continue and to provide a robust governance structure.

We also continued the groundwork in those areas that will be our responsibility in setting up the market. This included the following.

- In 'A level playing field for the water market – a discussion document', which we published in September 2013, we set out why a level playing field is important for an effective market, and the range of regulatory tools available to help us ensure that this happens.
- In 'Water market governance arrangements – a discussion document', which we published in September 2013, we set out some possible arrangements for agreeing market codes and the process for changing them once the new retail market begins.

- In 'Future access pricing in the water sector – a discussion paper', which we published in November 2013, we introduced some of the terminology, concepts and issues we will need to consider in developing new rules to govern the way monopoly companies charge retailers for accessing their services.

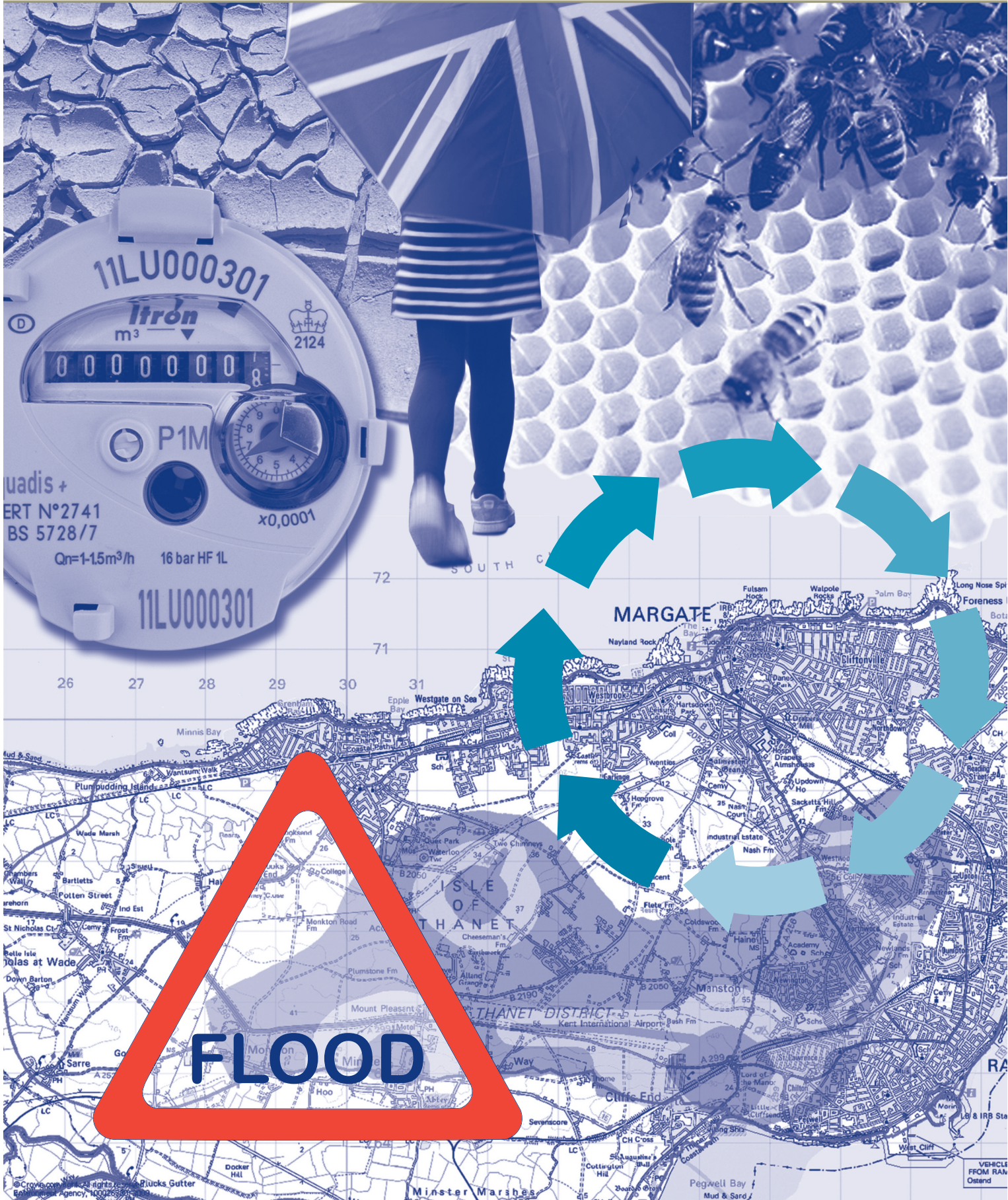
We will report on the progress of this work in next year's annual report.

Our PR14 methodology will also help monopoly companies in England prepare for operating in an expanded market for retail services. For example, we will be setting a separate price control for the services they deliver to non-household customers, which has required them to consider in more detail the price and services that these customers want.

We will report on progress in preparing for the new market in next year's annual report.

The introduction of upstream competition in England will take longer to plan and implement. During the year, we also continued working with the UK Government and other regulators in developing plans in this area – as well as changes to the overall framework governing the removal of water ('abstraction') from the natural environment.

We recognise that the Welsh Government is not currently minded to introduce further competition. We have tailored our regulation accordingly, and will retain specific protections for Welsh customers in the absence of competition.



Sustainable development

We have a duty to contribute to the achievement of sustainable development. We take this duty seriously – considering social, environmental and financial issues together and taking a long-term view is central to our strategy.

Taking action now

Water is one of our most precious resources. Changing weather patterns and a growing population will, among other things, make the delivery of safe, reliable, efficient and resilient water and wastewater services both more challenging and more important.

Each water company must prepare and maintain a water resources management plan (WRMP) that shows how it will manage and develop water resources to balance supply and demand for water over the next 25 years. Companies must review their WRMPs every year, and prepare and revise them every five years.

During the year, we made representations to the Secretary of State for the Environment, Food and Rural Affairs and the Welsh Minister on companies' draft WRMPs. We carried out a high-level review of the processes described in each company's plan against the requirements of the guidance they must follow (the 'Water Resources Planning Guideline'). Among other things, this included

checking that companies used robust processes to:

- consult their customers and other stakeholders in developing their WRMPs; and
- consider options such as trading water, reducing leakage and encouraging water efficiency appropriately – alongside others such as developing new water resources.

Our feedback will help ensure companies select the most efficient and sustainable options to deliver water services in their plans.

To help make delivering sustainable services easier, during the year we published a framework to help the companies negotiate 'bulk supplies' – the trading of water and wastewater services. Also, with the Environment Agency, we developed a framework to help water companies improve their long-term strategies for their drainage systems.

Each water company must show how it will balance supply and demand for water over the next 25 years

2013-14 highlights

Sustainable development

Planning for the future

Our PR14 methodology will encourage companies to deliver safe, resilient and sustainable services and focus on the long-term outcomes their customers value.

- Our targeted rewards and penalties ('incentives') will encourage companies to find more sustainable ways to meet their customers' needs while also

improving resilience. By incentivising water trading, we will encourage companies to make the most

The introduction of a new retail market in England in 2017 will drive innovation in water efficiency

efficient use of this scarce resource by moving water from wetter to drier areas where it is beneficial to do so.

- We have also changed the way companies decide the solutions in which they should invest. At previous price reviews, we treated capital expenditure (capex) and operating expenditure (opex) differently. Some stakeholders considered that, because of this, companies often preferred capital – and carbon-intensive – solutions, even if this is not the best thing for the environment. Under our new total expenditure (totex) approach, both capital and operating costs could be treated in the same way. So, a company that may have preferred to tackle sewer flooding in the past by increasing its underground equipment to store more rainfall during storms might

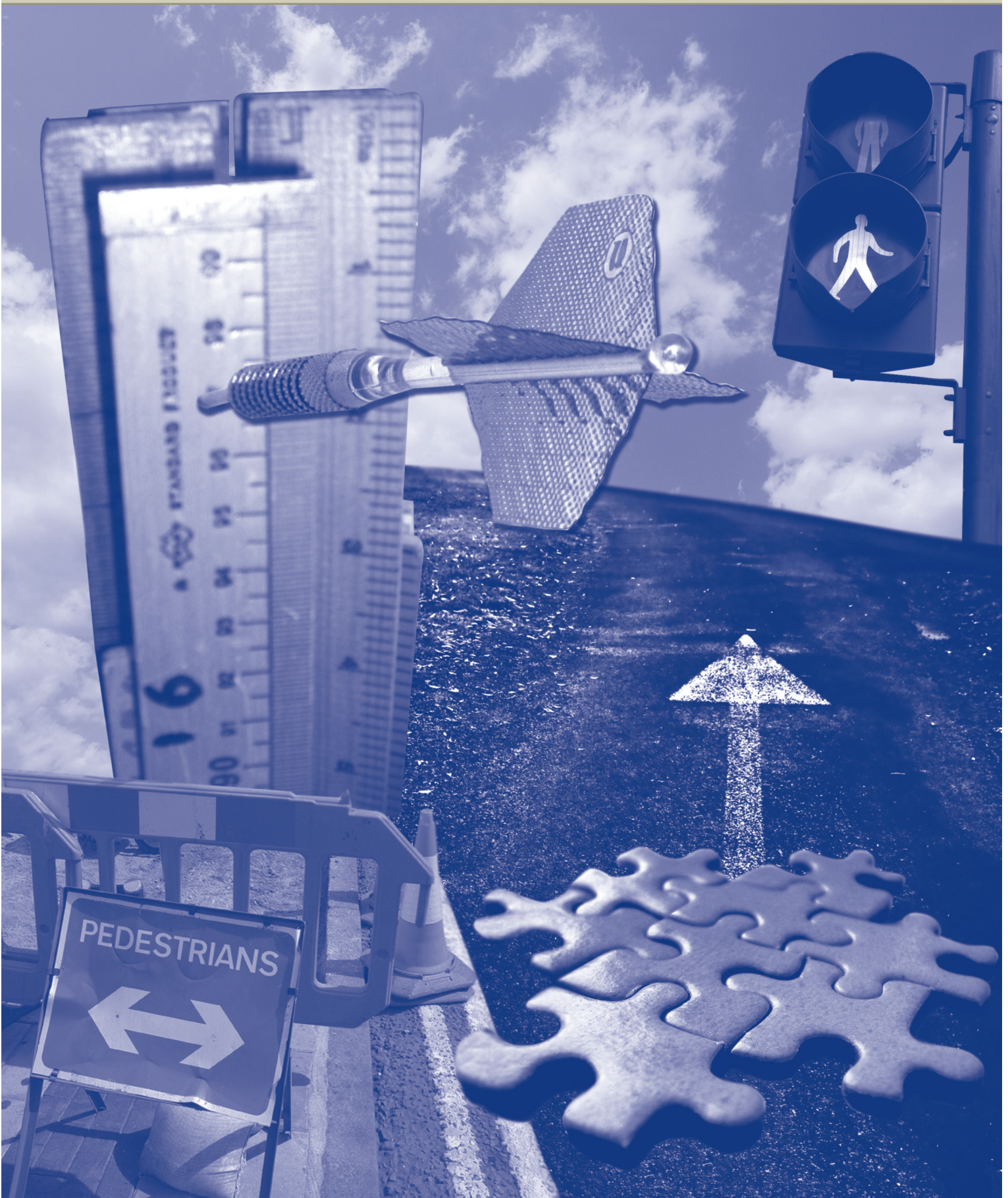
consider other options in future – including working with customers to manage the rainfall close to source, preventing it entering the sewers in the first place.

Through these new incentive arrangements we have already seen many examples of the innovative approaches that companies have taken in their business plans to address future challenges. This includes new proposals for trading water and more sustainable solutions for delivering services, which all have greater customer support.

The UK Government's Water Bill will also provide greater opportunities for more sustainable use of water and other resources within the sector. For example:

- the introduction of a new retail market in England in 2017 is expected to drive innovation in water efficiency techniques at customers' sites, as it has done in Scotland; and
- upstream reforms in England can drive efficiency from increased opportunities for trading water resources.

During the year, we continued to participate in the planning for these reforms (see page 22-23). We also continued to work with the UK Government, the Environment Agency and Natural Resources Wales on long-term changes to the system for managing the abstraction of water out of the environment.



Better regulation

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

Taking action now

The sector must evolve to meet new challenges, which means our regulation framework also needs to evolve to stay one step ahead. Over the past year, we have strengthened and widened the skills and experience of our Board and Senior Leadership Team. This includes appointing:

- four new Non-executive Directors;
- a new Chief Executive; and
- four new members of the Senior Leadership Team.

During 2013-14, alongside our work to develop a new long-term strategy, we began a programme to transform Ofwat into a leaner, more focused and more efficient and effective organisation. The programme has three parts: people management, delivery management and governance. It includes improving our management of:

- people, skills, learning and development, leadership and culture;
- infrastructure and ways of working;
- financial management;
- programme and project management; and
- our wider governance, including risk management.

Among other things, this will ensure we deliver the significant efficiencies and cost

reductions we require to operate within a much tighter budget from 2015-16 onwards. This is when we will be subject to a settlement imposed by HM Treasury through the Comprehensive Spending Review. We will report on the outcome of our strategy and business transformation programme in next year's annual report.

One part of our business transformation programme has been to improve our budget planning and forecasting processes. We identified the need for improvements as part of a review we carried out in this area during the year. This followed our announcement in July 2013 that we needed to increase our budget for 2013-14 part way through the year to pay for significant one-off costs of delivering our new price review methodology. As part of our review, we developed a detailed action plan to make improvements. We have already made significant progress in this area, including:

- improving our approach to programme, project and risk management; and
- developing a stronger financial culture.

A key part of our new strategy, and how we fulfil our role in future, will be greater partnership working and collaboration with government and other regulators to improve outcomes for consumers. That is why during 2013-14 we:

Better regulation

- launched the UK Regulators Network (UKRN), along with eight other economic regulators, to improve co-ordination across regulated sectors to enhance investment and efficiency for the benefit of consumers; and
- joined the UK Competition Network (UKCN), along with the new Competition and Markets Authority (CMA) and all of the other sector concurrent regulators, to promote competition for the benefit of consumers and to prevent anti-competitive behaviour. We look forward to working jointly with them on competition issues, which are likely to increase in importance as we help develop the retail market for water (see pages 19-20).

Planning for the future

A key aim of PR14 is to deliver better regulation in the price controls we set for 2015-20 – and in the processes we use to do it. We have engaged extensively with customer representatives, companies, investors and other stakeholders in developing our methodology. And many aspects of our methodology reflect the better regulation principles. We highlight some examples below.

- **Accountable.** We wanted companies to take full responsibility and accountability for planning and managing their business. So we did not set detailed requirements on what we expected them to provide in their business plans – other than specific information we needed to set price controls.
- **Targeted.** We are setting separate price controls for different parts of each company's business. Targeting price controls will allow us to set better rewards and penalties ('incentives') for different parts of the business to encourage companies to improve the services they offer to customers and the environment – and the price they do it for. For example, our 'non-household retail price control' will encourage companies in England to prepare for when all non-household customers can choose their supplier. Subject to legislation, this is expected to happen in 2017.
- **Proportionate.** Our risk-based review (see page 26) allowed us to focus on those areas and those companies where the biggest risks are for customers and the environment.
- **Consistent.** We want to make sure the overall price controls we set deliver the best possible outcome for current and future customers. As part of our initial risk-based review tests of companies' business plans (see pages 19-20) we found that companies' proposed packages for dealing with risk and setting rewards and penalties were not aligned with market evidence. So in January 2014, we issued further guidance to all companies on risk and reward, including our view on the cost of capital and other key financial parameters. All companies will need to accept our guidance in 2014-15 as part of our price controls.
- **Transparent.** We recognise the importance of being transparent about how we make our decisions during our price review – for example, in providing confidence to customers, investors, companies and other stakeholders that our decisions are balanced. This is why, as part of our announcement about the outcome of our risk-based review, we published the documents and other evidence our Board used to decide the quality of each company's business plan.

Part 2

Resource accounts

Management Commentary

Strategic report

Ofwat's annual report (pages 12 to 29) and associated appendices (pages 117 to 135) form part of the Strategic Report and contain information on:

- Ofwat's key activities and performance and during 2013-14;
- Ofwat's employees; and
- social, community and human rights issues.

Ofwat's strategy

Ofwat is currently reviewing its long-term strategy for regulating the water sector in England and Wales, which we aim to publish in the final quarter of 2014. Our aim remains to develop a strategy that helps us stay at the top of our game: helping all parties with an interest in water and wastewater.

Further information on our strategy refresh can be found in our forward programme for 2014-15.

Details of our current strategy, 'Delivering sustainable water – Ofwat's strategy', are available on our website.

Financial commentary

The financial highlights for Ofwat are summarised below.

Operating costs summary

	2013-14 £000	2012-13 £000
Income		
Deferred income from prior periods	–	3
Licence fees received	23,848	18,934
Other income	193	13
	24,041	18,950
Expenditure		
Administration costs	(27,939)	(20,098)
	(27,939)	(20,098)
Net operating cost	(3,898)	(1,148)

Core regulation budget

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

The core regulation operating budget set at the start of the year was £21.5 million. At the beginning of the financial year, we recovered £19.7 million in general licence fees and had secured approval from the Chief Secretary to draw a further £1.8 million from the Reserve. This reserve claim was made within our permitted flexibility associated with the accumulated balance of unspent licence fees; £4.2 million at 31 March 2013.

The 2014 price review (PR14) involves substantial change in how Ofwat regulates the water sector. The changes are expected to bring major benefits for customers, the environment and the economy. The new methodology was published on 25 July 2013, and therefore did not align with the budgetary cycle, meaning that the total costs of delivering the new methodology could not be fully understood at the time the 2013-14 budget was set.

This resulted in additional funding being required and a further reserve claim for £2.4 million was approved by the Chief Secretary in July 2013 and a special licence fee of £3.2 million was recovered from companies in August 2013. Later changes in the PR14 risk-based review process were announced in December 2013 and led to some re-phasing of activity between this and the next financial year. As a result, £0.85 million of the special fee was returned to companies via a credit note at 31 March 2014.

When announcing the additional funding requirement on 25 July 2013, Ofwat committed to carefully review, through its Audit and Risk Assurance Committee and Board, why the full resource requirements were not forecast earlier in the budgeting and planning cycle and identify lessons to improve future forecasting and budgeting. Further details on Ofwat's budget lessons learned are included in the Governance Statement on page 69. The total call from the Reserve for 2013-14 was £4.2 million, an amount equal to the total balance associated with accumulated unspent licence fees from previous years.

In October 2013, Ofwat consulted with companies on a section 13 proposal to modify company licence condition N. This sought to raise the specific cap included in company licences by increasing the element linked to companies' turnover from 0.1% of each company's turnover to 0.3% of that turnover. This proposal was accepted by all companies and will enable us to recover the increased costs of delivering the price review in 2014-15. Ofwat will operate within the Comprehensive Spending Review settlement from 1 April 2015.

The underspend against the core regulation budget at 31 March 2014 was 3.5%, in the main relating to the re-phasing of activity between financial years of the price review following changes to the risk-based review process.

Thames Tideway project

The regulation of the Thames Tideway project is funded under a separate licence. Its budget was £1.5 million with a final outturn of £1.3 million, funded through two special fees recovered from Thames Water Utilities Ltd.

Thames interim determination of price limits (IDoK)

We recovered a special fee of £519 thousand from Thames Water in January 2014 in respect of expenditure incurred by Ofwat for processing Thames Water's IDoK application. Further information on the final determination of Thames Water's IDoK application can be found on our website.

Capital expenditure

Capital expenditure is funded by budget cover, which has been agreed with HM Treasury, recorded within Ofwat's Main and Supplementary Estimate. The underspend against capital budget is 3%, which relates to unspent contingency budget ring-fenced for leasehold improvement expenditure relating to fitting out a new London office. We have no capital commitments at 31 March 2014.

Provisions

In July 2013, Ofwat entered into a contract with PwC as its Delivery Partner for PR14. The contract includes two incentive payments intended to secure good value for money from the Delivery Partner contract. As a result of these incentive mechanisms, we have provided for £701 thousand which represents the estimated maximum possible incentive payment due upon satisfactory completion of the risk-based review, which concluded on 4 April 2014. Following completion of an assurance exercise, we expect to make a recommendation to the Ofwat Board about whether the incentive payment, or part of it, is due in June 2014.

Recognising a need to change the organisation, Ofwat initiated a Business Transformation Programme in the second half of 2013-14. As a result of the programme, a voluntary exit scheme ran during March 2014 which requires a new provision of £328 thousand to be created to cover the costs of compensation payments due in 2014-15.

We continued to draw on provisions made in 2009-10 to cover redundancy and early retirement costs. An increase of £1 thousand was made to this existing provision for early departures in respect of inflation increases to pensions.

Details of our movements in provisions are detailed in note 13 to the accounts.

Employee involvement

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

Equal opportunities policy

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

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

All recruitment activity is subject to audit by the Civil Service Commissioners to ensure that we comply with the guidance set out in its recruitment code.

During the year, we carried out 32 separate competitive recruitments, off-setting 16 staff who left (excluding the voluntary exits, through which 11 staff agreed to leave the organisation in 2014-15), which in some cases sought to appoint more than one individual. Everyone was recruited through open competition.

Sustainability report

Summary of performance

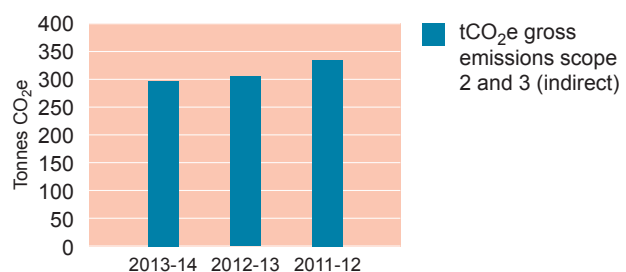
As a small department (<250 staff) Ofwat is not mandated to produce a Sustainability Report. However, because of our role in a regulated sector with a major environmental

impact, Ofwat has voluntarily undertaken to provide a report. The report below follows the guidance issued by HM Treasury.

Ofwat occupies two buildings – in Birmingham and London, respectively. We moved to our new office in London during 2013-14 so the data below is for our Birmingham office only.

Greenhouse gas (GHG) emissions		2013-14	2012-13	2011-12
Non-financial indicators (tCO ₂ e)	Total gross emissions	295.6	304.16	333.61
	Total net emissions	295.6	304.16	333.61
	Gross emissions scope 1 (direct)	–	–	–
	Gross emissions scope 2 and 3 (indirect)	295.6	304.16	333.61
Related energy consumption (million kWh)	Electricity – non-renewable	0.427	0.476	0.534
	Electricity – renewable	–	–	–
	Gas	–	–	–
	LPG	–	–	–
	Other	–	–	–
Financial indicators (£000)	Expenditure on energy	53	57.8	51
	CRC licence expenditure (2010 onwards)	0.95	1.29	1.29
	Expenditure on accredited offsets (for example, GCOF)	1.64	1.96	–
	Expenditure on official business travel	337	299	274

Greenhouse gas emissions



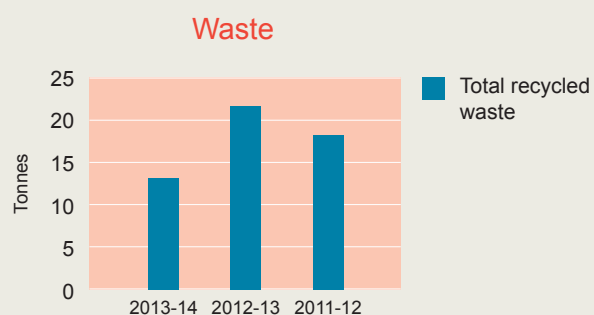
Performance commentary (including measures)

GHG conversion factors for electricity use have changed during this reporting year; data for previous years has been restated to reflect this change and ensure consistency. Emissions relating to air conditioning had previously been reported under scope 1. This has also been adjusted to scope 2 for each of the reporting years. Electrical use accounts for 217.25 tCO₂e. Travel accounts for 78.35 tCO₂e in 2013-14.

Controllable impacts commentary

We have installed new energy efficient devices in our Birmingham server room and offices (multi-function devices), which has improved energy efficiency during the latest reporting period.

Waste		2013-14	2012-13	2011-12	
Non-financial indicators (tonnes)	Total waste	13.45	21.8	18.5	
	Hazardous waste	Total	–	–	–
	Non-hazardous waste	Landfill	–	–	–
		Reused/recycled	13.45	21.8	18.5
		Composted	–	–	–
		Incinerated with energy recovery	–	–	–
Financial indicators (£000)	Total disposal cost	4.1	5.8	8	
	Hazardous waste	–	–	–	
	Non-hazardous waste	Landfill	–	–	–
		Reused/recycled	4.1	5.8	8
		Composted	–	–	–
		Incinerated with energy recovery	–	–	–
	Incinerated without energy recovery	–	–	–	



Performance commentary (including measures)

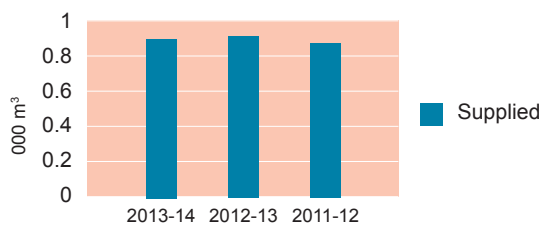
All general waste is segregated for recycling or landfill disposal. We are unable to accurately measure this type of waste as it is disposed via a central collection point in a multi-tenanted building. Our paper waste is recycled, accounting for 13.45 tonnes/£4.1 thousand.

Controllable impacts commentary

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

Finite resource consumption		2013-14	2012-13	2011-12	
Non-financial indicators (000 m ³)	Water consumption (office estate)	Supplied	0.913	0.923	0.889
		Abstracted	–	–	–
		Per FTE	0.00475	0.00518	0.00393
	Water consumption (non-official estate)	Supplied	–	–	–
		Abstracted	–	–	–
Financial indicators (£000)	Water supply costs (office estate)	0.2	0.2	0.2	
	Water supply costs (non-office estate)	–	–	–	

Water consumption (office estate)



Performance commentary (including measures)

Metered usage for the 2013-14 period indicates an average consumption of 4.75m³ per FTE.

Controllable impacts commentary

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

Overview of influenced impacts

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

Offices

Ofwat has two offices. We hold the direct lease for four floors within a multi-tenanted building in Birmingham, and lease our London office space under a Memorandum of Terms and Occupation (MOTO) from Sports England.

Ofwat owns no property.

Publications

Since 2006, we have carried out the design and printing of our publications and other materials at Ofwat. This has delivered significant cost savings. We have also managed to use materials and other resources more efficiently by:

- only printing what we need ('on demand printing'); and
- using our website as our main tool for communicating with our stakeholders ('web-based publication').

Travel

The use of trains is already the principal means of Ofwat's business transport and we invested in wider video conferencing facilities at our new London office in March 2014 to reduce our travel requirements.

Future plans

Ofwat will continue to investigate ways in which it can further improve its energy and water efficiency and wherever possible adhere to Government guidelines.

Reconciliation of resource expenditure between Estimates, Accounts and Budgets

Ofwat prepares resource accounts under section 5 of the Government Resources and Accounts Act 2000 and authority for us to incur expenditure is provided by Parliament through the public expenditure process. We are required to include a reconciliation of resource expenditure between Estimates, Budgets and Accounts.

	2013-14 £000	2012-13 £000
Net Resource Outturn (Estimates)	3,975	3,126
Total Resource Outturn (Budgets) of which:	3,898	1,148
Departmental Expenditure Limits (DEL)	3,898	1,148
Adjustments include:		
Actuarial loss	204	99
Net Operating Costs (Accounts)	4,102	1,247

The Estimate is a statement of Ofwat's budget for the coming year and for what purposes it is required, for which parliamentary authority is sought. This will include our cash receipts generated by licence fee income.

The Resource Budget is the means by which the Government plans and controls the expenditure of resources to meet its objectives.

Going concern

The statement of financial position at 31 March 2014 shows negative taxpayers' equity of £6.7 million (2012-13: £4.3 million). In common with other government departments, the future financing of Ofwat's liabilities are accordingly to be met by future grants of Supply and the application of future income, both to be approved annually by Parliament. There is no reason to think that future approvals will not be forthcoming. Accordingly, it has been considered appropriate to adopt a going concerns basis for the preparation of these financial statements.

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

Cathryn Ross
Accounting Officer
23 June 2014

Director's Report

Roles and responsibilities

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

The Board has a Non-executive Chairman, and during 2013-14 had seven Non-executive Directors and four Executive Directors, including the Chief Executive who is the Accounting Officer.

Membership of Ofwat's Senior Leadership Team is disclosed in the Remuneration Report.

Company directorships and other significant interests held by Ofwat Board members

Chief Executive

Cathryn Ross (from 14 October 2013)

(Member of the PR14 Programme Board from 14 October 2013)

Other current appointments include Director of Oxford Economic Consulting Ltd. Former appointments include Executive Director of Markets and Economics at the Office of Rail Regulation (until October 2013), and Director of Markets and Economics at Ofwat (2008-11).

Regina Finn (until 8 November 2013)

Current appointments include Non-executive Chair of Mutual Energy Limited, Non-executive Director of the Channel Island Competition and Regulatory Authority (from 1 June 2013), Director of Lucerna Partners (from 10 November 2013) and Non-executive Director of Irish Water from 11 November 2013. Appointments taken up by Regina Finn after leaving Ofwat are subject to Business Appointment Rules and clearance in accordance with those rules.

Non-executive Directors

Jonson Cox

(Board Chairman, Chairman of the Nominations and Governance Committee from 16 July 2013, Chairman of the PR14 Programme Board, member of the Remuneration and People Committee)

Other current appointments include Chairman of Coalfield Resources plc and its associate Harworth Estates Property Group Ltd, and Non-executive Director at Wincanton Plc.

Former appointments include Chairman of UK Coal plc, Group Chief Executive Officer of Anglian Water Group Plc (2004-10), Chairman of Morrison plc, Chief Executive Officer of Valpak (2002-03), Chief Operating Officer of Railtrack (2000-01) and Managing Director of Yorkshire Water (1996-2000) and Kelda Group (1994-2000).

Penny Boys CB (until 31 March 2014)

(Chair of the Audit and Risk Assurance Committee until 15 July 2013, Chair of the Casework Committee from 16 July 2013, Chair of the Open Water Committee from 16 July 2013, member of the Nominations and Governance Committee from 16 July 2013)

Other current appointments include Member of the Membership Selection Panel Network Rail Ltd, Non-executive Council Member of the Competition Commission and Member on the National House Builders Council Consumer Committee.

Former appointments include Member and then Deputy Chair of the Horserace Betting Levy Board (2006-11) and Executive Director of the Office of Fair Trading.

Robin Paynter Bryant

(Member of the Audit and Risk Assurance Committee from 16 July 2013, member of the Remuneration and People Committee until 15 July 2013)

Other current appointments include Partner of The Trinity Column Partners LLP, a firm authorised and regulated by the Financial Conduct Authority and Non-executive Director of Go Modern Ltd.

Former appointments include Non-executive Director of Prime International Investments Group Plc, listed on London PLUS-SX, and Director of The Trinity Column Ltd.

Wendy Barnes

(Chair of the Audit and Risk Assurance Committee from 16 July 2013, Chair of the Remuneration Committee until 15 July 2013, member of the Audit and Risk Assurance Committee until 15 July 2013)

Other current appointments include Director of the Enterprise Board of Chester Cathedral, Director and Shareholder in Practiq Consulting Ltd, Non-executive Director at Foreign and Commonwealth Services, Non-executive Director with the Met Office, Non-executive member of BMT Group and external adviser to Templar Executives.

Former appointments include Director with United Utilities, then North West Water (1989-2003).

Christopher Burchell (from 1 May 2013)

(Member of the Remuneration and People Committee from 16 July 2013, member of the Nominations and Governance Committee from 16 July 2013, member of the PR14 Programme Board from 16 July 2013)

Other current appointments include Managing Director of Southern Railway, Fellow of the Chartered Institute of Logistics and Transport, and Fellow of the Institution of Railway Operators.

Martin Lawrence (from 1 May 2013)

(Chairman of the Remuneration and People Committee from 16 July 2013, member of the Nominations and Governance Committee from 16 July 2013, member of Open Water Committee from 16 July 2013)

Other current appointments include Council Member of the Energy Institute.

Former appointments include Chairman of the Association of Electricity Producers (2009-12), Board member of Energy UK, Director at EDF Trading, and Managing Director at EDF Energy.

Catherine Waddams (from 1 May 2013)

(Member of the Casework Committee from 16 July 2013, member of the PR14 Programme Board from 16 July 2013)

Other current appointments include Professor in Norwich Business School, Member of the ESRC Centre for Competition at the University of East Anglia, Joint Academic Director of the Centre on Regulation in Europe and Member of the Consumer Expert Panel of the Office of Rail Regulation.

Former appointments include part-time reporting member of the UK Competition Commission (2001-09).

Christine Farnish (from 1 January 2014)

Other current appointments include Non-executive Director at ABTA, Non-executive Director at Brighton and Sussex University Hospitals, Chair of the Peer to Peer Finance Association, Civil Service Commissioner, Non-executive Director at Aggregate Industries (until 31 March 2014) and Chair of Consumer Futures (until March 2014).

Former appointments include Managing Director at Barclays, Chief Executive Officer at the National Association of Pension Funds, and Former Consumer Director at the FSA and OFTEL.

Non-executive Directors' terms of appointment

The terms of appointment for Ofwat's Non-executive Directors are as follows.

	Appointment date	Appointment end date
Jonson Cox, Chairman	1 November 2012	31 October 2015
Penny Boys	1 April 2006	31 March 2014
Robin Paynter Bryant	24 January 2012	23 January 2016
Wendy Barnes	7 February 2012	6 February 2016
Christopher Burchell	1 May 2013	30 April 2016
Martin Lawrence	1 May 2013	30 April 2016
Catherine Waddams	1 May 2013	30 April 2016
Christine Farnish	1 January 2014	31 December 2016

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.

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.

Richard Kennett (Chartered Accountant)

(Member of the Audit and Risk Assurance Committee)

Independent member of the Audit and Risk Assurance Committee of Hanover Housing Group. Council Member of the Health and Care Professions Council, where he is the Chairman of the Audit Committee. Non-executive Director of a West End theatre group. Financial Reporting Council – Professional Discipline Tribunals member. Chartered Institute for Securities and Investment – Disciplinary Panel member.

Philip Marsden (from 1 November 2013, Competition Lawyer)

(Member of the Casework Committee)

Senior Research Fellow at the British Institute of International & Comparative Law. Non-executive Director on the Board of the UK Office of Fair Trading. Non-executive Director of the Channel Island Competition and Regulatory Authorities.

Pension liabilities

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

The retired Directors General are covered by 'by-analogy pension schemes' that offer similar benefits to the PCSPS. However, unlike the PCSPS a pension liability is included in the accounts as required by IAS19. Further details are provided at note 1.13 of the accounts and within the remuneration report on page 55.

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 on our highly paid and/or senior off-payroll engagements.

Table 1: For all off-payroll engagements as of 31 March 2014, for more than £220 per day and that last for longer than six months

	Number of arrangements
Existing at 31 March 2014	5
Existed for less than one year at the time of reporting	3
Existed for between one and two years at the time of reporting	2

All five existing off-payroll engagements, outlined above, have at some point been subject to a risk-based assessment as to whether assurance is required that the individual is paying the right amount of tax and, where necessary, that assurance has been sought.

Table 2: For all new off-payroll engagements, or those that reached six months in duration, between 1 April 2013 and 31 March 2014, for more than £220 per day and that last for longer than six months

	1 April 2013 to 31 March 2014
Number of new engagements for more than £220 per day and that last longer than six months	11
Number of new engagements that include contractual clauses giving the department the right to request assurance in relation to Income Tax and National Insurance obligations	10
The number for whom assurance has been requested	11
The number for whom assurance has been requested and received	10
The number for whom assurance has been requested and not received	1
The number that have been terminated as a result of assurance not being received	–

In the single case where we have engaged without including a contractual clause allowing us to seek assurance as to the individual's tax obligations, this was as a result of the standard framework terms and conditions having not been updated by the framework manager. At the time we became aware that the standard terms and conditions did not include this clause we had already sought and received satisfactory assurance that the individual's tax obligations were being met.

In the single case where we have not received assurance, this is due to us having reviewed the contractor's initial response in late March 2014, and requiring further information before we could satisfy ourselves that their tax obligations are being met.

There is no reason for us to think that the contractor will not be able to provide the additional information requested.

We had no senior off-payroll engagements during 2013-14 for which the post holder held significant financial responsibility.

Sickness absence

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

- three periods of absence in a rolling period of 6 months; and
- four periods of absence in a rolling period of 12 months.

The Positive People Company provide 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.

	2013-14			2012-13		
	Short term	Long term	Total	Short term	Long term	Total
Days lost	618	620	1,231	604	358	962
Percentage lost			6.3%			2.6%

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

A few instances of long-term sickness absence are the main cause for an increase in the overall sickness absence in 2013-14. Short-term sickness absence levels have remained stable. Ofwat's sickness absence figures are below the Civil Service average of 7.6 days per year.

Supplier payment performance

Following a commitment to improve performance in supplier payments in 2013-14, we achieved 93.92% against our target for paying 100% of agreed invoices within 30 days of receipt. The corresponding figure for 2012-13 was 87.9%.

Protected personal data related incidents

We have an Information Risk Policy (IRP) and related procedures in place to manage the risk of protected personal data related incidents. There were no incidents during the year.

Company membership

Open Water Markets Limited (OWML) is a company limited by guarantee of which Ofwat is a member. Where Ofwat exercises powers as a regulatory member these are limited to our existing legislative powers as denoted in OWML's Articles of Association. Ofwat holds a £1 liability that would become payable should the company become insolvent.

Sonia Brown, Chief Regulation Officer, was appointed as a Non-executive Director of OWML on 11 February 2014.

Financial instruments

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

Internal audit

Grant Thornton was appointed as our internal audit service provider following a competitive procurement in October 2013. Their appointment replaced PricewaterhouseCoopers LLP (PwC), whose contract we terminated due to conflicts of interest risks following PwC's appointment as PR14 Delivery Partner.

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

External audit

Our external auditor is the Comptroller and Auditor General (C&AG), who is required to audit the financial statements under the Government Resources and Accounts Act 2000, and report to Parliament on this examination.

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

The notional cost of this service is £41 thousand (2012-13: £41 thousand).

Irregular expenditure

At the interim audit in January 2014, our external auditors identified two areas of potentially irregular historical expenditure. In both cases, we sought retrospective approval from HM Treasury. Subsequently, the Treasury declined one business case and one severance payment, which was worth £30,289 net (£40,142.68 gross).

Cathryn Ross
Accounting Officer
23 June 2014

Remuneration Report

Senior Leadership Team

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

Cathryn Ross* ^o from (14 October 2013)	Chief Executive
Regina Finn* ^o (until 8 November 2013)	Chief Executive
Keith Mason* ^o	Senior Director of Finance and Networks
Sonia Brown* ^o	Chief Regulation Officer
Claire Forbes (from 24 October 2013)	Senior Director of Corporate Communications
Richard Khaldi* ^o (from 6 January 2014)	Senior Director of Customers and Casework
Beverley Messinger (from 2 December 2013)	Senior Director of Operations
Stuart Crawford (until 31 December 2013)	Senior Director of Corporate Services and Programme Management
Robert Beasley (until 29 October 2013)	Interim Senior Director of Corporate Affairs

* denotes Board member

^o denotes member of the Senior Civil Service

Service contracts

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

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

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

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 Senior Salaries Review Body recommendations. The bonus is paid on the individual's performance. Bonus payments are non-consolidated and non-pensionable.

Each permanent member of the Senior Leadership Team, who is not part of the Senior Civil Service, is remunerated in line with Ofwat's staff remuneration policy.

Sonia Brown was appointed as a Non-executive Director of OWML on 11 February 2014. Other senior managers and Board members have declared that they have no company directorships or significant interests that might have caused a conflict with their Ofwat responsibilities.

Interim directors

In January 2013, we awarded a six-month contract for a value of £72 thousand to Capita Resourcing Ltd T/A Veredus for the service of the Interim Director of Corporate Affairs – Robert Beasley. During 2013-14, the contract was extended until 29 October 2013, to facilitate the external appointment of the permanent Senior Director of Corporate Communications at an additional contract cost of £35 thousand, net of VAT and expenses (total contract cost: £107 thousand net of VAT and expenses).

Staff remuneration policy

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

A non-consolidated bonus may be awarded to staff or teams whose performance is exceptional. Bonus nominations received are considered first by a panel of appointed senior staff who examine the applications for consistency and fairness before making a recommendation to the Senior Leadership Team. The Senior Leadership Team then meets to review and agree all bonus allocations. The annual bonus budget is agreed by the Remuneration and People Committee.

Non-executive Directors remuneration policy

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

Annual report and accounts 2013-14

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)	
	2013-14	2012-13	2013-14	2012-13	2013-14	2012-13	2013-14	2012-13	2013-14	2012-13
Cathryn Ross Chief Executive (from 14 October 2013)	70-75 (full year equivalent 150-155)	–	–	–	2,100	–	15,000	–	85-90	–
Regina Finn Chief Executive (until 8 November 2013)	90-95 (full year equivalent 145-150)	140-145	–	10-15	4,700	10,700	15,000	52,000	110-115	215-220
Sonia Brown Chief Regulation Officer	130-135	125-130	10-15	–	4,000	8,300	66,000	101,000	215-220	235-240
Keith Mason Senior Director of Finance and Networks	115-120	110-115	–	–	–	–	32,000	51,000	145-150	165-170
Claire Forbes Senior Director of Corporate Communications (from 24 October 2013)	35-40 (full year equivalent 95-100)	–	–	–	600	–	18,000	–	55-60	–
Richard Khaldi Senior Director of Customers and Casework (from 6 January 2014)	25-30 (full year equivalent 105-110)	–	–	–	1,400	–	10,000	–	35-40	–
Beverley Messinger Senior Director of Operations (from 2 December 2013)	35-40 (full year equivalent 115-120)	–	–	–	–	–	15,000	–	50-55	–
Stuart Crawford Senior Director of Corporate Services and Programme Management (until 31 December 2014)	90-95 (full year equivalent 120-125)	120-125	–	–	13,800	1,900	32,000	41,000	135-140	160-165
Voluntary redundancy compensation	71	–	–	–	–	–	–	–	–	–
Marian Spain Senior Director of Policy and Communications (until 31 March 2013)	–	85-90 (full year equivalent 100-105)	–	–	–	5,700	–	15,000	–	105-110
Voluntary redundancy compensation	–	95	–	–	–	–	–	–	–	–

2012-13 figures are restated to include PILON costs of £70 thousand, which were provided for in respect of the former Senior Director of Policy and Communications' voluntary redundancy. A further payment of £6 thousand was made to her in 2013-14, in settlement of outstanding annual leave.

The increase in the cost of benefits in kind provided for Stuart Crawford in 2013-14 reflects travel and subsistence costs associated with the business need for greater working from the London office.

Third party payments*

The following information was subject to audit.

	2013-14 payment £000	Restated 2012-13 payment £000
Capita Resourcing Ltd T/A Veredus Robert Beasley, Interim Senior Director of Corporate Affairs (six months from 25 February 2013)	115-120 (contract value 125-130)	15-20 (contract value 85-90)

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

The 2012-13 contract value disclosure has been updated to include the provision for unrecoverable VAT which is attributable to this contract. Expenses incurred by the interim are in addition to the contract value disclosed above.

Non-executive members of the Water Services Regulation Authority remuneration

The following information was subject to audit.

	Restated salary (£000)		Restated benefits in kind (to nearest £100)		Total (£000)	
	2013-14	2012-13	2013-14	2012-13	2013-14	2012-13
Jonson Cox Chairman (from 1 November 2012)	95-100	40-45 (full year equivalent 95-100)	12,100	2,000	110-115	45-50 (full year equivalent 100-105)
Penny Boys Non-executive Director (until 31 March 2013)	15-20	15-20	1,400	2,900	15-20	15-20
Robin Paynter Bryant Non-executive Director	10-15	10-15	100	1,400	10-15	10-15
Wendy Barnes Non-executive Director	15-20	10-15	2,400	2,000	15-20	10-15
Christopher Burchell Non-executive Director (from 1 May 2013)	15-20 (full year equivalent 15-20)	–	–	–	15-20 (full year equivalent 15-20)	–
Martin Lawrence Non-executive Director (from 1 May 2013)	15-20 (full year equivalent 15-20)	–	600	–	15-20 (full year equivalent 15-20)	–
Catherine Waddams Non-executive Director (from 1 May 2013)	15-20 (full year equivalent 15-20)	–	500	–	15-20 (full year equivalent 15-20)	–
Christine Farnish Non-executive Director (from 1 January 2014)	0-5 (full year equivalent 15-20)	–	–	–	0-5 (full year equivalent 15-20)	–

Ofwat's Chairman, Jonson Cox, received an annual London accommodation allowance of £7,196 (2012-13: £950) in lieu of any claim for London hotel accommodation. This allowance was agreed by Ofwat when he became Chairman in November 2012. At the time, Jonson Cox was assured that necessary approvals had been sought but in fact Ofwat had failed to secure the necessary approvals for this allowance from HM Treasury. The Treasury subsequently declined a business case seeking approval for the accommodation allowance. On principle, Jonson Cox chose to repay the allowance in full as soon as the business case was declined, and overnight subsistence costs in London will now be paid in line with the overnight expenses claimable by staff staying with family and friends. Ofwat's Chairman has been poorly served by the organisation's failure to secure the necessary approvals and Ofwat has apologised to him for this.

2012-13 figures have been restated to reflect the repayment of the allowance and to restate the benefit in kind disclosure for the Chairman's accommodation allowance, which was previously classified incorrectly as salary.

Independent members

The following information was subject to audit.

	2013-14		2012-13	
	Salary	Benefits in kind (to nearest £100)	Salary	Benefits in kind (to nearest £100)
Richard Kennett Independent Member	5-10	200	0-5	600
Philip Marsden* Casework Committee Member (from 1 November 2013)	0-5	–	–	–

* Philip Marsden is remunerated per attendance at committee meetings rather than provided an annual salary.

Salary

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

Benefits in kind

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

Bonuses

Bonuses are based on performance levels attained and are made as part of the appraisal process. Bonuses relate to the performance in the year in which they become payable to the individual. The bonuses reported in 2013-14 relate to performance in 2013-14 and the comparative bonuses reported for 2012-13 relate to performance in 2012-13.

Pay multiples

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 2013-14 was £155 thousand to £160 thousand (2012-13: £165 thousand to £170 thousand). This was 4.2 times (2012-13: 4.7 times) the median remuneration of the workforce, which was £37,741 (2012-13: £35,350).

In 2013-14, no employees received remuneration (2012-13: nil) in excess of the highest-paid director. Remuneration excluding senior managers ranged from £4,440 to £126,250 (2012-13: £3,059 to £104,807).

Total remuneration includes salary, non-consolidated performance related pay and benefits in kind. It does not include severance payments, employer pension contributions and 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 2014 and related lump sum £000	Real increase in pension and related lump sum at age 65 £000	CETV at 31 March 2014 £000	CETV at 31 March 2013 £000	Real increase in CETV £000
Cathryn Ross Chief Executive (from 14 October 2013)	20-25 lump sum: 70-75	0-2.5 lump sum: 0-2.5	324	309	7
Regina Finn Chief Executive (until 8 November 2013)	15-20 lump sum: –	0-2.5 lump sum: –	247	219	10
Sonia Brown Chief Regulation Officer	25-30 lump sum: 75-80	2.5-5 lump sum: 7.5-10	316	261	31
Keith Mason Senior Director of Finance and Networks	25-30 lump sum: 85-90	0-2.5 lump sum: 5-7.5	613	546	28
Claire Forbes Senior Director of Corporate Communications (from 24 October 2013)	5-10 lump sum: –	0-2.5 lump sum: –	86	72	7

	Accrued pension at age 65 at 31 March 2014 and related lump sum £000	Real increase in pension and related lump sum at age 65 £000	CETV at 31 March 2014 £000	CETV at 31 March 2013 £000	Real increase in CETV £000
Richard Khaldi Senior Director of Customers and Casework (from 6 January 2014)	0-5 lump sum: –	0-2.5 lump sum: –	5	–	3
Beverley Messinger Senior Director of Operations (from 2 December 2013)	0-5 lump sum: –	0-2.5 lump sum: –	11	–	7
Stuart Crawford Senior Director of Corporate Services and Programme Management (until 31 December 2013)	15-20 lump sum: –	0-2.5 lump sum: –	280	229	29

Pension liabilities

The main pension scheme for Ofwat staff is the Principal Civil Service Pension Scheme (PCSPS). This is a defined benefit, unfunded scheme. The payment of benefits from the scheme is borne by the Civil Service Superannuation Vote. The pension liabilities arising from Ofwat's employees' membership of the PCSPS are not provided for in these accounts in accordance with HM Treasury's instructions and as described on page 100.

A full provision has been made in the accounts for liabilities arising in respect of the by-analogy pension schemes for both the former Directors General as required by HM Treasury (note 13.2). Claims are made on the Exchequer to cover the pension costs that relate to employment other than with Ofwat.

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

Civil Service pensions

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

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

Employee contributions are salary related and range between 1.5% and 6.25% of pensionable earnings for classic, and 3.5% and 8.25% for **premium**, **classic plus** and **nuvos**. Increases to employee contributions will apply from 1 April 2014. 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 their pensionable earnings during their period of scheme membership. At the end of the scheme year (31 March), the member's earned pension account is credited with 2.3% of their pensionable earnings in that scheme year and the accrued pension is uprated in line with Pensions Increase legislation. In all cases, members may opt to give up (commute) pension for a lump sum up to the limits set by the Finance Act 2004.

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

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

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

Cash Equivalent Transfer Value (CETV)

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement

when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies.

The figures include the value of any pension benefit in another scheme or arrangement 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 effectively funded by the employer. It does not include the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement), and uses common market valuation factors for the start and end of the period.

Compensation for loss of office

Voluntary redundancies

During early 2013-14, three functional areas of the business were reviewed. This resulted in four employees leaving under voluntary redundancy terms. They received a compensation payment of between £21 thousand and £92 thousand. Of the four, none took early retirement.

Two of the four received compensation for additional paid annual leave totalling £60 thousand.

The continued use of the restructuring provision set up in 2009-10 is detailed in note 13.1.

Voluntary exits

Ofwat initiated a Business Transformation Programme in the second half of 2013-14. As a result of the programme, a voluntary exit scheme ran during March 2014. Eleven people were approved to leave under voluntary exit terms on 20 March 2014. They will receive a compensation payment of between £8 thousand and £61 thousand in June 2014.

Of the 11 voluntary exits, two took early retirement. The cost to Ofwat of buying out the actuarial reduction of their pension was between £8 thousand and £47 thousand. They did not receive any additional compensation.

The total cost associated with exits under the voluntary exit scheme have been provided for in 2013-14, as detailed in note 13.1.

Ill health retirement

On 29 March 2014, it was agreed that one member of staff would retire early on ill-health grounds, which resulted in £68 thousand of additional accrued pension liabilities. The full cost of the enhanced pension is accounted for by the pension scheme rather than Ofwat and is not represented within these financial statements.

Ex gratia payments

The former Senior Director of Policy and Communications received additional paid annual leave entitlement of two months, equivalent to additional compensation of £24 thousand, when she left the office in January 2013. This amount was disclosed as salary in the 2012-13 accounts remuneration report.

During 2013-14, two members of staff leaving under voluntary redundancy terms received additional paid annual leave representing additional compensation of £60 thousand. HM Treasury judged one of these severance payments worth £30,289 net (£40,142.68 gross) to be irregular.

Ex gratia payments are included within the cost of exit packages in note 3.1 of the accounts.

Cathryn Ross
Accounting Officer
23 June 2014

Statement of Accounting Officer's Responsibilities

Under section 5 of the Government Resources and Accounts Act 2000, HM Treasury has directed Ofwat to prepare for each financial year resource accounts detailing the resources acquired, held or disposed of during the year and the use of resources by 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 of 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; 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 the Treasury.

The Governance Statement

Scope of responsibility

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

Ofwat's duties are laid down by legislation, in particular the WIA91 and the Water Act 2003. Ofwat is a non-ministerial government department.

The purpose of the governance framework

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

The governance framework has been in place in Ofwat for the year ended 31 March 2014 and up to the date of approval of the annual report and accounts, and accords with HM Treasury guidance. Assurance is provided to the Accounting Officer by each member of the Senior Leadership Team, who have signed an assurance statement covering the period from 1 April 2013 to 31 March 2014.

Key elements of the governance framework

The Board

The Board recognises the importance of leadership to create an environment where performance and risk management are effective. In line with the principles of the Code, Ofwat's Board has a majority of non-executives with a Non-executive Chairman, seven Non-executive Directors and four Executive Directors, including the chief executive. The non-executive members are independent of management. The Board membership provides the necessary balance of experience and expertise covering Ofwat's duties and strategy. The Director of Legal Services is Board secretary and legal adviser. Following a recruitment exercise, Elizabeth Hillman has been appointed as General Counsel and will form part of our Senior Leadership Team from 1 May 2014.

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

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

- procedure for conflicts of interest;
- register of Board members' disclosable interests;
- matters reserved to the Board;
- Audit and Risk Assurance Committee terms of reference;
- Remuneration and People Committee terms of reference;
- PR14 Programme Board Committee terms of reference;
- Open Water Committee terms of reference;
- Casework Committee terms of reference;
- Nominations and Governance Committee terms of reference; and
- code of conduct.

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

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

From April 2013 to March 2014.

	Board meetings/ conference calls	Audit and Risk Assurance Committee Meetings	Remuner- ation and People Committee Meetings	PR14 Programme Board Committee	Casework Committee	Open Water Committee	Transitional Nomin- ations Committee
Number of meetings	(13 – 5)	(5)	(2)	(6)	(2)	(1)	(1)
Board members							
Jonson Cox Chairman	13/13 – 5/5	–	2/2	6/6	–	–	1/1
Penny Boys Non-executive Director (until 31 March 2013)	13/13 – 3/5	2/2	–	–	2/2	1/1	1/1
Wendy Barnes Non-executive Director	12/13 – 5/5	5/5	–	–	–	–	1/1
Robin Paynter Bryant Non-executive Director	13/13 – 4/5	3/3	–	–	–	–	1/1

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	Board meetings/ conference calls	Audit and Risk Assurance Committee Meetings	Remuner- ation and People Committee Meetings	PR14 Programme Board Committee	Casework Committee	Open Water Committee	Transitional Nomin- ations Committee
Number of meetings	(13 – 5)	(5)	(2)	(6)	(2)	(1)	(1)
Board members							
Martin Lawrence Non-executive Director (from 1 May 2013)	10/12 – 4/4	–	2/2	–	–	1/1	1/1
Christopher Burchell Non-executive Director (from 1 May 2013)	9/12 - 4/4	–	1/2	6/6	–	–	1/1
Catherine Waddams Non-executive Director (from 1 May 2013)	12/12 – 3/4	–	–	6/6	2/2	–	–
Christine Farnish ¹ Non-executive Director (from 1 January 2014)	3/4 – 5/5	–	–	–	–	–	–
Executive Board members							
Cathryn Ross ² Chief Executive (from 14 October 2013)	7/7 – 3/4	2/3	1/1	4/4	1/2	1/1	–
Regina Finn Chief Executive (Until 8 November 2013)	6/6 – 2/2	1/2	1/1	0/2	–	–	–
Sonia Brown Chief Regulation Officer	12/13 – 5/5	–	–	6/6	–	1/1	–
Keith Mason Senior Director of Finance and Networks	13/13 – 5/5	–	–	6/6	–	–	–
Richard Khaldi ³ Senior Director Customers and Casework (from 6 January 2014)	3/4 – 1/1	–	–	2/2	1/1	–	–

1. Christine Farnish attended the December Board meeting as an observer.

2. Cathryn Ross attended the September Board and sub-committee meetings as an observer.

3. Richard Khaldi attended the November and December Board meetings as an observer.

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

The Board met in Wales in June 2013, using the occasion to meet informally with the Welsh Minister for Natural Resources and Food, and officials of the Welsh Government.

In addition to its formal meetings, the Board held a number of challenge sessions to test emerging thinking on key policy issues and workshops to receive more advanced draft proposals to facilitate discussion and shaping of new policy and developments. These provide a valuable way for the Board to challenge and shape policy and developments ahead of consultation with stakeholders and final decision making. During the year, there were Board workshops on the price review (five workshops), strategy refresh (three workshops), charging arrangements (two workshops), risk appetite, choice and trading arrangements and Thames Tideway Tunnel.

During the year, the Board had six standing committees:

- Audit and Risk Assurance Committee;
- Remuneration and People Committee;
- PR14 Programme Board Committee (from 16 July 2013);
- Open Water Committee (from 16 July 2013);
- Casework Committee (from 16 July 2013); and
- Nominations and Governance Committee (from 16 July 2013).

Each committee is chaired by a Non-executive Director. The Chairman of each committee reports to the Board after each meeting and the Minutes are circulated for information.

Committees of the Board

Audit and Risk Assurance Committee (previously Audit Committee)

In line with the principles of the Code, the Audit and Risk Assurance Committee is chaired by a Non-executive Director. Penny Boys was Chair until 15 July 2013; Wendy Barnes was appointed as Chair of the Committee from 16 July 2013.

The non-executive members who served during the year are Wendy Barnes (until 15 July 2013 as a member of the Committee, as Chair from 16 July 2013), Robin Paynter Bryant (from 16 July 2013) and Richard Kennett (independent member). The Chief Executive, directors, other staff, the external auditors (National Audit Office), the internal auditors (PwC and Grant Thornton), and the Assistant Board Secretary attend by invitation.

The Committee's role is to support the Board in its responsibilities for issues of risk, internal control, and governance and associated assurance. This is done by reviewing the comprehensiveness of assurances in meeting the Board and Accounting Officer's assurance needs, reviewing the reliability and integrity of these assurances, and providing an opinion on how well the Board and Accounting Officer are supported in decision making and discharging their accountability obligations. The Committee met five times during 2013-14. In June 2013, the Committee submitted its annual report to the Board along with its recommendations to approve the annual accounts.

Matters discussed by the Committee in 2013-14 included:

- lessons learned from budget planning and forecasting;
- future of internal audit services across government;
- development and improvement of risk management in Ofwat; and
- risk management reviews on the Thames Tideway programme and Business Transformation Programme.

All of the scheduled internal audit reviews were completed. The 2013-14 internal audit findings were satisfactory and provided substantial assurance. However, it is recognised that the substantial assurance awarded to the procurement review was marginal and only achieved as a result of the improvement work already completed in 2013-14 to improve the function. Continuation of this improvement work and addressing the internal audit findings will be a key focus for Ofwat in 2014-15.

The risk assessment for the 2014-15 financial year remains high. The main areas of risk are:

- reputation and credibility, particularly linked with the successful delivery of PR14 and dealing with any challenges of our decisions;
- the need to deliver a major business transformation programme to enable Ofwat to operate within the Comprehensive Spending Review settlement from 1 April 2015, at the same time as the organisation faces significant delivery pressures associated with PR14; and
- associated risks of stakeholder engagement – with the price review, Ofwat's refreshed strategy and delivery of the Business Transformation Programme.

The internal audit plan for 2014-15 was agreed by the Audit and Risk Assurance Committee at its meeting on 14 May 2014.

Remuneration and People Committee (previously Remuneration Committee)

In line with the principles of the Code, the Remuneration Committee was chaired by a Non-executive Director, Wendy Barnes up to 15 July 2013 and Martin Lawrence from 16 July 2013. The other non-executive members who served during the year were Jonson Cox, Christopher Burchell (from 16 July 2013) and Robin Paynter Bryant (until 15 July 2013). The Committee's role is considering matters relating to the pay and conditions of employment of Ofwat's staff and succession planning. Issues discussed during the year included:

- consideration of SCS pay and bonus arrangements;
- HR metrics;
- scrutiny of people survey outcomes;
- initial consideration of the People Strategy and plan; and
- revisions to the Remuneration Committee's terms of reference, broadening its remit to cover wider people issues.

During 2014-15, the Committee will be focusing on:

- succession planning and development at a senior level;
- consideration of SCS pay and bonus arrangements, including benchmarking of senior pay and determination of future approach;
- oversight of continued development and implementation of the Business Transformation Programme and the People Strategy;
- in particular, scrutiny and monitoring of the delivery and development conversations (Ofwat's new approach to performance management of staff); and
- oversight of the new arrangements for pay and reward.

PR14 Programme Board Committee

In July 2013, the Board established an advisory committee called the PR14 Programme Board.

In line with principles of the Code, the PR14 Programme Board was chaired by our Non-executive Chairman, Jonson Cox. The other non-executive members who served during the year were Catherine Waddams and Christopher Burchell. The Chief Executive and Chief Regulation Officer are also members.

The Committee's role is to:

- provide challenge, support and advice to the Senior Reporting Officer; and
- monitor whether key elements of the PR14 delivery programme are being efficiently delivered.

The Chair of the Audit and Risk Assurance Committee has a role as Programme Management Office sponsor for PR14, and provides advice and support to the Programme Management Office for the price review.

Open Water Committee

In July 2013, the Board established an advisory committee called the Open Water Committee. In line with the principles of the Code, the Open Water Committee was chaired by a Non-executive Director, Penny Boys. The other non-executive member who served during the year was Martin Lawrence. The Chief Regulation Officer attends by invitation.

The Committee's role is to:

- provide challenge, support and advice to the Choice and Trading Arrangements Programme and any relevant successor programme or project, which includes work directly linked to the Open Water Programme; and
- monitor whether key elements of the Choice and Trading Arrangements Programme are being efficiently delivered.

Casework Committee

In July 2013, the Board established a committee called the Casework Committee to make certain final decisions in strategic cases. In line with the principles of the Code, the Casework Committee was chaired by a Non-executive Director, Penny Boys. The other non-executive members who served during the year were Catherine Waddams and Philip Marsden (independent member). During the year, no decisions in strategic cases were made by the Committee.

Nominations and Governance Committee

In July 2013, the Board established a Nominations and Governance Committee. In line with the principles of the Code, the Nominations and Governance Committee was chaired by Ofwat's Chairman, Jonson Cox. The Board Chairman shall not chair the Nominations and Governance Committee when it is dealing with matters relating to the chairmanship of the Board. The other non-executive members who served during the year were Penny Boys, Christopher Burchell and Martin Lawrence. The Chief Executive attends the Committee by invitation.

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.

Independent members of the Casework and Audit and Risk Assurance Committees are appointed, and their remuneration set, by the Chief Executive in consultation with the Chairman. The appointments of Non-executive Directors of the Board are recommended by the Chairman, with the Defra Minister responsible for Ofwat having a power of veto over the appointment of Non-executive Directors.

Senior Leadership Team (previously Executive Team)

The Senior Leadership Team comprises the executive members of the Board and the senior directors. Its role is to assist the Chief Executive in the day-to-day running of the office. It meets frequently and decides on key matters relating to policy, management and resources, subject to the overall direction,

reserved powers and control of the Board. Progress is fed back to each Board meeting in the Chief Executive's report. During the second half of 2013-14, a new Chief Executive and three new senior directors joined Ofwat's Senior Leadership Team. A General Counsel was also recruited, who joined the Senior Leadership Team on 1 May 2014.

During 2013-14, the key focus of the Senior Leadership Team has been on strategy and transforming Ofwat as an organisation, particularly addressing budgetary issues. The other major area of focus has been finalising our PR14 methodology, and putting in place and monitoring arrangements for programme delivery, including the Delivery Partner contract. Senior Leadership Team has also reviewed progress and informed policy on all of Ofwat's other major programmes.

The Senior Leadership Team has been involved in the creation of Open Water Markets Limited, a company limited by guarantee which has been established by the industry to support preparations for the opening of a market for non-household retail customers, which is due to open in 2017 under the Water Act. Sonia Brown, Ofwat's Chief Regulation Officer, is a Non-executive Director of Open Water Markets Limited.

Audit arrangements

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

Our internal audit service provides an independent appraisal service for management by measuring and evaluating the adequacy, reliability and effectiveness of management and financial control systems. Internal audit makes recommendations based on the appraisal of each system reviewed. An annual assurance report is provided to the Accounting Officer and the Audit and Risk Assurance Committee. We have chosen to outsource the provision of the internal audit service to ensure the delivery of wholly independent assurance and fully professional analysis and recommendations.

In October 2014, Grant Thornton was appointed as our internal audit service provider following a competitive procurement. Their appointment replaced PwC, whose contract we terminated due to conflict of interest risks following the award of the PR14 Delivery Partner contract to PwC. The new contract with Grant Thornton was let for a short interim period to 30 May 2014, reflecting Ofwat's intention to participate in the joint regulators' group procurement for the provision of internal audit services. At the conclusion of this process, Grant Thornton won the joint regulators' contract and was appointed as Ofwat's internal audit supplier under that contract from 1 April 2014.

The 2013-14 internal audit was performed in accordance with the Public Sector Internal Audit Standards (PSIAS).

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

Risk management

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

Each strategic risk is managed by a risk owner who is one of the senior directors. The risk management framework is based on HM Treasury standard guidance in the Orange Book. Its key elements are that:

- the goal of risk management is to support the delivery of our strategy;
- risk ownership responsibilities have been clearly allocated from the Accounting Officer and Board to specific members of staff;
- risk appetite is balanced proportionately between threats, opportunities and resources, and factors such as desired outcomes and maintenance of reputation;
- potential risk areas have been identified with mitigating actions for areas such as decision making, failure of quality assurance, inability to recruit the right staff, failure in business continuity, breaches of security, financial procedures and corporate governance;
- project and operational risk registers are reviewed regularly;
- programme and project directors attend the Audit and Risk Assurance Committee to provide briefings on risk management;
- the strategic risk register is updated regularly and reviewed by the Senior Leadership Team;
- reports on strategic risk are prepared quarterly for Board and Audit and Risk Assurance Committee; and
- actions arising from internal audit studies are followed up to the agreed timetable.

Our risk strategy is reviewed annually and updated as required. During 2013-14, we initiated a project to improve Ofwat's risk management. Building on a self-assessment conducted against the Treasury's Risk Management Assessment Framework in October 2013, the plan aims by the end of the 2014-15 financial year to achieve an improved rating by addressing five key objectives to:

- set out Ofwat's attitudes to risk in a clear risk management strategy;
- build capacity by ensuring people are equipped and supported to manage risks well;
- develop robust processes and co-ordination;
- embed a culture of effective and dynamic risk management across Ofwat; and
- be amongst the best at managing risk by learning from other organisations.

Risk environment

The overall risk environment remained high during the year due to the impact of the need to increase our budgets for 2013-14 and 2014-15, and the delivery pressures associated with the significant changes we

have made for the PR14 and the knock-on effects on other areas of work. At the same time, there has been a significant and high-risk programme of work to support the progress of the Water Bill and make preparations for market opening for non-household customers. Internally, we established a Business Transformation Programme, which will overhaul Ofwat and ensure we are best placed to deliver the new strategy that we have started to develop.

The key risks managed during the year were:

- PR14 has required effective risk management to ensure key strategic goals were progressed, both in terms of finalising the methodology for the price review and developing a robust delivery structure. This required significant additional resources and external engagement to ensure the highest risks were mitigated;
- stakeholder engagement and management of reputational risks, and the effective communication and management of the changes being introduced through PR14; and
- specific risks arising from the organisation's reliance on its Delivery Partner, and the need to implement effective mitigations for conflicts of interest risks across the organisation.

Looking ahead, the risk environment remains uncertain with effective risk management an essential component of delivering PR14, Ofwat's new strategy and the Business Transformation Programme. The cumulative impact of these three activities and their associated risks taken together also features large in the risk environment for the coming year. The new Chief Executive commissioned an internal audit review of procurement upon her arrival. Although this provided substantial assurance, it identified a number of risks which will be addressed by increased scrutiny by the Audit and Risk Assurance Committee, a follow-up internal audit, and a procurement theme within the Business Transformation Programme.

Budget lessons learned

The Senior Leadership Team devoted significant attention to learning lessons from the need, midway through the 2013-14 financial year, to increase Ofwat's 2013-14 budget. The budget increased by £5.6 million (from £21.5 million to £27.1 million) to address an under-estimate of the delivery costs of PR14. The under-estimate in part reflected the challenge of finalising very significant policy change arising from the new price setting methodology while developing a robust delivery plan.

The shortfall was bridged through a combination of a special licence fee of £3.2 million (subsequently offset by a credit note returning £0.85 million to companies to reflect re-profiling of price review activity), and approval from HM Treasury to draw down through the Supplementary Estimate an additional £2.4 million from unspent licence fees from previous years in addition to £1.8 million agreed in the original budget. For 2014-15, a licence modification has been agreed with the sector, which has the effect of increasing the licence fee cap using the provisions of Section 13 of the WIA91.

The Audit and Risk Assurance Committee considered the findings of a lessons learned exercise commissioned by Ofwat's Board on two occasions (in September and November 2013). The final report was considered by the Board in December 2013 and published on our website.

The Audit and Risk Assurance Committee is monitoring progress in implementing the report's recommendations, and the Board has been fully engaged in the process of setting the 2014-15 budget, which drew on the changes made in the light of the issues that emerged in the 2013-14 financial year. Ofwat has shared the lessons it has learned with key stakeholders, including HM Treasury, the National Audit Office and Defra, and is grateful for the constructive advice and support they have provided to the Senior Leadership Team and Board.

Information security statement

Ofwat holds a range of information, the majority of which is policy and commercial with a small number of personal information assets. We have an Information Risk Policy (IRP) and related procedures in place which are reviewed through the Security and Information Assurance Group, which provides clear directions and visible management support for security initiatives.

Although the internal audit review did not highlight any significant concerns for 2012-13, it was recognised that the Security and Information Assurance Group had failed to meet in the period. In 2013-14, the group met twice and it our intention that the group meets quarterly from 2014-15. This group provides governance of security, information risk and information assurance and follows up actions on behalf of the Senior Information Risk Owner.

It was identified as a follow up action in 2012-13, that our business continuity policy and plan required updating. This work is now critical for 2014-15, having delayed its implementation due to an unforeseen relocation of our London office. Now we have a permanent London office, we can now develop and agree a comprehensive business continuity policy that covers both the organisation's Birmingham and London sites.

The lack of a comprehensive information asset register in Ofwat was raised in last year's SRMO. The organisation has an information asset schedule in place, which has been reviewed by internal audit, delivering a 'substantial assurance' rating. The schedule and policy have been updated to reflect the recommendations of internal audit. During 2014-15, we will need to conduct a full information asset audit and develop, deliver and put in place robust arrangements to manage all information assets, including those relating to PR14 at the expiry of the Delivery Partner contract.

Our annual security return for 2013-14 was signed by the Accounting Officer (Senior Information Risk Owner) on 9 June 2014 and submitted to the Cabinet Office.

There are no information risk incidents in 2013-14 which require reporting to the Information Commissioner.

Ofwat's effectiveness

Organisational capability

During the 2013-14 financial year, a number of concerns about Ofwat's organisational capability and effectiveness were highlighted. In particular, the budget forecasting problems and the need to raise an

additional licence fee were symptomatic of problems with corporate planning and an organisation in which accountabilities for delivery and budgets within programmes and projects were not always clear. In addition, the administrative errors that led to the need to seek retrospective HM Treasury approval for expenditure in two areas was symptomatic of underlying cultural factors, also identified by Ofwat's internal auditors, of a culture where – at times – delivery took precedence over compliance. Further, it has been necessary to develop a new strategy that will take Ofwat forward, which has prompted a reassessment of the organisation's needs.

These underlying capability issues are currently being addressed: the organisation's leadership has been transformed during the year with a substantially strengthened Board, including four new Non-executive Directors. A new Chief Executive and Accounting Officer started work in October 2013, and she has appointed a largely new and strengthened Senior Leadership Team.

Business Transformation Programme

Without significant transformation, it is unlikely that Ofwat will be a high performing organisation well placed to fulfil its vision and refreshed strategy to deliver for customers and the sector. In addition, Ofwat becomes subject to the Comprehensive Spending Review from April 2015, and significant transformation is required to enable it to deliver within a substantially reduced budget. Although a re-organisation took place as recently as 2011, its benefits have not been as extensive as the organisation required and so a further change programme is needed. During the second half of 2013-14, Ofwat initiated a major Business Transformation Programme focusing on:

- what we do: clarity about areas of work, priorities and strategic alignment;
- how we work: structures for managing people and delivery, in particular addressing weaknesses in planning, programme and project management; and
- who we are: values, capabilities and experience.

The Business Transformation Programme is a key priority, intended to change Ofwat's culture to embed delivery through programmes and projects, with clear accountabilities for outputs, financial planning and management, as well as a better understanding and management of risk.

We made good progress on the programme during the latter stages of 2013-14 by running a successful voluntary exit scheme, delivering significant work to change our people management, programme management, risk management and business planning systems and by conducting an audit of governance arrangements to improve clarity about roles, responsibilities, delegations and decision making. This early progress provides a strong foundation for further transformation during 2014-15.

There is still further work to do. This includes work to develop and implement a new target operating model that addresses the shape of the organisation and its skill mix; that embeds more effective programme and project management; that delivers a major leadership and management development programme; that addresses issues in procurement, budgeting and financial management; that develops our infrastructure and smarter ways of working; and that develops improved internal governance, particularly improved business and operational planning and compliance and assurance.

The pressure to transform Ofwat at the same time as delivering PR14 will demand excellent management of a number of strategic and operational risks. In particular, the scale of the internal and external change agenda will mean we will need to prioritise rigorously, and ensure we do a few critical things really well. As well as delivering changes in systems, we will need to fully embed them across the organisation's culture. The Business Transformation Programme is a major opportunity for Ofwat to develop its capability and confidence in line with its ambition.

Reviewing Ofwat's effectiveness

The Accounting Officer and Board have responsibility for reviewing the effectiveness of the system of performance management and internal control. The evidence of performance and risk management is informed by the work of the internal auditors and the senior managers within Ofwat who have a responsibility for developing and maintaining the internal control framework, and comments made by the external auditors in their management letter and other reports.

The Accounting Officer has been advised on the implications of the result of her review of the effectiveness of the system of internal control by the Board and the Audit and Risk Assurance Committee and has ensured that the Business Transformation Programme will address weaknesses, deliver continuous improvements of the systems that are in place and provide assurance on compliance and governance.

As an Accounting Officer taking over halfway through the financial year, the Chief Executive took assurance for the first part of the year by:

- having a good general awareness of the organisation's internal control systems having worked at Ofwat as recently as 2011 as Director of Markets and Economics; before taking up post, she held numerous meetings relevant to internal control and assurance, particularly with key internal staff, and both our internal and external auditors;
- becoming involved and engaged in key issues before her arrival, particularly early development of the 2014-15 budget and active involvement in the final budget lessons learned report and action plan;
- based on her understanding of internal control and assurance, shaping and initiating the Business Transformation Programme (see below) to address areas requiring improvement;
- ensuring that each Senior Director has completed an assurance questionnaire confirming the existing of appropriate controls for their areas of responsibility;
- discussing the governance statement with the Senior Leadership Team as part of her assurance process prior to signing the governance statement for the year as a whole; and
- based on the engagement before her arrival, commissioning an immediate internal audit review of procurement and initiating a governance audit as part of the Business Transformation Programme.

The vision, mission and goals of Ofwat's strategy provide the basis of its annual priorities, which are set out in and consulted on, in the forward programme each year. This sets out our high-level objectives for the coming financial year plus a look forward to the following two years. This forward programme drives programme and project plans and ultimately each member of staff's objectives. Directors, project managers and team leaders regularly review progress on programme, project and team plans. The Senior Leadership Team and the Board review progress on the strategy and key projects each quarter.

We have a process of individual performance reviews for staff, which we have enhanced as part of our People Strategy and the wider Business Transformation Programme. The resource requirements for Ofwat are assessed regularly in the context of our rolling three-year Strategic Business Plan and the annual forward programme. The Non-executive Directors also provide the Accounting Officer with an independent view of our performance.

The Board, Audit and Risk Assurance Committee and Senior Leadership Team regularly assess and monitor our performance and related systems of internal control. Our internal auditors in 2013-14, PwC and Grant Thornton, review and advised on our risk management processes and internal controls and during the year reviewed systems and procedures in respect of finance and information security.

PwC and Grant Thornton operate to standards defined in the Public Sector Internal Audit Standards and submit regular reports, which include an independent opinion by the Head of Internal Audit on the adequacy and effectiveness of our systems of internal control together with recommendations for improvement. The opinion of the Head of Internal Audit is that Ofwat has adequate and effective risk management, control and governance processes to manage the achievement of its objectives.

The new Accounting Officer has also had to tackle a number of administrative failings that pre-date her arrival. In particular, this has involved seeking retrospective HM Treasury approval for two areas of historical expenditure, which, while relatively low value, were deemed material by their novel and contentious nature and so were outside Ofwat's delegations. HM Treasury did not approve one business case and rejected one severance payment and issued a penalty for Ofwat's failure to seek the necessary approvals. More detail on the business cases is included within the Remuneration Report. Reflecting the Accounting Officer's commitment to addressing the legacy issues which underpinned this irregular expenditure, a Compliance and Assurance Programme has been initiated within Ofwat's 2014-15 programme.

This has been a challenging financial year for Ofwat, particularly as a result of the issues that arose with the budget and irregular legacy expenditure. We have strengthened our internal controls to reflect these issues, and have shared transparently the actions we have taken to address the lessons learned from the budget issues. Despite these specific issues, internal audit reports have covered a wide range of internal control issues, all of which delivered 'substantial assurance'. On that basis, while recognising the issues that need to be addressed through the Business Transformation Programme, and the action already taken to clear up historical poor practice, we are able to conclude that overall internal control is effective.

Cathryn Ross
Accounting Officer
23 June 2014

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 Ofwat for the year ended 31 March 2014 under the Government Resource Accounts Act 2000. The financial statements comprise: the Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity; and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

Respective responsibilities of the Accounting Officer and auditor

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Chief Executive as 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 Resource 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 mis-statement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to Ofwat's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by Ofwat; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the Chief Executive's report and Part 1: 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 mis-statements 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 2014 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 Ofwat's affairs as at 31 March 2014 and of the net expenditure for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Resource Accounts Act 2000 and the Secretary of State directions issued thereunder.

Opinion on other matters

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with Secretary of State directions made under the Government Resource Accounts Act 2000; and
- the information given in the Chief Executive's report, Part 1: Annual report and the Management Commentary 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 part of the Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- I have not received all of the information and explanations I require for my audit; or
- the Governance Statement does not reflect compliance with HM Treasury's guidance.

Report

My report on these financial statements is on pages 77 to 82

Sir Amyas C E Morse
Comptroller and Auditor General
National Audit Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP
23 June 2014

The Report of the Comptroller and Auditor General to the Houses of Parliament

Introduction

The Water Services Regulation Authority (Ofwat) is the non-ministerial government department responsible for the economic regulation of the water and sewerage industry in England and Wales. Ofwat is independent of government and water companies, and is accountable both to Parliament and the Welsh Assembly. Ofwat's remit is to incentivise water companies to provide household and business customers with a good quality service and deliver value for money by:

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

Ofwat's statutory role and duties are currently laid out in the Water Industry Act 1991. These include the need to conduct a price review exercise on the industry every five years. The price review sets the price, investment and service package that water companies can charge to consumers each year. Ofwat is currently undertaking a review which is due to be completed by the end of the year that will set prices for the period 2015-2020.

Under the Government Resources and Accounts Act 2000, I am required to examine, certify and report on Ofwat's financial statements. This involves gathering evidence to satisfy myself that, in all material respects, the expenditure and income shown in the financial statements have been applied to the purposes intended by Parliament.

The purpose of my report

The 2013-14 financial statements cover a period of significant change and challenge for Ofwat. There has been substantial change to the Board and the senior management team including a new Chief Executive Officer. Ofwat is conducting a periodic price review, which has resulted in a significant increase in the Department's workload and additional pressure on the systems of internal control.

The Water Bill 2014, which received Royal Assent on 14 May 2014, has implications for Ofwat and the sector that it regulates. One of the changes is a new retail market for all

non-domestic customers in England. The Open Water programme has been set up to support delivery of the UK Government's vision for the future of water management in England.

My report explains:

- How I have gained sufficient assurance to support my audit opinion at a time of significant change at Ofwat and when Ofwat has seen failures in the systems of internal control;
- How I have assured myself that the additional funds provided by Parliament to support the price review have been properly applied;
- How I have examined regularity concerns in respect of the Chairman's remuneration package and a small number of ex-gratia severance payments;
- The steps taken by the new senior management team and board to address the weaknesses in internal control;
- Significant areas of judgment; and
- The implications of changes as a result of the Water Act 2014.

Failures in the systems of internal control governing financial planning and forecasting

When preparing for the 2014 price review, Ofwat's new senior management team identified that the Department lacked the necessary skills and capacity to complete the required work effectively. The Board therefore agreed that Ofwat should develop an outsourced delivery partner role to provide greater flexibility to deliver the review. The partnership arrangement was put out for tender, which was subsequently won by PricewaterhouseCoopers. As well as lacking the necessary skills and capacity, Ofwat had also failed to include budgetary cover for the partnership element of the price review exercise when it agreed its budget with HM Treasury to cover its published forward programme covering the financial years 2011-12 to 2014-15. The value of the delivery partner contract to support the price review, which will be incurred in 2013-14 and 2014-15, is up to £6.45 million.

Parliament approved a 2013-14 main estimate for Ofwat, allowing the Department to spend £21.325 million of resource and £0.500 million of capital. This budget was insufficient to fund the price review work, Ofwat's normal regulatory activity, and the cost of moving to a new London office, following the early termination of their lease at the Headquarters of the Department for Communities and Local Government. Ofwat therefore requested a supplementary estimate from Parliament to increase the approval

to spend up to £28.525 million of resource and £0.850 million of capital, in aggregate an increase of £7.550 million or 34.6 per cent. Parliament subsequently approved this additional resource, funded from the Treasury reserve, in part by £2.4 million of unspent licence fees which had previously been surrendered to the Consolidated Fund, and an additional special licence fee levied on the industry. The need for such a large supplementary estimate indicates a significant failure in Ofwat's financial planning. Ofwat's Board has set a gross budget for 2014-15 of £29.940 million to cover the remaining costs of the price review and to fund a business transformation exercise to change Ofwat's structure, embed effective systems and processes and improve organisational culture. The net licence fee will be £0.85 million lower, reflecting unspent resources from 2013-14 being returned to the industry.

The failure to properly plan and budget for the costs of what is a regular periodic activity has caused significant financial pressure for Ofwat. In conducting my audit, I have examined in detail the major liabilities which Ofwat is required to meet, to ensure that all those which relate to activities carried out in 2013-14 are reported in the financial statements. I have also examined Ofwat's year-end cut off procedures to ensure that expenditure incurred in 2013-14 has not been deferred to future years. In carrying out my audit, I have also considered the results of the lessons learned exercise carried out by Ofwat, and reported publicly on the Department's website in January 2014.

Failures in the systems of internal financial controls not delegated to Ofwat

Ofwat has undergone periodic restructuring exercises in recent years. This has resulted in staff leaving the Department under voluntary severance arrangements. My work identified that severance payments made to three staff were over and above those permitted by the Civil Service Compensation Scheme and Ofwat's standard contract of employment. The power to grant extra-contractual payments is not delegated to departments, and requires approval by HM Treasury as set out in Managing Public Money. Consequently Ofwat had to make a retrospective application to HM Treasury to gain approval for the extra-contractual element of the payments which totalled £63,000. Without HM Treasury approval, these payments would have been irregular.

HM Treasury granted retrospective approval for two of the cases, however did not approve one case, where a former staff member (but not a member of the Board or Executive Team) received an ex-gratia benefit to the value of £30,000. The benefit comprised a five month period of gardening leave paid in addition to that individual's contractual notice period. I do not consider this to be material in the context of Ofwat's

financial statements and have therefore not qualified my opinion on regularity in this respect.

My audit of the Department's remuneration report identified allowances paid to the Chairman of Ofwat's Board totalling £16,651 including tax and national insurance, in lieu of hotel costs in 2013-14. These allowances were agreed by a former member of Ofwat's Executive Management Team, and were intended to contribute towards the costs of a flat owned by the Chairman in London when he used it on Ofwat business. I considered these payments to be novel and contentious as defined in Managing Public Money, and as a result Ofwat had no delegated authority to make these payments without HM Treasury approval. Ofwat requested retrospective approval for these payments and for an ongoing accommodation allowance for the Chairman both of which were refused. HM Treasury's refusal to approve the payments meant that they were an irregular charge to Ofwat's budget and would have affected my audit opinion on the regularity of Ofwat's financial statements. Having received the payments in good faith, the Chairman has subsequently repaid the accommodation allowances received by him since his appointment. This is disclosed both in the remuneration report and Accounting Officer's Governance Statement. Ofwat takes responsibility for the arrangements that were put in place. The repayment of these amounts means that there are no irregular transactions in this respect.

Governance Statement and actions of the Board and Chief Executive

The matters on which I have reported reflect significant internal control failures during the financial year. It is important that Ofwat learns from the issues experienced this year and develops robust systems of internal control. I therefore welcome the lessons learned review, which examined in detail the failures of the financial planning and forecasting processes. The report has been published on Ofwat's website and shared with stakeholders and other regulators. It includes an action plan to address the causes of the issues that emerged during this reporting year. This is a welcome plan and crucial for Ofwat, as it is likely to face tighter budgetary constraints in the next spending round period. Ofwat has also exhausted the deferred income that it surrendered to HM Treasury in 2012-13, which represented unspent licence fees that it was no longer permitted to retain following the implementation of the alignment project.

Since her appointment in September 2013, the Accounting Officer has begun to set out a revised strategy for the Department to be delivered through a business transformation programme. She has also worked to address the weaknesses in internal control, as well as carrying out the price review. In my view, the Governance Statement provides a

transparent assessment of the difficulties that Ofwat has faced in the financial year. The statement is also supported by assurances provided by Ofwat's management, and by the new Internal Auditor.

Significant areas of judgment

My audit has also examined in detail, some of the main areas of judgment that have impacted on the financial statements in 2013-14. The largest of these relates to the provision in the financial statements for the performance incentive payment that PricewaterhouseCoopers are eligible to earn for the satisfactory delivery of the price review. The contract includes a delivery milestone for the completion of the risk based review by 30 April 2014 at which point a performance payment of up to 15 per cent of the total value of work invoiced in 2013-14 falls due. As a result of my audit, I am content that Ofwat has correctly provided for the incentive payment in accordance with International Accounting Standard 37 (Provisions, Contingent Liabilities and Contingent Assets). I am also content that this expenditure has been incurred in accordance with Parliamentary authority.

In 2014-15, Ofwat may be liable to pay a second element of the contractual performance incentive payment if the price review exercise is successfully completed by December 2014. As the work has yet to be completed, these costs are not reflected in the financial statements.

A further material area of judgment relates to the capitalisation of costs incurred by Ofwat in fitting out new office accommodation in London, following the early termination of their lease for accommodation in the headquarters of the Department for Communities and Local Government, which paid Ofwat £150,000 towards the cost of fitting out new accommodation. The Statement of Parliamentary Supply shows that the Department came within £25,000 of its capital Parliamentary control total. I have, therefore, examined all costs relating to the office fit-out to ensure that costs have been correctly classified between resource and capital. I am able, as a result of my work, to provide assurance that costs have been correctly classified reported in the financial statements.

Open Water

The 2014 Water Act requires the implementation of market reform in the water sector. This will involve the creation of a new market for retail water and sewerage services for non-domestic customers in England. To allow preparatory work to be undertaken the Department for Environment, Food and Rural Affairs (DEFRA) set up the Open Water

Programme. The water industry, with Ofwat's participation has set up a 'High Level Group' of stakeholders, Chaired by DEFRA and a company, Open Water Market Limited, funded by the industry to deliver this work.

Open Water Market Limited (OWM) is a company limited by guarantee, established by the industry to undertake preliminary work on the Open Water programme. Ofwat provides no direct funding to OWM. The members of OWM are: Ofwat; the Water Industry Commission for Scotland (WICS); and water companies.

The Accounting Officer is considering how to implement a governance structure which will protect her position as being accountable to Parliament for Ofwat's activities, when the accounts of OWM are consolidated with Ofwat's in future years. These proposals have been discussed with my staff, and I have been provided with all of the information and explanations necessary to allow me to undertake my audit of Ofwat's financial statements.

Sir Amyas C E Morse
Comptroller and Auditor General
National Audit Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP
23 June 2014

Statement of Parliamentary Supply

For the year ended 31 March 2014.

Summary of Resource and Capital Outturn 2013-14

£000		Estimate			Outturn			2013-14	2012-13	
		Note	Voted	Non-voted	Total	Voted	Non-voted	Total	Voted outturn compared with Estimate: saving/ (excess)	Total
	Departmental expenditure limit	SOSP3								
	– Resource		3,975	–	3,975	3,898	–	3,898	77	1,148
	– Capital		850	–	850	825	–	825	25	268
	Annually managed expenditure									
	– Resource		–	–	–	–	–	–	–	–
	– Capital		–	–	–	–	–	–	–	–
	Total budget		4,825	–	4,825	4,723	–	4,723	102	1,416
	Total resource		3,975	–	3,975	3,898	–	3,898	77	1,148
	Total capital		850	–	850	825	–	825	25	268
	Total		4,825	–	4,825	4,723	–	4,723	102	1,416

The variance between outturn Resource DEL and Estimated Resource DEL is £77 thousand and is mainly attributable to additional income received, and an unspent contingency budget held for late expenditure adjustments.

The variance between outturn Capital DEL and Estimated Resource DEL is £25 thousand and reflects an unspent contingency budget for leasehold improvement overrun costs for fitting out a new London office.

Net cash requirement 2013-14

£000				2013-14	2012-13
	Note	Estimate	Outturn	Outturn compared with Estimate: saving/ (excess)	2010-11 Outturn
	SOSP4	4,730	1,722	3,008	406

The variance between outturn Net Cash Requirement and Estimated Net Cash Requirement is £1.7 million, reflecting larger than forecast working capital balance at 31 March 2014. As a result, we expect a greater net cash requirement in 2014-15 to settle our creditor balances.

Administration costs 2013-14

£000	2013-14 Estimate	2013-14 Outturn	2012-13 Outturn
	3,975	3,898	1,148

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

Notes to the Departmental Resource Accounts (Statement of Parliamentary Supply)

SOPS1. Statement of accounting policies

The Statement of Parliamentary Supply and supporting notes have been prepared in accordance with the 2013-14 Government Financial Reporting Manual (FReM) issued by HM Treasury. The Statement of Parliamentary Supply accounting policies contained in the FReM are consistent with the requirements set out in the 2013-14 Consolidated Budgeting Guidance and Supply Estimates Guidance Manual.

SOPS1.1 Accounting convention

The Statement of Parliamentary Supply and related notes are presented consistently with HM Treasury budget control and Supply Estimates. The aggregates across government are measured using National Accounts, prepared in accordance with the internationally agreed European System of Accounts (ESA95) framework. ESA95 is in turn consistent with the System of National Accounts (SNA93), which is prepared under the auspices of the United Nations.

The budgeting system, and the consequential presentation of Supply Estimates and the Statement of Parliamentary Supply and related notes have different objectives to IFRS-based accounts. The system supports the achievement of macro-economic stability by ensuring that public expenditure is controlled, with relevant Parliamentary authority, in support of the Government's fiscal framework. The system provides incentives to departments to manage spending well so as to provide high quality public services that offer value for money to the taxpayer.

The Government's objectives for fiscal policy are set out in the Charter for Budget Responsibility. These are to:

- ensure sustainable public finances that support confidence in the economy, promote intergenerational fairness, and ensure the effectiveness of wider government policy; and
- support and improve the effectiveness of monetary policy in stabilising economic fluctuations.

SOPS1.2 Provisions

As per requirements specified in the 2013-14 Consolidated Budgeting Guidance and Supply Estimates Guidance Manual for regulators that are wholly or substantially funded from income, Ofwat's provisions score exceptionally within Departmental Expenditure Limits (DEL).

Annual report and accounts 2013-14

SOPS2. Net Outturn

For the year ended 31 March 2014.

SOPS2.1 Analysis of net resource outturn by section

£000	Administration						Programme		2013-14	2012-13	
	Gross Income		Net	Gross Income		Net	Total	Net total	Estimate	Outturn	
								Net total compared to Estimate, adjusted for virements			
Spending in departmental expenditure limit											
Voted:											
A	27,939	(24,041)	3,898	–	–	–	3,898	3,975	77	–	1,148
Total	27,939	(24,041)	3,898	–	–	–	3,898	3,975	77	–	1,148

Section A – Water Services Regulation Authority.

SOPS2.2 Analysis of capital outturn by section

£000	Administration				Programme		2013-14	2012-13		
	Gross Income		Net	Gross Income		Net	Total	Estimate	Outturn	
								Net total compared to Estimate, adjusted for virements		
Spending in departmental expenditure limit										
Voted:										
A	825	–	825	–	–	–	850	25	–	268
Total	825	–	825	–	–	–	850	25	–	268

Section A – Water Services Regulation Authority.

SOPS3. Reconciliation of outturn to net operating cost against Administration Budget

For the year ended 31 March 2014.

SOPS3.1 Reconciliation of net resource outturn to net operating cost

			2013-14 £000	2012-13 £000
	Note	Outturn	Supply Estimate	Outturn compared to Estimate
Total resource outturn in Statement of Parliamentary Supply	SOSP2.1	3,898	3,975	77
Net operating costs in Consolidated Statement of Comprehensive Net Expenditure		3,898	3,975	77

SOPS3.2 Outturn against final Administration Budget

	2013-14 £000 Outturn	2012-13 £000 Outturn
Estimate – Administration costs limit	3,975	3,126
Outturn – Gross administration costs	27,939	20,098
Outturn – Gross income relating to administration costs	(24,041)	(18,950)
Outturn – Net administration costs	3,898	1,148

SOPS4. Reconciliation of Net Resource Outturn to Net Cash Requirement

For the year ended 31 March 2014.

	Note	Estimate	Outturn	2013-14 £000 Net total outturn compared to Estimate: saving/ (excess)
Resource outturn	SOPS2.1	3,975	3,898	77
Capital outturn	SOPS2.2	850	825	25
Accruals to cash adjustments, of which:		(95)	(3,001)	2,906
Adjustments to remove non-cash items:				
Depreciation	4	(390)	(374)	16
New provisions and adjustments to previous provisions	4	(140)	(1,086)	(946)
Other non-cash items	4	(45)	(146)	(101)
Adjustments to reflect movements in working balances:				
Increase/(decrease) in receivables	11	–	160	160
(Increase)/decrease in payables	12	272	(2,024)	(2,296)
Use of provisions	13.1, 13.2	208	469	261
Net cash requirement		4,730	1,722	3,008

Statement of Comprehensive Net Expenditure

For the year ended 31 March 2014.

	Note	2013-14 £000	2012-13 £000
Administration costs			
Staff costs	3	12,164	10,607
Other costs	4	15,775	9,491
Income	5	(24,041)	(18,950)
Net operating costs for the year ended 31 March 2014		3,898	1,148
Total expenditure		27,939	20,098
Total income		(24,041)	(18,950)
Income deferred from prior years		–	–
Net operating costs for the year ended 31 March 2014		3,898	1,148
Other comprehensive Net Expenditure			
Items that will not be reclassified to net operating costs:			
Non-cash charges – actuarial (gain)/loss		204	99
Total comprehensive expenditure for the year ended 31 March 2014		4,102	1,247

Statement of Financial Position

For the year ended 31 March 2014.

	Note	31 March 2014 £000	31 March 2013 £000
Non-current assets:			
Property, plant and equipment	6	1,047	619
Intangible assets	7	215	192
Trade and other receivables	11	3	–
Total non-current assets		1,265	811
Current assets:			
Trade and other receivables	11	604	447
Cash and cash equivalents	10	898	1,712
Total current assets		1,502	2,159
Total assets		2,767	2,970
Current liabilities:			
Trade and other payables	12	(5,448)	(4,234)
Total current liabilities		(5,448)	(4,234)
Total assets less current liabilities		(2,681)	(1,264)
Non-current liabilities:			
Provisions	13	(1,184)	(392)
Pension liabilities	13	(2,785)	(2,651)
Other payables	12	(5)	(9)
Total non-current liabilities		(3,974)	(3,052)
Assets less liabilities		(6,655)	(4,316)

	Note	31 March 2014 £000	31 March 2013 £000
Taxpayers' equity:			
General Fund		(6,657)	(4,354)
Revaluation Reserve		2	38
Total equity		(6,655)	(4,316)

Cathryn Ross
Accounting Officer
23 June 2014

Statement of Cash Flows

For the year ended 31 March 2014.

	Note	2013-14 £000	2012-13 £000
Cash flows from operating activities			
Net operating cost	SOSP3	3,898	1,148
Adjustments for non-cash transactions	4	(1,606)	(769)
Increase/(decrease) in trade and other receivables		160	(108)
Increase in trade payables		(1,210)	(571)
Less movements in payables relating to items not passing through the Comprehensive Statement of Net Expenditure		(858)	(40)
Use of provisions	13	469	403
Net cash outflow from operating activities		853	63
Cash flows from investing activities			
Purchase of property, plant and equipment		719	248
Purchase of intangible assets		106	20
Net movement in capital receivables		48	77
Net cash outflow from investing activities		873	345
Cash flows from financing activities			
From the Consolidated Fund (Supply) – current year		(2,620)	(2,118)
Advance from the Contingencies Fund		5,500	4,500
Repayment to the Contingencies Fund		(5,500)	(4,500)
Capital element of payments in respect of finance leases		(4)	(2)
Net financing		(2,624)	(2,120)
Net increase in cash and cash equivalents in the period before adjustment for receipts and payments to the Consolidated Fund		898	1,712
Receipts due to the Consolidated Fund which are outside the scope of the Department's activities		–	–
Payment of amounts due to the Consolidated Fund		(1,712)	(1,679)
Net increase/(decrease) in cash and cash equivalents in the period after adjustment for receipts and payments to the Consolidated Fund		(814)	33
Cash and cash equivalents at the beginning of the period	10	1,712	1,679
Cash and cash equivalents at the end of the period	10	898	1,712

Statement of Changes in Taxpayers' Equity

For the year ended 31 March 2014.

	Note	General Fund £000	Revaluation Reserve £000	Total Reserves £000
Balance at 1 April 2012		(3,554)	38	(3,516)
Changes in taxpayers' equity for 2012-13				
Total comprehensive Net Expenditure for the year		(1,247)	–	(1,247)
Non-cash charges – auditor's remuneration	4	41	–	41
Net Parliamentary Funding – drawn down		2,118	–	2,118
Amounts issued from Consolidated Fund but not spent at year end	10	(1,712)	–	(1,712)
Balance at 31 March 2013		(4,354)	38	(4,316)
Changes in taxpayers' equity for 2013-14				
Total comprehensive Net Expenditure for the year		(4,066)	(36)	(4,102)
Non-cash charges – auditor's remuneration	4	41	–	41
Net Parliamentary Funding – drawn down		2,620	–	2,620
Amounts issued from Consolidated Fund but not spent at year end	10	(898)	–	(898)
Balance at 31 March 2014		(6,657)	2	(6,655)

Notes to the Departmental Accounts

1. Statement of accounting policies

These financial statements have been prepared in accordance with the 2013-14 Government Financial Reporting Manual (FReM) issued by HM Treasury. The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of Ofwat for the purpose of giving a true and fair view has been selected. The particular policies adopted by Ofwat are described below. They have been applied consistently in dealing with items that are considered material to the accounts.

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

1.1 Accounting convention

These accounts have been prepared under the historical cost convention modified to account for the revaluation of property, plant and equipment and intangible assets at fair value to the business by reference to their valuation in existing use.

1.2 Property, plant and equipment

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

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

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

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

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

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

1.3 Intangible assets

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

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

1.4 Amortisation

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

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

1.5 Financial instruments

Owat does not hold any complex financial instruments. Financial instruments included within these accounts are receivables and payables (notes 11 and 12). Trade receivables are recognised initially at fair value less provision for impairment. A provision for impairment is made when Owat is unable to collect an amount due in accordance with the agreed terms.

1.6 Financing

Owat is primarily resourced by licence fees. Licence fees are charged to companies that Owat regulates in the water sector. The licence fees levied are subject to a ceiling governed by condition N of the WIA91.

1.7 Operating income

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

Since all costs are recovered through the licence fees and are invoiced in advance based on estimated costs, any income from licence fees that exceeds the level of operating costs is to be surrendered to the Consolidated Fund.

1.8 Cash

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

1.9 Trade receivables

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

1.10 Fines and penalty income

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

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

1.11 Administration and programme expenditure

Administration costs are recorded in the Statement of Comprehensive Net Expenditure. They include the costs of running Ofwat, as determined under the administration cost-control framework. There was no programme expenditure between 1 April 2013 and 31 March 2014 (2012-13: nil).

1.12 Leases

Rentals due on operating leases are charged over the lease term on a straight line basis or on the basis of actual rental payable where this fairly reflects usage.

Equipment purchased under a finance lease is charged to the Statement of Comprehensive Net Expenditure through depreciation on a straight line basis over

the minimum term of the lease. An annual interest charge is calculated at either the rate explicit in the lease or the Bank of England base rate as at the contractual date if no rate is explicit in the lease.

1.13 Pensions

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

The retired Directors General are covered by 'by-analogy pension schemes' that offer similar benefits to the PCSPS. However, unlike the PCSPS a pension liability is included in the accounts as required by IAS19.

1.14 Value Added Tax

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

1.15 Provisions

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

The discount rate for pension liabilities changed from to 2.35% per annum to 1.8% per annum with effect from 31 March 2014.

1.16 Contingent liabilities

In addition to contingent liabilities disclosed in accordance with IAS37, Ofwat discloses for Parliamentary reporting and accountability purposes certain statutory and non-

statutory contingent liabilities where the likelihood of a transfer of economic benefit is remote, but which have been reported to Parliament in accordance with the requirements of Government Accounting.

Where the time value of money is material, contingent liabilities which are required to be disclosed under IAS37 are stated at discounted amounts and the amount reported to Parliament separately noted. Contingent liabilities that are not required to be disclosed by IAS37 are stated at the amounts reported to Parliament.

1.17 Going concern

The Statement of Financial Position at 31 March 2014 shows negative taxpayers' equity of £6.7 million. In common with other government departments, the future financing of the Ofwat's liabilities are accordingly to be met by future grants of Supply and the application of future income, both to be approved annually by Parliament. There is no reason to think that future approvals will not be forthcoming. Accordingly, it has been considered appropriate to adopt a going concern basis for the preparation of these financial statements.

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

1.18 Staff costs

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

1.19 Accounting estimates

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

2. Operating costs

2.1 Statement of operating costs by strategy strand

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

Description of strands	2013-14 £000	2012-13 £000
Ensuring a fair deal for consumers	4,475	2,796
Keeping companies accountable	4,651	3,047
Making monopolies improve	3,801	3,509
Harnessing market forces	4,695	3,912
Contributing to sustainable development	3,671	2,073
Delivering better regulation	5,377	3,526
Thames Tideway project regulation	1,269	1,235
Total expenditure	27,939	20,098
Total income	(24,041)	(18,950)
Net expenditure	3,898	1,148

3. Staff costs

3.1 Staff numbers and related costs

Staff costs comprise:

	2013-14 £000				2012-13 £000
	Total	Permanently employed staff	Others	Non-exec Directors	Total
Wages and salaries	9,303	8,917	177	209	8,221
Social Security costs	842	821	–	21	741
Other pension costs	1,800	1,800	–	–	1,581
Other staff costs	219	219	–	–	64
Sub-total	12,164	11,757	177	230	10,607
Less recoveries in respect of outward secondments	(27)	(27)	–	–	–
Total net costs*	12,137	11,730	177	230	10,607

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

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded multi-employer defined benefit scheme but Ofwat is unable to identify its share of the underlying assets and liabilities. The scheme actuary valued the scheme as at 31 March 2007. Details can be found in the accounts of the Cabinet Office: Civil Service Superannuation (www.civilservice.gov.uk/pensions).

For 2013-14, employer's contributions of £1,758,171 were payable to the PCSPS (2012-13: £1,538,824) at one of four rates in the range 16.7% to 24.3% (2012-13: 16.7% to 24.3%) of pensionable pay, based on salary bands. The Scheme Actuary reviews employer contributions usually every four years following a full scheme valuation. The salary bands and contribution rates are set to meet the cost of the benefits accruing during 2013-14 to be paid when the member retires and not the benefits paid during this period to existing pensioners.

Employees can opt to open a partnership pension account, a stakeholder pension with an employer contribution. Employers' contributions of £22,038 (2012-13: £32,693) were paid to one or more of the panel of three appointed stakeholder pension providers. Employer contributions are age-related and range from 3% to 12.5% of pensionable pay. Employers also match employee contributions up to 3% of pensionable pay. In addition, employer contributions of £1,561, 0.8% (2012-13: £2,269; 0.8%) of pensionable pay, were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service or ill health retirement of these employees.

Contributions due to the partnership pension providers at the date of the Statement of Financial Position were £1,377 (2012-13: £2,576). Contributions prepaid at that date were nil (2012-13: nil).

3.2 Average number of persons employed

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

	Permanently employed staff		2013-14 number		2012-13 number
	Total	Others	Non-exec Directors	Directors	Total
Ensuring a fair deal for consumers	34.04	33.89	–	0.15	31.35
Keeping companies accountable	35.89	35.74	–	0.15	33.78
Making monopolies improve	27.09	26.94	–	0.15	21.98
Harnessing market forces	33.33	33.18	–	0.15	33.95
Contributing to sustainable development	28.42	25.27	3.00	0.15	24.58
Delivering better regulation	26.30	26.15	–	0.15	31.90
Thames Tideway project regulation	3.15	3.00	–	0.15	2.12
Total	188.22	184.17	3.00	1.05	179.66

3.3 Reporting of Civil Service and other compensation schemes – exit packages

Redundancy and other departure costs have been paid in accordance with the provisions of the Civil Service Compensation Scheme, a statutory scheme made under the Superannuation Act 1972. Exit costs are accounted for in the year that obligation has arisen. Where the department has agreed early retirements, the additional costs are met by the department and not by the Civil Service pension scheme. Exit costs do not include the balance of any annual leave due at the date of exit and are not included in this table.

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

Cost band	2013-14	2013-14	2013-14	Restated 2012-13
	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	–	1	1	–
£10,000 – £25,000	–	4	4	1
£25,001 – £50,000	–	5	5	1
£50,001 – £100,000	–	4	4	–
£100,001 – £150,000	–	1	1	2
£150,001 – £200,000	–	–	–	1
Total resource cost (£000)	–	717	717	482

The 2012-13 disclosure has been restated to include the cost of payments in lieu of notice that formed part of the exit packages.

Ex gratia payments paid during the period are included in the table above and disclosed on page 58 of the Remuneration Report.

4. Other administration costs

	2013-14 £000 Outturn	2012-13 £000 Outturn
Rentals under operating leases:		
Accommodation	1,489	1,073
Office equipment	37	36
	1,526	1,109
Non-cash items:		
Depreciation	291	244
Amortisation	83	87
Loss on disposal of assets	–	3
Restructuring provisions	385	271
Incentive payment provisions	701	–
Other finance costs	105	123
External auditor's remuneration	41	41
	1,606	769
Other expenditure:		
Consultancy and professional services	7,425	4,057
Contingent labour	2,643	1,321
Training	77	109
Travel and subsistence	521	400
Taxation charges	43	50
Rates	268	205
Computer hire and maintenance	392	354
Other hire and maintenance	71	85
Seminars, meetings and conferences	112	159
Minor items and stationery	32	21
Publications	45	45
Books and periodicals	36	33

	2013-14 £000 Outturn	2012-13 £000 Outturn
Postal services and couriers	18	11
Telecommunications	124	142
Recruitment costs	220	199
Office consumables	195	58
Accommodation expenses	96	141
Internal audit fees	52	38
Professional subscriptions	26	51
Transfer allowance – relocation	2	–
Payroll and pension services	21	29
Business continuity	25	23
Record management	15	19
Pay case penalty	120	–
Other	64	63
	12,643	7,613
Total	15,775	9,491

Rentals under operating lease expenditure during 2013-14 include overlapping Memorandum of Terms and Occupation (MOTO) in relation to our London office for the period 1 September 2013 to 31 March 2014. This covers the period of leasehold improvement works at the new permanent office and relocation following early termination of our previous agreement by the Department of Communities and Local Government.

The new MOTO has a 15-month rent-free period, which is spread over the life of the lease in line with accounting standard IAS 17 – Leases, and is recorded as deferred income in note 12.

Office consumables includes the revenue costs associated with fitting out the new London office in 2013-14.

5. Income

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

	2013-14 £000 Outturn	2012-13 £000 Outturn
RfR1		
Licence fees	23,848	18,934
Licence fees received in advance – prior year	–	3
Miscellaneous	193	13
Total	24,041	18,950

Ofwat is mandated to collect licence fees from the appointed companies and licensed suppliers in respect of the Consumer Council for Water's operating costs. In 2013-14, we collected £5.1 million, which was transferred to the Department for Environment, Food and Rural Affairs. In accordance with HM Treasury guidance, we do not record these transactions in our financial statements.

6. Property, plant and equipment

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

	£000	£000	£000	£000	£000	£000
	Furniture and fittings	Office machinery and telecomms	Leasehold improve- ments	Information technology payments on account	Information technology	Total
Cost or valuation						
At 1 April 2013	65	327	550	–	1,555	2,497
Additions	–	3	643	14	59	719
Disposals	–	(259)	–	–	–	(259)
At 31 March 2014	65	71	1,193	14	1,614	2,957

	£000	£000	£000	£000	£000	£000
	Furniture and fittings	Office machinery and telecomms	Leasehold improve- ments	Information technology payments on account	Information technology	Total
Depreciation						
At 1 April 2013	20	290	228	–	1,340	1,878
Charged in year	6	12	145	–	128	291
Disposals	–	(259)	–	–	–	(259)
At 31 March 2014	26	43	373	–	1,468	1,910
Carrying amount at 31 March 2014	39	28	820	14	146	1,047
Carrying amount at 31 March 2013	45	37	322	–	215	619
Asset financing:						
Owned	39	20	820	14	146	1,039
Finance leased	–	8	–	–	–	8
Carrying amount at 31 March 2014	39	28	820	14	146	1,047
Cost or valuation						
At 1 April 2012	58	350	381	102	1,517	2,408
Additions	7	16	176	–	49	248
Reclassifications	–	–	–	(102)	102	–
Disposals	–	(39)	(7)	–	(113)	(159)
At 31 March 2013	65	327	550	–	1,555	2,497

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	£000	£000	£000	£000	£000	£000
	Furniture and fittings	Office machinery and telecomms	Leasehold improve- ments	Information technology payments on account	Information technology	Total
Depreciation						
At 1 April 2012	14	267	153	–	1,357	1,791
Charged in year	6	62	79	–	96	243
Disposals	–	(39)	(4)	–	(113)	(156)
At 31 March 2013	20	290	228	–	1,340	1,878
Carrying amount at 31 March 2013	45	37	322	–	215	619
Carrying amount at 31 March 2012	44	83	228	102	160	617
Asset financing:						
Owned	45	26	322	–	215	608
Finance leased	–	11	–	–	–	11
Carrying amount at 31 March 2013	45	37	322	–	215	619

7. Intangible assets

Purchased software licences.

	£000	£000	£000
	Purchased software licences	Assets under development	Total
Cost or valuation			
At 1 April 2013	375	13	388
Additions	106	–	106
At 31 March 2014	481	13	494

	£000	£000	£000
	Purchased software licences	Assets under development	Total
Amortisation			
At 1 April 2013	196	–	196
Charged in year	83	–	83
At 31 March 2014	279	–	279
Carrying amount at 31 March 2014	202	13	215
Carrying amount at 31 March 2013	179	13	192
Cost or valuation			
At 1 April 2012	409	26	435
Additions	20	–	20
Reclassifications	13	(13)	–
Disposals	(67)	–	(67)
At 31 March 2013	375	13	388
Amortisation			
At 1 April 2012	176	–	176
Charged in year	87	–	87
Disposals	(67)	–	(67)
At 31 March 2013	196	–	196
Carrying amount at 31 March 2013	179	13	192
Carrying amount at 31 March 2012	233	26	259

8. Capital and other commitments

8.1 Capital commitments

	2013-14 £000	2012-13 £000
Contracted capital commitments at 31 March not otherwise included in these financial statements		
Property, plant and equipment	–	9
Intangible assets	–	149
	–	158

8.2 Operating leases

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

	2013-14 £000	2012-13 £000
Obligations under operating leases comprise:		
Buildings		
Not later than one year	1,525	1,131
Later than one year and not later than five years	4,492	2,874
Later than five years	2,255	–
	8,272	4,005
Other		
Not later than one year	40	–
Later than one year and not later than five years	143	–
Later than five years	–	–
	183	–

8.3 Finance leases

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

	2013-14 £000	2012-13 £000
Obligations under finance leases comprise:		
Other		
Not later than one year	4	4
Later than one year and not later than five years	5	9
Later than five years	–	–
	9	13
Less interest element	(1)	(1)
	8	12

9. Financial instruments

Ofwat is not exposed to the degree of financial risk faced by commercial entities because of the largely non-trading nature of its activities and the way in which government departments are financed. Ofwat has no powers to borrow or invest surplus funds. Financial assets and liabilities are generated by day-to-day operational activities and are not held to change the risks facing the office in carrying out its activities.

9.1 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 liquidity risks.

9.2 Interest rates and foreign currency risks

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

9.3 Fair values

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

10. Cash and cash equivalents

	2013-14 £000	2012-13 £000
Balance at 1 April	1,712	1,679
Net change in cash and cash equivalent balances	(814)	33
Balance at 31 March	898	1,712
The following balances are held at:		
Government Banking Services (GBS)	898	1,712
Balance at 31 March	898	1,712

11. Trade receivables and other current assets

11.1 Analysis by type

	2013-14 £000	2012-13 £000
Amounts falling due within one year		
Trade receivables	27	17
Deposits and advances	153	55
HM Revenue and Customs (VAT)	69	53
Prepayments and accrued income	355	322
	604	447
Amounts falling due after more than one year		
Prepayments and accrued income	3	–
	3	–

11.2 Intra-government balances

	Amounts falling due within one year		Amounts falling due after more than one year	
	£000		£000	
	2013-14	2012-13	2013-14	2012-13
Balances with other central government bodies	69	53	–	–
Balances with local authorities	49	20	–	–
Intra-government balances	118	73	–	–
Balances with bodies external to government	486	374	3	–
Total receivables at 31 March	604	447	3	–

12. Trade payables and other current liabilities

12.1 Analysis by type

	2013-14 £000	2012-13 £000
Amounts falling due within one year		
Trade payables	1,390	175
Other payables	206	174
Accruals	2,294	1,894
Deferred income	374	15
Current part of finance leases	3	3
Other taxation and Social Security	283	261
Excess cash due to be paid to the Consolidated Fund	898	1,712
	5,448	4,234
Amounts falling due after more than one year		
Finance leases	5	9
	5	9

12.2 Intra-government balances

	Amounts falling due within one year		Amounts falling due after more than one year	
	£000		£000	
	2013-14	2012-13	2013-14	2012-13
Balances with other central government bodies	1,318	2,018	–	–
Balances with other public bodies	152	–	–	–
Intra-government balances	1,470	2,018	–	–
Balances with bodies external to government	3,978	2,216	5	9
Total payables at 31 March	5,448	4,234	5	9

13. Provisions for liabilities and charges

13.1 Provisions

	Restructure costs	Incentive payment costs	2013-14	2012-13
			£000	£000
			Total	Total
Balance at 1 April 2013	392	–	392	354
Provided in the year	385	701	1,086	271
Provisions utilised in the year	(294)	–	(294)	(233)
Balance at 31 March 2014	483	701	1,184	392
Analysis of expected timing of discounted flows				
Not later than one year	416	701	1,117	294
Later than one year and not later than five years	67	–	67	98
Later than one year and not later than five years	–	–	–	–
Balance at 31 March 2014	483	701	1,184	392

The Strategic Report provides further information in respect to new provisions and movements in provisions for 2013-14.

13.2 Pension liabilities

	2013-14 £000	2012-13 £000
Balance at 1 April 2013	2,651	2,600
Analysis of the amount charged to the Statement of Comprehensive Net Expenditure:		
Interest costs	105	122
Benefits paid	(175)	(170)
Analysis of the amount recognised in the Statement of Changes in Taxpayers' Equity:		
Experience (gain)/loss	61	24
Actuarial (gain)/loss	143	75
Balance at 31 March 2014	2,785	2,651

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 2014.

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

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

members of the same age and gender. Husbands are assumed to be three years older than their wives.

The main financial assumptions (used to assess liabilities at 31 March 2014) are as follows.

- The gross discount rate is assumed to be 4.35 % a year (31 March 2013: 4.10%).
- The rate of increase in salaries is assumed to be 4.50% (31 March 2013: 3.95%).
- The rate of increase in pensions payments is assumed to be 2.50% (31 March 2013: 1.70%).
- Consumer price inflation 2.50% (31 March 2013: 1.70%).

A cumulative actuarial loss of £1.9 million has been incurred by the scheme since 1 April 2004.

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 5.0% or £139 thousand.
- Decreasing the CPI inflation assumption by 0.5% would result in a corresponding decrease in liabilities of approximately 5.0% or £139 thousand.
- Increasing assumed life expectancies in retirement to be equal to those of people one year younger, would result in a corresponding increase in liabilities of approximately 4.0% or £111 thousand.

The opposite changes in assumptions to those set out above 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.

Analysis of actuarial loss

	2013-14 £000	2012-13 £000	2011-12 £000
Experience (gains)/losses arising on the scheme liabilities	61	24	71
Changes in assumptions underlying the present value of scheme liabilities	143	75	39
Per Statement of Changes in Taxpayers' Equity	204	99	110

History of experience losses

	2013-14	2012-13	2011-12	2010-11	2009-10
Experience (gains)/losses arising on the scheme liabilities					
Amount (£000)	61	24	71	15	63
Percentage of the present value of the scheme liabilities	2.2%	0.9%	2.7%	0.6%	2.2%
Total amount recognised in Statement of Taxpayers' Equity					
Amount (£000)	204	99	110	(103)	546
Percentage of the present value of the scheme liabilities	7.3%	3.7%	4.2%	(4.1)%	18.8%

14. Contingent liabilities disclosed under IAS37

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

Open Water Markets Limited is company limited by guarantee of which Ofwat is a member. Ofwat holds a £1 liability that would become payable should the company become insolvent.

15. Related party transactions

Ofwat transferred £5.1 million to the Department for Environment, Food and Rural Affairs in respect of the Consumer Council for Water's operating costs for 2013-14.

Open Water Markets Limited is company limited by guarantee of which Ofwat is a member; since incorporation (26 November 2013) Sonia Brown, Ofwat's Chief Regulation Officer, is a Non-executive Director of Open Water Markets Limited. Ofwat has provided support to the company as prudent preparation ahead of the Water Bill receiving Royal Assent. Services provided to Open Water Markets Limited total £98 thousand, and include the secondment of three members of staff and provision of refreshments for business meetings. In addition, Ofwat has provided services in kind, which include use of our meeting rooms.

During 2013-14, Ofwat spent £271 thousand with Lucerna Partners Ltd on two contracts, which expired on 31 July 2013. The former Chief Executive, Regina Finn, became a director of Lucerna Partners on 10 November 2013.

Ofwat also has a small number of immaterial transactions with other government departments. There are no related party transactions between Ofwat and any of its Directors.

16. Events after the reporting period

There are no events that materially impact on the financial statements.

The Accounting Officer duly authorised the issue of these financial statements on the date of the Comptroller and Auditor General's audit certificate.

Part 3

Appendices

Appendix 1

Measuring our performance

In 2012-13, we published 'A consultation on measuring and reporting our performance' alongside the consultation on our forward work programme for 2013-14 to 2015-16. It set out our proposed performance framework for measuring our 'Delivering sustainable water' strategy, which we published in 2010. It also set out our intention to trial our performance framework and report on the results in this year's annual report.

During 2013-14, we began to develop a new strategy. We plan to use our draft performance framework, and the responses we received to our consultation, as we develop a performance framework for our new strategy. This will include our proposals for publishing regular information about our performance so that we continue to be accountable to:

- customers;
- taxpayers; and
- other stakeholders.

Appendix 2

Having regard to guidance from Government

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

Guidance from the Secretary of State

In May 2013, and following consultation, the UK Government published a strategic policy statement (SPS) to us, including revised social and environmental guidance. This sets out ten priority areas to which the UK Government expects us to have regard in carrying out our work.

The SPS makes it a requirement:

- for us to report on a regular basis to the Secretary of State on how we have reflected these priorities in our regulatory decisions;
- for our Chairman to agree a reporting timetable with the Secretary of State – and review it every year;
- for us to summarise what action we have taken to support the delivery of the priorities in our annual report and accounts; and
- for us to summarise the steps we propose to take to further the delivery of the priorities in our forward work programme each year.

We have written to the Secretary of State setting out that alongside reporting in our annual report against the ten priorities in the SPS, we will publish specific reports each year on agreed specific priorities. For 2013-14, this comprises:

- a contribution to the UK Government's sustainable development objectives;
- evidence of sufficient company action to help customers struggling to pay bills; and
- progress on competition.

Below, we summarise what action we have taken to support the delivery of the priorities.

Priority and contribution

1. Impacts of regulatory changes on sector investment prospects

We developed our PR14 methodology (see pages 13-14) in close consultation with our stakeholders, including investors. Our methodology will benefit customers, the environment, companies and investors. For example, we maintained the stable, transparent and predictable regulatory framework that investors need to have the confidence to invest. We did this by committing to:

- set companies' wholesale price controls using tried and tested tools – including using the familiar concept of the regulatory capital value (RCV) – that investors value;
- provide more opportunities for companies to innovate and outperform our assumptions in price controls – and investors to benefit as a result; and
- place clear accountability for the quality of each company's business plan on its directors – and the opportunity to earn rewards by submitting an enhanced plan.

2. Proportionality of the regulatory framework

Our PR14 methodology included us taking a risk-based – and more proportionate – approach to reviewing companies' business plans (see page 20).

Our approach to Board leadership, transparency and governance (see page 17) will encourage companies and their owners to take a self-regulatory approach, rather than imposing new burdens. We welcome the support we have had from companies' boards to this approach.

Our principles-based approach to customer information (see page 14) also gave companies more freedom and responsibility to meet their customers' needs.

3. Impacts of the regulatory framework on sector investment profile / 4. Contribution to the UK Government's sustainable development objectives / 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 / 7. Impacts of the regulatory approach on sector resilience and sustainable water resource management / 10. Effectiveness of the 2014 price review in delivering outcomes sought by customers and other stakeholders

Our PR14 methodology has:

- focused companies on delivering the services their customers want (see page 14);
- allowed companies the flexibility to deliver innovative solutions that meet these outcomes in the most cost-efficient way (see page 26);

Appendix 2

- tackled the perceived bias companies had towards building new large-scale capital solutions, allowing them to propose more innovative and sustainable solutions such as catchment management, water trading and water efficiency (see page 26);
- maintained a stable regulatory framework to enable investment into the sector (see priority 1); and
- placed the onus on company Boards to own and be accountable for their business plans, including providing assurance that their plan was high quality and will deliver good outcomes for current and future customers and the environment (see page 20).

Our work on the Thames Tideway (see page 14) has supported the development of a long-term investment proposition which will enable the delivery of a major infrastructure project. This project will bring the River Thames into compliance with the Urban Wastewater Treatment Directive and provide necessary resilience in the sewer network for future generations.

We have contributed to preparations to implement an effective market to allow all non-household customers to choose their supplier (see page 23). Based on the experience of a similar market in Scotland, retail competition is expected to increase water efficiency by non-household customers significantly, which will also help reduce their bills and carbon emissions.

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

Our PR14 methodology has encouraged companies, among other things, to consider wider affordability to all of their customers and specific help to vulnerable customers.

In their business plans (see page 20), only two companies in England proposed an increase in their average household bills for their customers between 2015 and 2020 before inflation. And every company proposed a social tariff as part of their engagement with customers. Only two companies were unable to secure customer acceptability for their social tariff in their business plan so have no plans to introduce one.

A key part of company action to help customers struggling to pay bills is to make these customers aware to the support that already exists. Our principles-based approach to customer information (see page 14) gave companies more freedom and responsibility to meet their customers' needs, including those struggling to pay.

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

The UK Government's Water Bill will allow all non-household customers in England to choose their water and wastewater services supplier. We have contributed to preparations to implement these reforms (see page 22).

Appendix 2

Guidance from the Welsh Government

In December 2013, and following consultation, the Welsh Government laid before the Assembly new social and environmental guidance (SEG) to us, including the priority areas to which they expect us to have regard in carrying out our work. In February 2014, this was confirmed by the Assembly. The SEG includes an expectation that we will provide feedback on the management of these overarching priorities as part of our annual reporting process.

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

Appendix 2

Priority and contribution

Regulatory proposals: assess impacts of regulatory changes on consumers and investors / Research and evidence-based decisions and policy making: take account of research and costs in making decisions

We developed our PR14 methodology (see page 19) in close consultation with our stakeholders, including customer representatives and investors. Our methodology will benefit customers, the environment, companies and investors.

Our approach to Board leadership, transparency and governance (see page 17) has encouraged a self-regulatory approach, rather imposing new burdens.

Our principles-based approach to customer information (see page 14) also gave companies more freedom and responsibility to meet their customers' needs.

Sustainable development: contribute to the Welsh Government's sustainable development objectives / Efficiency and cost effective solutions: drive innovation within the boundaries set by the Welsh Government to ensure improvements in efficiency / Resilience and joined up outcome-based solutions: enable resilience against natural and other hazards / Integrated water management solutions: encourage sustainable and innovative water management solutions / Future resource management: encourage integrated long term planning and solutions

Our PR14 methodology has:

- focused companies on delivering the services their customers want (see page 14);
 - allowed companies the flexibility to deliver innovative solutions that meet these outcomes in the most cost-efficient way (see page 26);
 - tackled the perceived bias companies had towards building new large-scale capital solutions, allowing them to propose more innovative and sustainable solutions such as catchment management, trading water and water efficiency (see page 26);
 - maintained a stable regulatory framework to enable investment into the sector (see priority 1); and
 - placed the onus on company Boards to own and be accountable for their business plans, including providing assurance that their plan was high quality and will deliver good outcomes for current and future customers and the environment (see page 20).
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Appendix 2

Affordability: take account of affordability issues in Wales

Our PR14 methodology has encouraged companies, among other things, to consider wider affordability to all of their customers and specific help to vulnerable customers.

In its December business plan (see page 20), Dŵr Cymru proposed to reduce the average household water and wastewater bill for its customers between 2015 and 2020 by 4.8% before inflation. Dee Valley Water proposed an increase of 8.9% before inflation.

We will challenge both companies' plans during 2014-15 to get the best deal for customers in Wales, while making sure that the service they receive from their water company improves. In its revised business plan, submitted in May 2014, Dŵr Cymru proposed a bill reduction of 6% in real terms.

Both Dŵr Cymru and Dee Valley Water have also proposed introducing a social tariff between 2015 and 2020, which will help customers who are struggling to pay their bills. While Dŵr Cymru proposes to introduce a social tariff in 2015-16, Dee Valley Water has stated that it would introduce one during the next five years.

A key part of company action to tackle affordability is to make these customers aware of the support that already exists. Our principles-based approach to customer information (see page 14) gave companies more freedom and responsibility to meet their customers' needs, including those struggling to pay.

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

In Wales, Natural Resources Wales is responsible for regulating and ensuring compliance with environmental obligations. The Drinking Water Inspectorate (DWI) regulates and ensures compliance with drinking water quality.

Our PR14 methodology required companies to prepare business plans for the next five years (see page 20) that, among other things, delivered their drinking water and environmental obligations. For example, Dŵr Cymru included a specific outcome of 'Safe drinking water' in its December business plan, while Dee Valley Water's December business plan had a similar outcome to 'Provide excellent water quality'.

Both Natural Resources Wales and the DWI have played an active part in the PR14 process. For example, they were members of companies' customer challenge groups (see page 14), which challenged each company's engagement with customers and other stakeholders in developing its business plan.

Appendix 3

List of impact assessments carried out during 2013-14

'Updated Price Limits Impact Assessment, Water Services Regulation Authority (Ofwat)', October 2013.

Appendix 4

Review of Board effectiveness

Following my appointment as Ofwat's Chairman in November 2012, the Board engaged in a 'real time' programme to review its own effectiveness and that of the Board Committees. Together with Defra, which sets water policy, we concluded that it would be timely to strengthen the non-executive membership of the Board.

During 2013-14, we welcomed four new colleagues who were selected in a process designed to strengthen our breadth of skill and expertise, and to complement the skills of existing Board members. Appointments are made by the Secretary of State on the recommendation of the Chairman of Ofwat and the interviewing panel. Christopher Burchell, Martin Lawrence and Catherine Waddams joined us in May 2013, and Christine Farnish joined us in January 2014 in anticipation of Penny Boys' retirement.

In May 2013, we embarked on a process to find a new Chief Executive, Cathryn Ross, and at the same time promoted Sonia Brown to the position of Chief Regulation Officer. Cathryn joined us as CEO and an Executive Director in November 2013. We also appointed and welcomed several new Senior Directors to the Senior Leadership Team, including the appointment of Richard Khaldi, Senior Director of Customers and Casework. Richard joined the Board as an Executive Director.

During the year, we carried out a review of the Board Committees, resulting in new appointments to the Remuneration and Audit Committees, both now operating under new Chairs, respectively Martin Lawrence and Wendy Barnes. We created new committees for PR14, Nominations, and Casework as detailed elsewhere in this report.

In view of this real time succession management, we concluded that formal processes of evaluation should be delayed into 2014 so that the Board had at least six months of experience of working as a team. As an interim measure, a number of informal discussions were held to review the effectiveness and working style of the Board. The Board and Board Committees will be carrying out an annual review of effectiveness in quarter 3 this year. We will report the outcome in next year's annual report.

Jonson Cox
Chairman

Appendix 5

Progress in reducing regulatory burdens

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 set out below.

Report on progress

Our more targeted and proportionate price setting methodology has meant we have been able to reduce the regulatory burden on companies in a number of areas.

- We changed our approach in respect of what each company included in its plan. We looked to companies to deliver high-quality business plans based on providing the services their customers wanted and meeting their legal obligations as opposed to meeting our regulatory information requirements.
- Where we considered that plans were of a high quality we committed to stepping back and allowing those companies to get on with delivering for customers. So, South West Water and Affinity Water will face reduced scrutiny as a result of them delivering the highest quality ('enhanced') business plans.

During the year, we adopted a new, less prescriptive regulatory approach for ensuring that companies meet their obligations to customers in terms of the information they receive. Our principles-based approach gives companies the freedom to be more innovative, and significantly more responsive, to customers' rapidly changing information needs. Among other things, it will also:

- reduce unnecessary regulatory burdens by requiring less frequent routine scrutiny of how companies are meeting their obligations; and
- target our regulatory oversight on the more risky areas or companies.

Appendix 6

Performance against stated levels of service

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

We set out our performance for 2013-14 against our standards of service below.

General enquiries

In 2013-14, we replied to more than 5,300 enquiries, including phone calls and written correspondence. This compares with 4,700 in 2012-13.

Performance standard for general enquiries

Standard	2013-14	2012-13
At least 95% of all enquiries to be dealt with within ten working days	98.3%	97.3%

Information requests

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

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

Over the past year, we received 265 information requests that we dealt with under the FOIA and EIR. We responded to 97.35% within deadlines.

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.

Appendix 6

Disputes and complaints about water and wastewater services

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

We are responsible for the following disputes and complaints.

- Complaints about regulatory policy.
- Allegations of breach of duty by a company.
- Water supply and sewer connection charges.
- Requisitioning of water mains, sewers and lateral drains.
- Adoption and financial arrangements in respect of self-laid mains.
- Sewer transfer appeals.
- Refusals by the companies to install an optional meter.
- Guaranteed standards scheme (GSS) payments.
- Trade effluent appeals.
- Pipe-laying in streets and across private land.

The time taken to resolve disputes and complaints depends on the nature and complexity of individual cases.

In 2013-14, we introduced new performance measures, to complement our existing measures, to monitor and improve our performance. We continue to keep all aspects of our performance under review.

Initial response to disputes and complaints

We aim to respond to all disputes and complaints efficiently and effectively. We aim to meet our performance standard.

In 2013-14, we received 221 disputes and complaints. We set out our performance against our performance standard below.

Performance standard for general enquiries		
Standard	2013-14	2012-13
Initial response to 95% of all complaints within ten working days	94%	96%

Appendix 6

Initial assessment of disputes and complaints

Before we investigate a dispute or complaint we carry out an initial assessment to decide whether:

- it falls within our jurisdiction; and
- we should investigate.

In 2013-14, we closed 84% of the 221 complaints we received within our initial assessment phase target. This is the first year we collected this information.

Investigations we carry out

We aim to investigate as quickly and thoroughly as possible. Where we investigate a dispute or complaint we estimate when we will resolve it (the 'case closure phase'). The complexity of some cases can change after we begin an investigation, so sometimes we are unable to resolve them in the case closure phase.

In 2013-14, we resolved 71% of 34 complaints within the case closure phase. This is the first year we collected this information.

Resolved complaints

We resolved 223 complaints during the year. Of these:

- 87% were resolved within three months (compared with 80% in 2012-13); and
- 90% were resolved within six months (compared with 82% in 2013-13).

Complaints to the Parliamentary and Health Service Ombudsman

If anyone is unhappy with how we have handled their dispute or complaint, we carry out an internal review to review whether we handled it correctly. If the complainant remains dissatisfied with our handling of their complaint, they can ask the Parliamentary and Health Service Ombudsman (PHSO) to investigate.

During 2013-14, one complaint was investigated by the PHSO. This complaint is still under investigation. We will report on the outcome in next year's annual report.

Appendix 7

Resource management 2013-14

Staff recruitment (by gender and ethnic group)

Level and salary range	2013-14			2012-13		
	Full-time equivalent staff appointed ¹	Proportion of women (%) ²	Proportion from ethnic minorities (%) ²	Full-time equivalent staff appointed ¹	Proportion of women (%) ²	Proportion from ethnic minorities (%) ²
Band 1 – £15,623 to £22,220	1	0	100	2	0	50
Band 2 – £22,221 to £31,448	3	67	0	7	85	44
Band 3 – £31,449 to £47,146	12	25	0	10	31	16
Band 4 – £47,147 to £72,114	7	57	0	8	49	25
Band 5 – £72,115 to £108,171	4	50	0	6	0	0
Total	27	48	4	33	40	25

Notes:

1. We introduced a new pay banding system during 2012-13, so data for 2011-12 is not comparable, which is why there are only two years reported.

2. Rounded to the nearest whole number.

Staff in post

Type	31 March 2014	31 March 2013	31 March 2012
Employed head count	199	185	181
Non-payroll head count	20	17	2

Appendix 7

Employed staff information

Area	As at 31 March 2014	As at 31 March 2013	As at 31 March 2012
Full-time equivalent staff	191	177	174
Proportion of women (%)	48	47	49
Proportion from ethnic minorities (%)	12	18	17.5
Proportion disabled (%)	3	2.3	1.7
Members of the Senior Civil Service	8	11	9
Number of fixed-term and casual contracts	13	13	7
Number of staff working part-time	28	30	26
Staff turnover (%)	12	16	24

Staff training attendance (by ethnic group)

Ethnic group	2013-14		2012-13		2011-12	
	Number of training days (rounded up)	Percentage (%) (rounded to nearest whole number)	Number of training days (rounded up)	Percentage (%) (rounded to nearest whole number)	Number of training days (rounded up)	Percentage (%) (rounded to nearest whole number)
White	318	78	418	77	166	86
Other ethnic groups	48	12	89	17	27	14
Unknown	42	10	32	6	–	–
Total number of training days	407	100	539	100	193	100

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 to have due regard to the need to:

- eliminate discrimination;
- advance equality of opportunity; and
- foster good relations between different people when carrying out their activities.

The equality duty is supported by specific duties set out in regulations, which came into force on 10 September 2011. 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 further equality is largely through our general regulatory approach. We seek to ensure these approaches do not have unintended or disproportionate impacts.

In 2012, we set an objective to continue to ensure that equality and diversity issues are reflected in our policies. One of the ways in which we do so is through impact assessments (which are also a way in which our performance can be measured).

Impact assessments are a tool that helps us to make decisions that are soundly based and well informed. We have published a policy on impact assessments. This sets out that we will consider producing an impact assessment if, among other things, the action we propose to take will have a significant impact on water or sewerage customers generally or on specific types of customer.

During 2013-14, we published an impact assessment of Ofwat's methodology for setting price limits for the period from 2015 to 2020 (see appendix 3).

In 2012, we also set an objective to respond to any new social and environmental guidance from the UK or Welsh Governments. In appendix 2, we summarise the actions we have taken in 2013-14 in relation to the UK Government's strategic policy statement to us, including revised social and environmental guidance, and the Welsh Government's social and environmental guidance.

Appendix 8

During the year, we identified potential risks to consumers from the activity of some billing agents with unsustainable business models, or false or dubious claims. Concerns about billing agents in the water sector feature in customer contacts to Citizens Advice, as well as Ofwat and CCWater. Elderly customers or those without access to support seem to be particularly affected.

We want to enable customers to make informed choices about billing agents. We have discussed with independent organisations such as Citizens Advice and Age UK how best to communicate with the groups they serve, and intend to work with them to raise awareness. This work is ongoing.

Also, we are working with companies, CCWater and Water UK (the representative body for water companies) to help the industry set up an independent alternative dispute resolution (ADR) scheme by the end of the 2014-15 financial year. This scheme will enable customers to resolve disputes they have with their water company without the need for litigation, which is not a viable option for many customers. The scheme will be free of charge to customers and will give them the opportunity to seek redress if they have suffered detriment as a result of the actions of their water company and the company has not resolved the complaint to the customer's satisfaction.

As an organisation, we offer a range of services in relation to publications and correspondence to help advance equality of opportunity through access to information. For example, we make publications available in large print and braille formats and are committed to a website that complies with Government guidance on accessibility. We have a Welsh language scheme and use a scoring system to objectively identify any material which need not be published in Welsh or bilingually. We will issue a reply in Welsh when someone writes to us in Welsh. We will also, if practicable, reply in the same language to correspondence we receive in languages other than Welsh or English.

Internal

In 2013, we put in place a People Strategy to deliver our objectives by adopting strong people management practices and ultimately by becoming an employer of choice – one that is recognised as being attractive to existing employees and prospective candidates because our work, culture, environment and rewards make it a great place to be. It includes a commitment to put our values of respect, integrity, leadership and excellence at the forefront of everything we do. We also want a working environment that, among other things, provides a welcoming culture that is free from discrimination and values diversity and opinions.

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

Appendix 8

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

All recruitment activity is subject to audit by the Civil Service Commissioners to ensure that we comply with the guidance set out in its recruitment principles.

We actively support events, such as Black History Month, that raise awareness of our diverse population.

In 2012, we set an objective for the 2012-14 period to continue to be recognised for equality and diversity good practice. One of the ways in which our performance is measured is by our staff survey results. We committed to maintaining more than 80% agreement with our equality question in staff surveys. In our 2013 staff survey, 80% agreed that staff were treated fairly. This is similar to results in previous years and compares favourably with the equivalent question in the Civil Service People Survey 2013.

Equality objectives for 2014-18

Objectives	Measured by	Due date
To put our values (respect, integrity, leadership and excellence) at the forefront of everything we do	There are year-on-year improvements in our performance against our key performance indicators.	By the end of 2016
To provide a working environment that is welcoming and diverse and that supports effective working	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.	
	We are recognised as an employer of choice and people seek out opportunities to work here.	By the end of 2018
	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.	



Annual report and accounts 2013-14





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About this report

This document sets out our annual report and accounts for the period 1 April 2013 to 31 March 2014.

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

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

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

Further information about our work is available on our website at www.ofwat.gov.uk.

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Chairman's foreword

The year 2013-14 was an eventful one for the water sector in England and Wales, and for Ofwat. In March 2013, as the incoming Chairman, I set out an agenda of six priorities to guide the way that Ofwat would evolve its approach to ensure that the sector continues to be successful. Among these priorities were putting customers' interests at the forefront: customers' respect is hard won and easily lost, and we must never take their needs or their ability to pay for granted. We regulate an enormously important public service and maintaining customer confidence is vital to the legitimacy of all other functions, including ensuring that the sector can efficiently raise capital to finance investment in infrastructure.

I am pleased to report Ofwat's progress on many fronts in 2013-14. Over the past year, many customers continued to face significant pressure on their cost of living. A number of companies listened to our concerns and took steps to share some of the gains they have made as a result of benign economic conditions. Six of them did not take up their allowed price increases for 2014-15, while others committed to further investment.

During the summer, we engaged with the water sector to finalise our methodology

for price setting. Cathryn Ross details in her report some of the many positive changes in the approach for this price review.

Our work on Board leadership, transparency and governance during the year led to a sector-specific set of principles for the Boards of regulated companies. By 31 March 2014, all companies had submitted their governance codes to us, including their plans to reshape their Boards in the light of these principles. We were concerned about risks to customers' confidence in the sector due to the complex holding company structures of some companies. Our work with a group of investors led to a parallel set of principles for the holding companies of the privately owned companies.

It was clear from events in 2012 that Ofwat needed to broaden its engagement with the sector. This year has seen a much more extensive engagement with regulated companies, independent Non-executive Directors, Chairmen and investors. As an example, our team have carried out more than 200 meetings with investors during 2013-14 – in addition to hosting events and conference calls – to explain the changes to our regulatory framework and the 2014 price review process. This is many times the number of meetings held at a comparable time during the 2009 price review.

2013-14 was also a year of internal change and development. Regina Finn left us during the year. We were



Jonson Cox
Chairman

delighted to appoint Cathryn Ross as our incoming Chief Executive in November 2013. We also welcomed four new Non-executive Directors: Christopher Burchell, Christine Farnish, Martin Lawrence and Catherine Waddams. We appointed five new members of the Senior Leadership Team, including Richard Khaldi as an Executive Director. Sonia Brown was promoted to Chief Regulation Officer, with particular responsibility for leading the current price review. I consider the skills and experience we have in place at Board level, from the combination of existing and new members, will equip Ofwat well for the future.

This was also a year of change for the sector. The UK Government's Water Bill, which received Royal Assent in May 2014, announced some of the biggest legislative changes we have seen since privatisation, including introducing choice for all business and non-household customers in England. We welcomed these changes and consider they will further strengthen the changes we have made to our own regulatory framework in making companies more focused on their customers and on the efficiency of their businesses.

As the economic regulator of the sector in both England and Wales, we also respect the guidance of the Welsh Government. During the year, the Welsh Government set out its priorities for how the sector in Wales should develop. Shortly after the end of this reporting year, it released a draft of the Water Strategy for Wales for consultation, which sets out the long-term

direction for its water agenda. We look forward to making progress on the Welsh Government's strategy and priorities for customers in Wales.

Under Cathryn Ross' leadership the Executive and Board are taking forward the work we started in 2013 on our approach to regulating the sector. This year, we expect to complete a forward-looking strategy for Ofwat for the coming years. Cathryn has quickly recognised that Ofwat will need to change its

organisation to implement this strategy and has launched an ambitious transformation plan to ensure

Ofwat operates at the top of its game. The Senior Leadership Team and Board will all be part of the engagement with the sector as we test and refine our strategy.

Finally, I would like to place on record my sincere thanks, on behalf of all members of the Board, to everyone in Ofwat and our partner organisations for the efforts of the past year. We have made progress but there is still more to do. I look forward to further progress over the coming year in placing water customers firmly at the heart of everything we do now and for the future to ensure the continuing success of this vital public service.

**A number of companies
took steps to share
some of the gains
they have made**



Chief Executive's report

This is my first annual report and accounts since my appointment as Chief Executive in November 2013. As a former Senior Director of Ofwat, I am not a newcomer to this sector. But, having been away for a few years, I have a fresh perspective of where this sector has come from – and, crucially, where it has to go next.

It is now 25 years since this sector was privatised. Most people will recognise the improvements in services in that time.

The sector needs to evolve if it is to continue to deliver to customers and the environment

But the sector needs to evolve if it is to continue to deliver to customers and the environment.

These are essential public services and their future depends on maintaining the trust and confidence of customers. Stable, independent economic regulation has a crucial role to play in making that happen. And that means we also need to evolve so that we are always at the cutting edge in facilitating and incentivising the sector's delivery of the outcomes that customers and society care about. Change is never easy and there have been some bumps along the road, but I am amazed at what has been achieved.

Our 2014 price review is an excellent example of our new approach to regulation. Our final methodology for setting

companies' price controls for 2015-20, which we published in July 2013, has:

- encouraged companies to focus more on listening to their customers and delivering the things that really matter to them;
- given the sector space to innovate in products and customer service; and
- allowed us to focus our regulatory interventions on where they are really needed and – crucially – allowed us to step back where we are assured that companies' business plans reflected:
 - good information and sufficient evidence;
 - extensive engagement with customers and environmental and quality regulators;
 - where Boards have been fully engaged; and
 - where the outturns are in line with our expectations on costs and the cost of capital.

We were particularly pleased that the business plans that companies sent us in December 2013 demonstrated that they had made a real step change in planning and delivering their businesses to focus on their customers.

But the 2014 price review is just the start. We need to continue to evolve the way we regulate. That is why, during the year, we began to develop our new strategy for regulating the sector. Among other things, our strategy will:

- recognise that water and wastewater are essential public services and put the customer at the centre of everything we do;
- reflect the needs of everyone who benefits from water and wastewater services, including current and future customers, and wider society;
- address the relationship between water and wastewater services and the wider environment;
- understand that, although the regulated water companies have a crucial role to play in delivering what customers need and want, other companies and organisations also have important roles and effects upon, and within, the sector;
- recognise the need for certain standards to be set and maintained – for example, in public health, environmental protection and core levels of service – and Ofwat’s role in their delivery;
- focus on Ofwat’s role in ensuring effective relationships between water companies, investors and customers;
- continue to harness the benefits of competition and market forces where appropriate to drive efficiencies and give better outcomes for all customers; and
- continue to see Ofwat supporting conditions under which efficient companies can finance their water and wastewater businesses.

We have already had some excellent discussions about our strategy with the many groups and organisations that play an important role in the water sector. And I would like to thank them for the excellent



Cathryn Ross
Chief Executive

response we have received. This engagement will help us determine a strategy that will provide a robust basis for our regulation in years to come.

At the same time, we have also been working hard to ensure that Ofwat – as an organisation – is really at the top of its game. Alongside developing our strategy, we have put in place a business transformation programme to help us deliver our work more effectively and efficiently. This will ensure that what we do, the type of organisation we are and the way we work all give us the confidence and capabilities to deliver against an ambitious strategy.

Finally, I would like to echo and amplify Jonson’s thanks to Ofwat’s staff and stakeholders for their work during the year. There may be significant challenges on the horizon, but our achievements during 2013-14 gives us a good start to securing the best possible outcomes for customers and the environment now and over the long term.

Our year at a glance

Protecting customers

During the year, we:

- started work on a new strategy, which will continue to place customers at the centre of our work, and drive the sector to deliver the best outcomes for customers – including the environment – now and over the long term;
- challenged monopoly companies to consider whether they need to take up their allowed price increases and rejected an extra increase in the bills of Thames Water's customers; and
- delivered a 2014 price review methodology that gives customers a stronger voice.

Company accountability

As part of our work to ensure that companies are accountable to their customers, we:

- encouraged regulated companies and their owners to improve their Board leadership, transparency and governance;
- delivered a 2014 price review methodology that encouraged companies to take ownership of their business plans; and
- made sure that where monopoly companies identified issues with their performance during 2012-13, that they got back on track.

Improving monopolies

Over the period covered by this report, we have continued to:

- encourage monopoly companies to continue to improve their customer service;
- encourage each monopoly company to develop a high-quality plan for 2015-20 and in the longer term; and
- produced a 2014 price review methodology that has delivered real benefits to customers in identifying substantial cost efficiencies, a lower cost of capital, and more than £2 billion of net benefits associated with setting separate retail controls and encouraging water trading.



WATER WORKS

If one "Utility" is owned rent is 4 times amount shown on dice.

If both "Utilities" are owned rent is 10 times amount shown on dice.

Mortgage Value £75.

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Promoting competition

During the year, we:

- granted nine new appointment variations that will deliver a range of benefits to more than 9,000 household customers;
- contributed to preparations to allow all non-household customers in England to choose their supplier from April 2017; and
- delivered a 2014 price review methodology that should help prepare monopoly companies for the introduction of more competition in England.

Better regulation

As part of our commitment to the better regulation principles of proportionality, accountability, consistency, transparency and targeting, we:

- made rapid progress on implementing a programme to transform Ofwat into a leaner, more focused and more efficient and effective organisation;
- contributed to the launch of the UK Regulators Network, along with eight other regulators – and joined the UK Competition Network, with the Competition and Markets Authority (CMA) and other concurrent regulators; and
- delivered a 2014 price review methodology that reflects better regulation principles in many aspects of our approach.

Sustainable development

Our work on sustainability during the year included:

- challenging the processes companies used to prepare their 25-year water resources management plans in order to check they are following rules for preparing good plans, such as incorporating customers' views;
- encouraging companies to trade water where this the most efficient option for meeting demand; and
- producing a 2014 price review methodology that encouraged companies to consider long-term sustainable options for delivering services.

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

Taking action now

Despite recent improvements in the general economy, many customers across England and Wales continue to face difficult economic circumstances.

So in October 2013, we called on all monopoly companies to consider whether they needed to take up the rises in prices they were allowed in 2014-15. And in February 2014, we were pleased to welcome the announcement that Affinity Water, Anglian Water, Southern Water, United Utilities, Wessex Water and Yorkshire Water all committed to benefit customers by reducing their allowed bill increases in 2014-15. From 1 April 2014, the average household water and wastewater bill across England and Wales will increase by £8, or 2% – a rise below the Retail Price Index (RPI) rate of inflation.

Also, in November 2013 we announced our decision to turn down Thames Water's application for an additional price increase for 2014-15. This followed its application for an 'interim determination of price limits' (IDoK), which allows companies to ask us to reset their price limits between price reviews as long as certain criteria are met. Thames Water wanted to increase the bills of more than five million of its customers by an extra £29, or 8%, on average. Having assessed the evidence that the company submitted, we found that it had not done enough to justify its

proposed increase. Thames Water decided not to appeal our decision to the Competition Commission.

At the same time as we considered Thames Water's application, in September 2013 we announced that we were looking at the extent to which the company has benefited from wider economic circumstances beyond its control, and whether it could return these gains to customers through an established regulatory process to reset its price limits (the 'substantial favourable effect' mechanism). After considering responses to a short, technical consultation – and Thames Water's acceptance that its investors could absorb cost increases that have occurred in 2010-15 – in February 2014, we decided not to issue a substantial favourable effect notice on the company.

Planning for the future

The continued pressure on household incomes means that the legitimacy to customers of their water and wastewater services – and the bills they pay – will be even more important in future.

In July 2013, we confirmed our plans to give customers a stronger voice in the way prices and

2013-14 highlights

Many customers continue to face difficult economic circumstances

Protecting customers

services are decided. This was part of our final methodology for how we will set the price and service packages ('price controls') the monopoly water and sewerage and water only companies in England and Wales must deliver in each of the five years between 2015 and 2020. Some of the key approaches we used in our methodology to give customers a stronger voice include the following.

- Companies had to develop their business plans by talking to and listening with their customers. This included developing the outcomes – and the rewards and penalties companies receive for delivering or not delivering them ('outcome delivery incentives') – that customers want during 2015-20.
- Each company had to set up an independent customer challenge group (CCG) – a group of customer representatives – to make sure it engaged properly with its customers.
- We used the CCGs' reports – and our own customer advisory panel – to help inform our decisions on the quality of companies' business plans.

Placing customers at the centre of price setting is just one way we are seeking to increase companies' focus on their customers. Good quality information can help customers lower their bills, secure better quality services, and also sustain affordable investment. So in May 2013, we published our final decisions on changes so that companies provide better information to their customers. Our new, principles-led framework takes a risk-based approach that gives companies the freedom to be more innovative and more

responsive to customers' rapidly changing information needs. But with this freedom comes more responsibility for delivery – developments that companies and consumer groups welcomed.

Large infrastructure projects can have a sustained impact on the level of customers' bills. During the year, we continued to review progress on Thames Water's 'Thames Tideway' project, which involves building a large sewer tunnel beneath London. Our work included challenging and reviewing the company's processes for managing risks and estimating the costs of the tunnel to ensure that customers receive value for money. We also worked with Defra, HM Treasury, Infrastructure UK and Thames Water to develop a financing model for the project.

As the economic regulator we have a big role to play in ensuring customers get value for money and the services they want. During the year, we began work on a new strategy, which will, among other things:

- continue to place customers at the centre of our work; and
- help us drive the sector to deliver the best outcomes for customers – including the environment – now and over the long term.

Our initial work has included engaging with the sector and other stakeholders to develop a shared vision on the direction of the sector and Ofwat's future role. We will report on the outcome of this in next year's annual report.

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

Taking action now

In September 2013, we reported that companies received about 12,000 fewer complaints in 2012-13. This was the fifth year in a row that complaints had fallen.

Companies reported that they generally delivered good levels of service to most customers in 2012-13. Yet there are areas they need to improve – in particular, sewer flooding and pollution incidents.

Each company is required to maintain its water and sewerage treatment works, and underground networks of water mains and sewers (its 'assets') to a certain standard so that it can provide reliable services to customers over the long term. We call this 'stable serviceability'. When a company is

not maintaining its assets effectively, there will be a rise in the number of incidents such

as burst water mains or overflowing sewers. So it is important they get it right.

Companies that had less than stable ('marginal') serviceability in 2012-13 are seeking to restore assets to stable serviceability. We will review their progress as part of the 2014 price review (PR14). This includes clawing back

money for customers where companies have not restored their performance.

In 2013-14, we also followed up companies that had identified issues with their environmental performance to ensure they got back on track. If companies fail to deliver the agreed environmental performance, we and the Environment Agency will consider together what action we each need to take to protect the environment and customers' interests.

As well as their obligations to customers and the environment, the companies also have other obligations – including under competition law.

During the year, we continued our investigation into whether Anglian Water abused its dominant position – and infringed the Competition Act 1998 – in relation to pricing for providing water and wastewater services to the 'Fairfield' development site at Milton Keynes, which is in the company's supply area.

We also continued to investigate Bristol Water for potentially abusing its dominant position in the contestable market of providing new water connections through the price and other terms it offers for its services to independent providers ('self-lay organisations'). We will provide an update on both cases in next year's annual report.

Companies received about 12,000 fewer complaints in 2012-13

Company accountability

Planning for the future

Each company has a licence that sets out the conditions under which it is allowed to operate in the water sector in England and Wales. But they also have other obligations.

Water, wastewater and drainage services are essential public services. Most people across England and Wales cannot choose their supplier and must pay to receive services from private monopoly companies. This means that customers' expectations of these companies are high in terms of:

- how well they plan and deliver services ('leadership');
- how open they are about what they do and how they perform ('transparency'); and
- how well they govern what they do ('governance').

Companies that perform well in these areas will help build customers' trust and confidence in the services they receive ('customer legitimacy'). This is vital if customers are to continue to pay their bills and finance the services on which everyone relies.

Our PR14 methodology gives companies' Boards greater ownership of – and responsibility for – how well they deliver for customers and the environment in the long term. While we provided help and support to companies, under our approach, they each took full responsibility for planning their business and listening to their customers, and not simply tick regulatory boxes.

To further encourage companies and their owners to maintain legitimacy, during 2013-14 we:

- developed a set of principles with companies and other stakeholders that represent our minimum expectations for regulated companies in terms of Board leadership, transparency and governance; and
- worked with a group of water company investors to develop the minimum standards we think should apply to the owners of water companies ('holding companies').

Customer legitimacy is vital if customers are to continue to pay their bills

By adopting these principles as a minimum, companies will show that they fully understand and meet the responsibilities of providing an essential public service. Each company has developed its own codes voluntarily by 1 April 2014 – and we expect them to fully meet our principles by 1 April 2015. We have also asked owners to implement our principles by 1 April 2015. We will report on the outcome of this work in next year's annual report.

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

Taking action now

In September 2013, we announced that customers contacting their water and sewerage or water only company in 2012-13 received an improved service from them.

We asked 16,000 customers to give us their view on how well their water company did on a scale of 1 to 5 (where '5' indicates they were very satisfied). The average result for all companies in 2012-13 was 4.44. This is the second consecutive year that companies' performance on this measure has improved.

We introduced the level of customer satisfaction in April 2010 as a way of getting companies to improve how they treat customers. It forms part of our service incentive mechanism (SIM), a regulatory tool that focuses on customer experience.

Planning for the future

One of the tools we use to ensure monopoly companies deliver to customers is the five-yearly price review. And in 2014-15, we will set price controls for each of the five years from 2015 to 2020.

In July 2013, we published our final methodology for how we will set price controls in 2014-15. Independent analysis

from PwC showed that changes we have made to our PR14 methodology could bring more than £2 billion in benefits to customers, as well as substantial cost and financing efficiencies. This includes:

- empowering customers today by giving them a stronger voice in how companies deliver services, and how much they pay for them;
- protecting the needs of future customers by ensuring companies plan how they will deliver secure and sustainable supplies over the long term;
- encouraging companies to produce high-quality business plans based on their legal obligations and effective customer engagement – and giving them greater ownership for delivering those plans;
- challenging companies to keep costs low and deliver improved value to customers and the environment;
- ensuring that the balance between risk and reward is sufficiently aligned with customers' best interests;
- maintaining the stability and transparency that investors value and which will encourage them to continue to finance long-term investment; and
- revealing new information from companies to improve how we set price

Changes we have made to our methodology could bring more than £2 billion in benefits to customers

2013-14 highlights

Improving monopolies

controls in future and continue to protect customers' interests.

Based on our methodology, in December 2013, each water and sewerage and water only company in England and

Wales submitted five-year business plans to us.

We then carried out a series of tests on

companies' plans to rate their quality and highlight any areas of risk (our 'risk-based review'). This included looking at:

- each company's proposed key deliverables for consumers, including current and future customers and the environment, and the incentives associated with delivering them;
- the costs, for both wholesale and retail businesses, associated with delivering each company's proposed outcomes;
- how each company's proposals balance risk and the rewards for bearing those risks between consumers, including current and future customers and the environment, and the company and its investors; and
- the impact of each company's proposals on customers' bills, and its ability to finance its functions.

We published the full outcome for all companies shortly after the end of the reporting year.

Overall, we were delighted that the quality of companies' business plans was

significantly better than at the same stage at previous price reviews. We saw evidence of a real change from them with, among other things:

- Boards taking real ownership and accountability for business plans;
- companies going to great lengths to engage with their customers and other stakeholders and to develop business plans that reflected their priorities; and
- more innovative approaches for delivering services to improve resilience and long-term sustainability (see page 26).

The business plans of two companies – South West Water and Affinity Water – really stood out. Both demonstrated that they would deliver outcomes that customers wanted, at bill levels they can afford. So in March 2014, we invited these companies to qualify for 'enhanced status' – subject to them accepting our guidance on risk and reward (see page 29). Both companies accepted, so will now be rewarded with:

- less scrutiny of their business plans;
- financial benefits; and
- earlier decisions on their price controls.

Other non-enhanced companies will follow a different timetable for setting their price controls.

We will make our decisions on all companies' price controls during 2014-15, and will report on this in next year's annual report.

The quality of companies' business plans was significantly better than at previous price reviews

We make sure that where markets for water and wastewater services exist they operate efficiently and effectively, and deliver benefits to customers and the environment. We also make recommendations to the UK and Welsh Governments where we consider there would be benefits to customers from making changes to markets or introducing further competition.

2013-14 highlights

Taking action now

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

We granted nine appointment variations during 2013-14. More than 9,000 household customers will be supplied at the sites we approved. Customers benefited in the following ways.

- Three of the nine appointment variations offered a discount on the charges they would have paid to their previous supplier. At one of these sites, the new appointee uses rainwater harvesting and recycling to provide a non-drinking water supply. This enables customers, for example, to wash their cars with cheaper water.
- At six of the nine sites, developers are being supplied with water, sewerage, gas and electricity infrastructure by a

single company. So, they only have to deal with one supplier. It also means that the infrastructure is installed together, which can be quicker and cheaper.

- At one of the sites, the developer chose the company it preferred to supply the site.

Water supply licensing is another means by which non-household customers can choose their supplier. During the year, we granted one water supply licence (WSL) to Source For Business Ltd and we revoked Satec's licence. We have seen an increase in the number of applications for WSLs and expressions of interest to apply.

Planning for the future

In June 2013, we welcomed the publication by the UK Government of its Water Bill. The Bill – which received UK Parliamentary approval ('Royal Assent') in May 2014 – will:

- allow all non-household customers in England to choose their supplier for customer-facing ('retail') water and wastewater services by April 2017; and
- introduce competition in England into less customer-facing ('wholesale' or 'upstream') water and wastewater services after 2019.

Promoting competition

Establishing an effective retail market is a complex task that takes a lot of planning. So in 2012, the UK Government established a group of key stakeholders, including us (the 'High Level Group'), to help prepare for a new retail market and other market reforms. The High Level Group (HLG) established the 'Open Water' programme to deliver this work.

In 2013-14, we contributed to the work of the HLG and Open Water. For example, we provided input to Open Water's draft market blueprint, which set out initial plans for the high-level design of the retail market arrangements. We also supported the water sector in setting up a company limited by guarantee – Open Water Market Limited (OWML) – funded by licensed monopoly water and sewerage and water only companies to ensure Open Water's work can continue and to provide a robust governance structure.

We also continued the groundwork in those areas that will be our responsibility in setting up the market. This included the following.

- In 'A level playing field for the water market – a discussion document', which we published in September 2013, we set out why a level playing field is important for an effective market, and the range of regulatory tools available to help us ensure that this happens.
- In 'Water market governance arrangements – a discussion document', which we published in September 2013, we set out some possible arrangements for agreeing market codes and the process for changing them once the new retail market begins.
- In 'Future access pricing in the water sector – a discussion paper', which we published in November 2013, we introduced some of the terminology, concepts and issues we will need to consider in developing new rules to govern the way monopoly companies charge retailers for accessing their services.

We will report on the progress of this work in next year's annual report.

Our PR14 methodology will also help monopoly companies in England prepare for operating in an expanded market for retail services. For example, we will be setting a separate price control for the services they deliver to non-household customers, which has required them to consider in more detail the price and services that these customers want.

We will report on progress in preparing for the new market in next year's annual report.

The introduction of upstream competition in England will take longer to plan and implement. During the year, we also continued working with the UK Government and other regulators in developing plans in this area – as well as changes to the overall framework governing the removal of water ('abstraction') from the natural environment.

We recognise that the Welsh Government is not currently minded to introduce further competition. We have tailored our regulation accordingly, and will retain specific protections for Welsh customers in the absence of competition.

We have a duty to contribute to the achievement of sustainable development. We take this duty seriously – considering social, environmental and financial issues together and taking a long-term view is central to our strategy.

Taking action now

Water is one of our most precious resources. Changing weather patterns and a growing population will, among other things, make the delivery of safe, reliable, efficient and resilient water and wastewater services both more challenging and more important.

Each water company must prepare and maintain a water resources management plan (WRMP) that shows how it will manage and develop water resources to balance supply and demand for water over the next 25 years. Companies must review their WRMPs every year, and prepare and revise them every five years.

During the year, we made representations to the Secretary of State for the Environment, Food and Rural Affairs and the Welsh Minister on companies' draft WRMPs. We carried out a high-level review of the processes described in each company's plan against the requirements of the guidance they must follow (the 'Water Resources Planning Guideline'). Among other things, this included

checking that companies used robust processes to:

- consult their customers and other stakeholders in developing their WRMPs; and
- consider options such as trading water, reducing leakage and encouraging water efficiency appropriately – alongside others such as developing new water resources.

Our feedback will help ensure companies select the most efficient and sustainable options to deliver water services in their plans.

To help make delivering sustainable services easier, during the year we published a framework to help the companies negotiate 'bulk supplies' – the trading of water and wastewater services. Also, with the Environment Agency, we developed a framework to help water companies improve their long-term strategies for their drainage systems.

Each water company must show how it will balance supply and demand for water over the next 25 years

2013-14 highlights

Sustainable development

Planning for the future

Our PR14 methodology will encourage companies to deliver safe, resilient and sustainable services and focus on the long-term outcomes their customers value.

- Our targeted rewards and penalties ('incentives') will encourage companies to find more sustainable ways to meet their customers' needs while also

improving resilience. By incentivising water trading, we will encourage companies to make the most

The introduction of a new retail market in England in 2017 will drive innovation in water efficiency

efficient use of this scarce resource by moving water from wetter to drier areas where it is beneficial to do so.

- We have also changed the way companies decide the solutions in which they should invest. At previous price reviews, we treated capital expenditure (capex) and operating expenditure (opex) differently. Some stakeholders considered that, because of this, companies often preferred capital – and carbon-intensive – solutions, even if this is not the best thing for the environment. Under our new total expenditure (totex) approach, both capital and operating costs could be treated in the same way. So, a company that may have preferred to tackle sewer flooding in the past by increasing its underground equipment to store more rainfall during storms might

consider other options in future – including working with customers to manage the rainfall close to source, preventing it entering the sewers in the first place.

Through these new incentive arrangements we have already seen many examples of the innovative approaches that companies have taken in their business plans to address future challenges. This includes new proposals for trading water and more sustainable solutions for delivering services, which all have greater customer support.

The UK Government's Water Bill will also provide greater opportunities for more sustainable use of water and other resources within the sector. For example:

- the introduction of a new retail market in England in 2017 is expected to drive innovation in water efficiency techniques at customers' sites, as it has done in Scotland; and
- upstream reforms in England can drive efficiency from increased opportunities for trading water resources.

During the year, we continued to participate in the planning for these reforms (see page 22-23). We also continued to work with the UK Government, the Environment Agency and Natural Resources Wales on long-term changes to the system for managing the abstraction of water out of the environment.

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

Taking action now

The sector must evolve to meet new challenges, which means our regulation framework also needs to evolve to stay one step ahead. Over the past year, we have strengthened and widened the skills and experience of our Board and Senior Leadership Team. This includes appointing:

- four new Non-executive Directors;
- a new Chief Executive; and
- four new members of the Senior Leadership Team.

During 2013-14, alongside our work to develop a new long-term strategy, we began a programme to transform Ofwat into a leaner, more focused and more efficient and effective organisation. The programme has three parts: people management, delivery management and governance. It includes improving our management of:

- people, skills, learning and development, leadership and culture;
- infrastructure and ways of working;
- financial management;
- programme and project management; and
- our wider governance, including risk management.

Among other things, this will ensure we deliver the significant efficiencies and cost

reductions we require to operate within a much tighter budget from 2015-16 onwards. This is when we will be subject to a settlement imposed by HM Treasury through the Comprehensive Spending Review. We will report on the outcome of our strategy and business transformation programme in next year's annual report.

One part of our business transformation programme has been to improve our budget planning and forecasting processes. We identified the need for improvements as part of a review we carried out in this area during the year. This followed our announcement in July 2013 that we needed to increase our budget for 2013-14 part way through the year to pay for significant one-off costs of delivering our new price review methodology. As part of our review, we developed a detailed action plan to make improvements. We have already made significant progress in this area, including:

- improving our approach to programme, project and risk management; and
- developing a stronger financial culture.

A key part of our new strategy, and how we fulfil our role in future, will be greater partnership working and collaboration with government and other regulators to improve outcomes for consumers. That is why during 2013-14 we:

Better regulation

- launched the UK Regulators Network (UKRN), along with eight other economic regulators, to improve co-ordination across regulated sectors to enhance investment and efficiency for the benefit of consumers; and
- joined the UK Competition Network (UKCN), along with the new Competition and Markets Authority (CMA) and all of the other sector concurrent regulators, to promote competition for the benefit of consumers and to prevent anti-competitive behaviour. We look forward to working jointly with them on competition issues, which are likely to increase in importance as we help develop the retail market for water (see pages 19-20).

Planning for the future

A key aim of PR14 is to deliver better regulation in the price controls we set for 2015-20 – and in the processes we use to do it. We have engaged extensively with customer representatives, companies, investors and other stakeholders in developing our methodology. And many aspects of our methodology reflect the better regulation principles. We highlight some examples below.

- **Accountable.** We wanted companies to take full responsibility and accountability for planning and managing their business. So we did not set detailed requirements on what we expected them to provide in their business plans – other than specific information we needed to set price controls.
- **Targeted.** We are setting separate price controls for different parts of each company's business. Targeting price controls will allow us to set better rewards and penalties ('incentives') for different parts of the business to encourage companies to improve the services they offer to customers and the environment – and the price they do it for. For example, our 'non-household retail price control' will encourage companies in England to prepare for when all non-household customers can choose their supplier. Subject to legislation, this is expected to happen in 2017.
- **Proportionate.** Our risk-based review (see page 26) allowed us to focus on those areas and those companies where the biggest risks are for customers and the environment.
- **Consistent.** We want to make sure the overall price controls we set deliver the best possible outcome for current and future customers. As part of our initial risk-based review tests of companies' business plans (see pages 19-20) we found that companies' proposed packages for dealing with risk and setting rewards and penalties were not aligned with market evidence. So in January 2014, we issued further guidance to all companies on risk and reward, including our view on the cost of capital and other key financial parameters. All companies will need to accept our guidance in 2014-15 as part of our price controls.
- **Transparent.** We recognise the importance of being transparent about how we make our decisions during our price review – for example, in providing confidence to customers, investors, companies and other stakeholders that our decisions are balanced. This is why, as part of our announcement about the outcome of our risk-based review, we published the documents and other evidence our Board used to decide the quality of each company's business plan.

Management Commentary

Strategic report

Ofwat's annual report (pages 12 to 29) and associated appendices (pages 117 to 135) form part of the Strategic Report and contain information on:

- Ofwat's key activities and performance and during 2013-14;
- Ofwat's employees; and
- social, community and human rights issues.

Ofwat's strategy

Ofwat is currently reviewing its long-term strategy for regulating the water sector in England and Wales, which we aim to publish in the final quarter of 2014. Our aim remains to develop a strategy that helps us stay at the top of our game: helping all parties with an interest in water and wastewater.

Further information on our strategy refresh can be found in our forward programme for 2014-15.

Details of our current strategy, 'Delivering sustainable water – Ofwat's strategy', are available on our website.

Financial commentary

The financial highlights for Ofwat are summarised below.

Operating costs summary

	2013-14 £000	2012-13 £000
Income		
Deferred income from prior periods	–	3
Licence fees received	23,848	18,934
Other income	193	13
	24,041	18,950
Expenditure		
Administration costs	(27,939)	(20,098)
	(27,939)	(20,098)
Net operating cost	(3,898)	(1,148)

Core regulation budget

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

The core regulation operating budget set at the start of the year was £21.5 million. At the beginning of the financial year, we recovered £19.7 million in general licence fees and had secured approval from the Chief Secretary to draw a further £1.8 million from the Reserve. This reserve claim was made within our permitted flexibility associated with the accumulated balance of unspent licence fees; £4.2 million at 31 March 2013.

The 2014 price review (PR14) involves substantial change in how Ofwat regulates the water sector. The changes are expected to bring major benefits for customers, the environment and the economy. The new methodology was published on 25 July 2013, and therefore did not align with the budgetary cycle, meaning that the total costs of delivering the new methodology could not be fully understood at the time the 2013-14 budget was set.

This resulted in additional funding being required and a further reserve claim for £2.4 million was approved by the Chief Secretary in July 2013 and a special licence fee of £3.2 million was recovered from companies in August 2013. Later changes in the PR14 risk-based review process were announced in December 2013 and led to some re-phasing of activity between this and the next financial year. As a result, £0.85 million of the special fee was returned to companies via a credit note at 31 March 2014.

When announcing the additional funding requirement on 25 July 2013, Ofwat committed to carefully review, through its Audit and Risk Assurance Committee and Board, why the full resource requirements were not forecast earlier in the budgeting and planning cycle and identify lessons to improve future forecasting and budgeting. Further details on Ofwat's budget lessons learned are included in the Governance Statement on page 69. The total call from the Reserve for 2013-14 was £4.2 million, an amount equal to the total balance associated with accumulated unspent licence fees from previous years.

In October 2013, Ofwat consulted with companies on a section 13 proposal to modify company licence condition N. This sought to raise the specific cap included in company licences by increasing the element linked to companies' turnover from 0.1% of each company's turnover to 0.3% of that turnover. This proposal was accepted by all companies and will enable us to recover the increased costs of delivering the price review in 2014-15. Ofwat will operate within the Comprehensive Spending Review settlement from 1 April 2015.

The underspend against the core regulation budget at 31 March 2014 was 3.5%, in the main relating to the re-phasing of activity between financial years of the price review following changes to the risk-based review process.

Thames Tideway project

The regulation of the Thames Tideway project is funded under a separate licence. Its budget was £1.5 million with a final outturn of £1.3 million, funded through two special fees recovered from Thames Water Utilities Ltd.

Thames interim determination of price limits (IDoK)

We recovered a special fee of £519 thousand from Thames Water in January 2014 in respect of expenditure incurred by Ofwat for processing Thames Water's IDoK application. Further information on the final determination of Thames Water's IDoK application can be found on our website.

Capital expenditure

Capital expenditure is funded by budget cover, which has been agreed with HM Treasury, recorded within Ofwat's Main and Supplementary Estimate. The underspend against capital budget is 3%, which relates to unspent contingency budget ring-fenced for leasehold improvement expenditure relating to fitting out a new London office. We have no capital commitments at 31 March 2014.

Provisions

In July 2013, Ofwat entered into a contract with PwC as its Delivery Partner for PR14. The contract includes two incentive payments intended to secure good value for money from the Delivery Partner contract. As a result of these incentive mechanisms, we have provided for £701 thousand which represents the estimated maximum possible incentive payment due upon satisfactory completion of the risk-based review, which concluded on 4 April 2014. Following completion of an assurance exercise, we expect to make a recommendation to the Ofwat Board about whether the incentive payment, or part of it, is due in June 2014.

Recognising a need to change the organisation, Ofwat initiated a Business Transformation Programme in the second half of 2013-14. As a result of the programme, a voluntary exit scheme ran during March 2014 which requires a new provision of £328 thousand to be created to cover the costs of compensation payments due in 2014-15.

We continued to draw on provisions made in 2009-10 to cover redundancy and early retirement costs. An increase of £1 thousand was made to this existing provision for early departures in respect of inflation increases to pensions.

Details of our movements in provisions are detailed in note 13 to the accounts.

Employee involvement

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

Equal opportunities policy

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

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

All recruitment activity is subject to audit by the Civil Service Commissioners to ensure that we comply with the guidance set out in its recruitment code.

During the year, we carried out 32 separate competitive recruitments, off-setting 16 staff who left (excluding the voluntary exits, through which 11 staff agreed to leave the organisation in 2014-15), which in some cases sought to appoint more than one individual. Everyone was recruited through open competition.

Sustainability report

Summary of performance

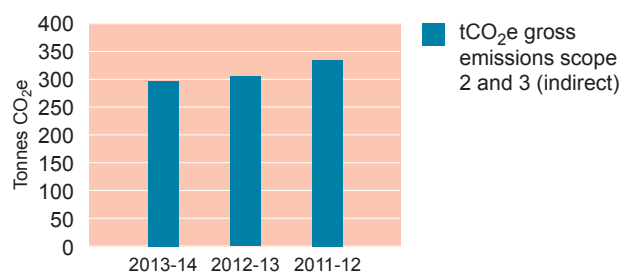
As a small department (<250 staff) Ofwat is not mandated to produce a Sustainability Report. However, because of our role in a regulated sector with a major environmental

impact, Ofwat has voluntarily undertaken to provide a report. The report below follows the guidance issued by HM Treasury.

Ofwat occupies two buildings – in Birmingham and London, respectively. We moved to our new office in London during 2013-14 so the data below is for our Birmingham office only.

Greenhouse gas (GHG) emissions		2013-14	2012-13	2011-12
Non-financial indicators (tCO ₂ e)	Total gross emissions	295.6	304.16	333.61
	Total net emissions	295.6	304.16	333.61
	Gross emissions scope 1 (direct)	–	–	–
	Gross emissions scope 2 and 3 (indirect)	295.6	304.16	333.61
Related energy consumption (million KWh)	Electricity – non-renewable	0.427	0.476	0.534
	Electricity – renewable	–	–	–
	Gas	–	–	–
	LPG	–	–	–
	Other	–	–	–
Financial indicators (£000)	Expenditure on energy	53	57.8	51
	CRC licence expenditure (2010 onwards)	0.95	1.29	1.29
	Expenditure on accredited offsets (for example, GCOF)	1.64	1.96	–
	Expenditure on official business travel	337	299	274

Greenhouse gas emissions



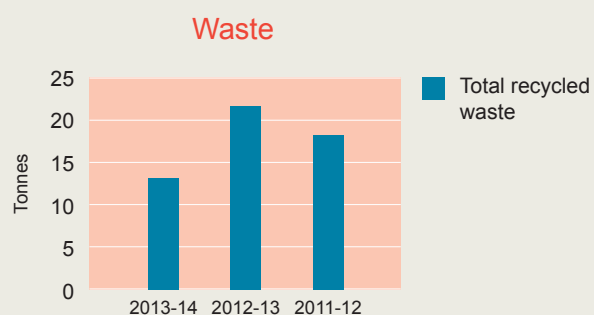
Performance commentary (including measures)

GHG conversion factors for electricity use have changed during this reporting year; data for previous years has been restated to reflect this change and ensure consistency. Emissions relating to air conditioning had previously been reported under scope 1. This has also been adjusted to scope 2 for each of the reporting years. Electrical use accounts for 217.25 tCO₂e. Travel accounts for 78.35 tCO₂e in 2013-14.

Controllable impacts commentary

We have installed new energy efficient devices in our Birmingham server room and offices (multi-function devices), which has improved energy efficiency during the latest reporting period.

Waste		2013-14	2012-13	2011-12	
Non-financial indicators (tonnes)	Total waste	13.45	21.8	18.5	
	Hazardous waste	Total	–	–	–
	Non-hazardous waste	Landfill	–	–	–
		Reused/recycled	13.45	21.8	18.5
		Composted	–	–	–
		Incinerated with energy recovery	–	–	–
Financial indicators (£000)	Total disposal cost	4.1	5.8	8	
	Hazardous waste	–	–	–	
	Non-hazardous waste	Landfill	–	–	–
		Reused/recycled	4.1	5.8	8
		Composted	–	–	–
		Incinerated with energy recovery	–	–	–
	Incinerated without energy recovery	–	–	–	



Performance commentary (including measures)

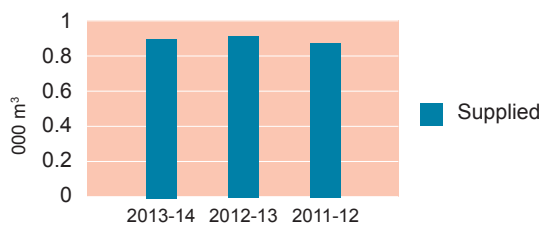
All general waste is segregated for recycling or landfill disposal. We are unable to accurately measure this type of waste as it is disposed via a central collection point in a multi-tenanted building. Our paper waste is recycled, accounting for 13.45 tonnes/£4.1 thousand.

Controllable impacts commentary

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

Finite resource consumption			2013-14	2012-13	2011-12
Non-financial indicators (000 m ³)	Water consumption (office estate)	Supplied	0.913	0.923	0.889
		Abstracted	–	–	–
		Per FTE	0.00475	0.00518	0.00393
	Water consumption (non-official estate)	Supplied	–	–	–
		Abstracted	–	–	–
Financial indicators (£000)	Water supply costs (office estate)		0.2	0.2	0.2
	Water supply costs (non-office estate)		–	–	–

Water consumption (office estate)



Performance commentary (including measures)

Metered usage for the 2013-14 period indicates an average consumption of 4.75m³ per FTE.

Controllable impacts commentary

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

Overview of influenced impacts

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

Offices

Ofwat has two offices. We hold the direct lease for four floors within a multi-tenanted building in Birmingham, and lease our London office space under a Memorandum of Terms and Occupation (MOTO) from Sports England.

Ofwat owns no property.

Publications

Since 2006, we have carried out the design and printing of our publications and other materials at Ofwat. This has delivered significant cost savings. We have also managed to use materials and other resources more efficiently by:

- only printing what we need ('on demand printing'); and
- using our website as our main tool for communicating with our stakeholders ('web-based publication').

Travel

The use of trains is already the principal means of Ofwat's business transport and we invested in wider video conferencing facilities at our new London office in March 2014 to reduce our travel requirements.

Future plans

Ofwat will continue to investigate ways in which it can further improve its energy and water efficiency and wherever possible adhere to Government guidelines.

Reconciliation of resource expenditure between Estimates, Accounts and Budgets

Ofwat prepares resource accounts under section 5 of the Government Resources and Accounts Act 2000 and authority for us to incur expenditure is provided by Parliament through the public expenditure process. We are required to include a reconciliation of resource expenditure between Estimates, Budgets and Accounts.

	2013-14 £000	2012-13 £000
Net Resource Outturn (Estimates)	3,975	3,126
Total Resource Outturn (Budgets) of which:	3,898	1,148
Departmental Expenditure Limits (DEL)	3,898	1,148
Adjustments include:		
Actuarial loss	204	99
Net Operating Costs (Accounts)	4,102	1,247

The Estimate is a statement of Ofwat's budget for the coming year and for what purposes it is required, for which parliamentary authority is sought. This will include our cash receipts generated by licence fee income.

The Resource Budget is the means by which the Government plans and controls the expenditure of resources to meet its objectives.

Going concern

The statement of financial position at 31 March 2014 shows negative taxpayers' equity of £6.7 million (2012-13: £4.3 million). In common with other government departments, the future financing of Ofwat's liabilities are accordingly to be met by future grants of Supply and the application of future income, both to be approved annually by Parliament. There is no reason to think that future approvals will not be forthcoming. Accordingly, it has been considered appropriate to adopt a going concerns basis for the preparation of these financial statements.

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

Cathryn Ross
Accounting Officer
23 June 2014

Director's Report

Roles and responsibilities

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

The Board has a Non-executive Chairman, and during 2013-14 had seven Non-executive Directors and four Executive Directors, including the Chief Executive who is the Accounting Officer.

Membership of Ofwat's Senior Leadership Team is disclosed in the Remuneration Report.

Company directorships and other significant interests held by Ofwat Board members

Chief Executive

Cathryn Ross (from 14 October 2013)

(Member of the PR14 Programme Board from 14 October 2013)

Other current appointments include Director of Oxford Economic Consulting Ltd. Former appointments include Executive Director of Markets and Economics at the Office of Rail Regulation (until October 2013), and Director of Markets and Economics at Ofwat (2008-11).

Regina Finn (until 8 November 2013)

Current appointments include Non-executive Chair of Mutual Energy Limited, Non-executive Director of the Channel Island Competition and Regulatory Authority (from 1 June 2013), Director of Lucerna Partners (from 10 November 2013) and Non-executive Director of Irish Water from 11 November 2013. Appointments taken up by Regina Finn after leaving Ofwat are subject to Business Appointment Rules and clearance in accordance with those rules.

Non-executive Directors

Jonson Cox

(Board Chairman, Chairman of the Nominations and Governance Committee from 16 July 2013, Chairman of the PR14 Programme Board, member of the Remuneration and People Committee)

Other current appointments include Chairman of Coalfield Resources plc and its associate Harworth Estates Property Group Ltd, and Non-executive Director at Wincanton Plc.

Former appointments include Chairman of UK Coal plc, Group Chief Executive Officer of Anglian Water Group Plc (2004-10), Chairman of Morrison plc, Chief Executive Officer of Valpak (2002-03), Chief Operating Officer of Railtrack (2000-01) and Managing Director of Yorkshire Water (1996-2000) and Kelda Group (1994-2000).

Penny Boys CB (until 31 March 2014)

(Chair of the Audit and Risk Assurance Committee until 15 July 2013, Chair of the Casework Committee from 16 July 2013, Chair of the Open Water Committee from 16 July 2013, member of the Nominations and Governance Committee from 16 July 2013)

Other current appointments include Member of the Membership Selection Panel Network Rail Ltd, Non-executive Council Member of the Competition Commission and Member on the National House Builders Council Consumer Committee.

Former appointments include Member and then Deputy Chair of the Horserace Betting Levy Board (2006-11) and Executive Director of the Office of Fair Trading.

Robin Paynter Bryant

(Member of the Audit and Risk Assurance Committee from 16 July 2013, member of the Remuneration and People Committee until 15 July 2013)

Other current appointments include Partner of The Trinity Column Partners LLP, a firm authorised and regulated by the Financial Conduct Authority and Non-executive Director of Go Modern Ltd.

Former appointments include Non-executive Director of Prime International Investments Group Plc, listed on London PLUS-SX, and Director of The Trinity Column Ltd.

Wendy Barnes

(Chair of the Audit and Risk Assurance Committee from 16 July 2013, Chair of the Remuneration Committee until 15 July 2013, member of the Audit and Risk Assurance Committee until 15 July 2013)

Other current appointments include Director of the Enterprise Board of Chester Cathedral, Director and Shareholder in Practiq Consulting Ltd, Non-executive Director at Foreign and Commonwealth Services, Non-executive Director with the Met Office, Non-executive member of BMT Group and external adviser to Templar Executives.

Former appointments include Director with United Utilities, then North West Water (1989-2003).

Christopher Burchell (from 1 May 2013)

(Member of the Remuneration and People Committee from 16 July 2013, member of the Nominations and Governance Committee from 16 July 2013, member of the PR14 Programme Board from 16 July 2013)

Other current appointments include Managing Director of Southern Railway, Fellow of the Chartered Institute of Logistics and Transport, and Fellow of the Institution of Railway Operators.

Martin Lawrence (from 1 May 2013)

(Chairman of the Remuneration and People Committee from 16 July 2013, member of the Nominations and Governance Committee from 16 July 2013, member of Open Water Committee from 16 July 2013)

Other current appointments include Council Member of the Energy Institute.

Former appointments include Chairman of the Association of Electricity Producers (2009-12), Board member of Energy UK, Director at EDF Trading, and Managing Director at EDF Energy.

Catherine Waddams (from 1 May 2013)

(Member of the Casework Committee from 16 July 2013, member of the PR14 Programme Board from 16 July 2013)

Other current appointments include Professor in Norwich Business School, Member of the ESRC Centre for Competition at the University of East Anglia, Joint Academic Director of the Centre on Regulation in Europe and Member of the Consumer Expert Panel of the Office of Rail Regulation.

Former appointments include part-time reporting member of the UK Competition Commission (2001-09).

Christine Farnish (from 1 January 2014)

Other current appointments include Non-executive Director at ABTA, Non-executive Director at Brighton and Sussex University Hospitals, Chair of the Peer to Peer Finance Association, Civil Service Commissioner, Non-executive Director at Aggregate Industries (until 31 March 2014) and Chair of Consumer Futures (until March 2014).

Former appointments include Managing Director at Barclays, Chief Executive Officer at the National Association of Pension Funds, and Former Consumer Director at the FSA and OFTEL.

Non-executive Directors' terms of appointment

The terms of appointment for Ofwat's Non-executive Directors are as follows.

	Appointment date	Appointment end date
Jonson Cox, Chairman	1 November 2012	31 October 2015
Penny Boys	1 April 2006	31 March 2014
Robin Paynter Bryant	24 January 2012	23 January 2016
Wendy Barnes	7 February 2012	6 February 2016
Christopher Burchell	1 May 2013	30 April 2016
Martin Lawrence	1 May 2013	30 April 2016
Catherine Waddams	1 May 2013	30 April 2016
Christine Farnish	1 January 2014	31 December 2016

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.

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.

Richard Kennett (Chartered Accountant)

(Member of the Audit and Risk Assurance Committee)

Independent member of the Audit and Risk Assurance Committee of Hanover Housing Group. Council Member of the Health and Care Professions Council, where he is the Chairman of the Audit Committee. Non-executive Director of a West End theatre group. Financial Reporting Council – Professional Discipline Tribunals member. Chartered Institute for Securities and Investment – Disciplinary Panel member.

Philip Marsden (from 1 November 2013, Competition Lawyer)

(Member of the Casework Committee)

Senior Research Fellow at the British Institute of International & Comparative Law. Non-executive Director on the Board of the UK Office of Fair Trading. Non-executive Director of the Channel Island Competition and Regulatory Authorities.

Pension liabilities

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

The retired Directors General are covered by 'by-analogy pension schemes' that offer similar benefits to the PCSPS. However, unlike the PCSPS a pension liability is included in the accounts as required by IAS19. Further details are provided at note 1.13 of the accounts and within the remuneration report on page 55.

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 on our highly paid and/or senior off-payroll engagements.

Table 1: For all off-payroll engagements as of 31 March 2014, for more than £220 per day and that last for longer than six months

	Number of arrangements
Existing at 31 March 2014	5
Existed for less than one year at the time of reporting	3
Existed for between one and two years at the time of reporting	2

All five existing off-payroll engagements, outlined above, have at some point been subject to a risk-based assessment as to whether assurance is required that the individual is paying the right amount of tax and, where necessary, that assurance has been sought.

Table 2: For all new off-payroll engagements, or those that reached six months in duration, between 1 April 2013 and 31 March 2014, for more than £220 per day and that last for longer than six months

	1 April 2013 to 31 March 2014
Number of new engagements for more than £220 per day and that last longer than six months	11
Number of new engagements that include contractual clauses giving the department the right to request assurance in relation to Income Tax and National Insurance obligations	10
The number for whom assurance has been requested	11
The number for whom assurance has been requested and received	10
The number for whom assurance has been requested and not received	1
The number that have been terminated as a result of assurance not being received	–

In the single case where we have engaged without including a contractual clause allowing us to seek assurance as to the individual's tax obligations, this was as a result of the standard framework terms and conditions having not been updated by the framework manager. At the time we became aware that the standard terms and conditions did not include this clause we had already sought and received satisfactory assurance that the individual's tax obligations were being met.

In the single case where we have not received assurance, this is due to us having reviewed the contractor's initial response in late March 2014, and requiring further information before we could satisfy ourselves that their tax obligations are being met.

There is no reason for us to think that the contractor will not be able to provide the additional information requested.

We had no senior off-payroll engagements during 2013-14 for which the post holder held significant financial responsibility.

Sickness absence

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

- three periods of absence in a rolling period of 6 months; and
- four periods of absence in a rolling period of 12 months.

The Positive People Company provide 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.

	2013-14			2012-13		
	Short term	Long term	Total	Short term	Long term	Total
Days lost	618	620	1,231	604	358	962
Percentage lost			6.3%			2.6%

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

A few instances of long-term sickness absence are the main cause for an increase in the overall sickness absence in 2013-14. Short-term sickness absence levels have remained stable. Ofwat's sickness absence figures are below the Civil Service average of 7.6 days per year.

Supplier payment performance

Following a commitment to improve performance in supplier payments in 2013-14, we achieved 93.92% against our target for paying 100% of agreed invoices within 30 days of receipt. The corresponding figure for 2012-13 was 87.9%.

Protected personal data related incidents

We have an Information Risk Policy (IRP) and related procedures in place to manage the risk of protected personal data related incidents. There were no incidents during the year.

Company membership

Open Water Markets Limited (OWML) is a company limited by guarantee of which Ofwat is a member. Where Ofwat exercises powers as a regulatory member these are limited to our existing legislative powers as denoted in OWML's Articles of Association. Ofwat holds a £1 liability that would become payable should the company become insolvent.

Sonia Brown, Chief Regulation Officer, was appointed as a Non-executive Director of OWML on 11 February 2014.

Financial instruments

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

Internal audit

Grant Thornton was appointed as our internal audit service provider following a competitive procurement in October 2013. Their appointment replaced PricewaterhouseCoopers LLP (PwC), whose contract we terminated due to conflicts of interest risks following PwC's appointment as PR14 Delivery Partner.

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

External audit

Our external auditor is the Comptroller and Auditor General (C&AG), who is required to audit the financial statements under the Government Resources and Accounts Act 2000, and report to Parliament on this examination.

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

The notional cost of this service is £41 thousand (2012-13: £41 thousand).

Irregular expenditure

At the interim audit in January 2014, our external auditors identified two areas of potentially irregular historical expenditure. In both cases, we sought retrospective approval from HM Treasury. Subsequently, the Treasury declined one business case and one severance payment, which was worth £30,289 net (£40,142.68 gross).

Cathryn Ross
Accounting Officer
23 June 2014

Remuneration Report

Senior Leadership Team

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

Cathryn Ross* ^o from (14 October 2013)	Chief Executive
Regina Finn* ^o (until 8 November 2013)	Chief Executive
Keith Mason* ^o	Senior Director of Finance and Networks
Sonia Brown* ^o	Chief Regulation Officer
Claire Forbes (from 24 October 2013)	Senior Director of Corporate Communications
Richard Khaldi* ^o (from 6 January 2014)	Senior Director of Customers and Casework
Beverley Messinger (from 2 December 2013)	Senior Director of Operations
Stuart Crawford (until 31 December 2013)	Senior Director of Corporate Services and Programme Management
Robert Beasley (until 29 October 2013)	Interim Senior Director of Corporate Affairs

* denotes Board member

^o denotes member of the Senior Civil Service

Service contracts

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

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

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

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 Senior Salaries Review Body recommendations. The bonus is paid on the individual's performance. Bonus payments are non-consolidated and non-pensionable.

Each permanent member of the Senior Leadership Team, who is not part of the Senior Civil Service, is remunerated in line with Ofwat's staff remuneration policy.

Sonia Brown was appointed as a Non-executive Director of OWML on 11 February 2014. Other senior managers and Board members have declared that they have no company directorships or significant interests that might have caused a conflict with their Ofwat responsibilities.

Interim directors

In January 2013, we awarded a six-month contract for a value of £72 thousand to Capita Resourcing Ltd T/A Veredus for the service of the Interim Director of Corporate Affairs – Robert Beasley. During 2013-14, the contract was extended until 29 October 2013, to facilitate the external appointment of the permanent Senior Director of Corporate Communications at an additional contract cost of £35 thousand, net of VAT and expenses (total contract cost: £107 thousand net of VAT and expenses).

Staff remuneration policy

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

A non-consolidated bonus may be awarded to staff or teams whose performance is exceptional. Bonus nominations received are considered first by a panel of appointed senior staff who examine the applications for consistency and fairness before making a recommendation to the Senior Leadership Team. The Senior Leadership Team then meets to review and agree all bonus allocations. The annual bonus budget is agreed by the Remuneration and People Committee.

Non-executive Directors remuneration policy

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

Annual report and accounts 2013-14

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)	
	2013-14	2012-13	2013-14	2012-13	2013-14	2012-13	2013-14	2012-13	2013-14	2012-13
Cathryn Ross Chief Executive (from 14 October 2013)	70-75 (full year equivalent 150-155)	–	–	–	2,100	–	15,000	–	85-90	–
Regina Finn Chief Executive (until 8 November 2013)	90-95 (full year equivalent 145-150)	140-145	–	10-15	4,700	10,700	15,000	52,000	110-115	215-220
Sonia Brown Chief Regulation Officer	130-135	125-130	10-15	–	4,000	8,300	66,000	101,000	215-220	235-240
Keith Mason Senior Director of Finance and Networks	115-120	110-115	–	–	–	–	32,000	51,000	145-150	165-170
Claire Forbes Senior Director of Corporate Communications (from 24 October 2013)	35-40 (full year equivalent 95-100)	–	–	–	600	–	18,000	–	55-60	–
Richard Khaldi Senior Director of Customers and Casework (from 6 January 2014)	25-30 (full year equivalent 105-110)	–	–	–	1,400	–	10,000	–	35-40	–
Beverley Messinger Senior Director of Operations (from 2 December 2013)	35-40 (full year equivalent 115-120)	–	–	–	–	–	15,000	–	50-55	–
Stuart Crawford Senior Director of Corporate Services and Programme Management (until 31 December 2014)	90-95 (full year equivalent 120-125)	120-125	–	–	13,800	1,900	32,000	41,000	135-140	160-165
Voluntary redundancy compensation	71	–								
Marian Spain Senior Director of Policy and Communications (until 31 March 2013)	–	85-90 (full year equivalent 100-105)	–	–	–	5,700	–	15,000	–	105-110
Voluntary redundancy compensation	–	95								

2012-13 figures are restated to include PILON costs of £70 thousand, which were provided for in respect of the former Senior Director of Policy and Communications' voluntary redundancy. A further payment of £6 thousand was made to her in 2013-14, in settlement of outstanding annual leave.

The increase in the cost of benefits in kind provided for Stuart Crawford in 2013-14 reflects travel and subsistence costs associated with the business need for greater working from the London office.

Third party payments*

The following information was subject to audit.

	2013-14 payment £000	Restated 2012-13 payment £000
Capita Resourcing Ltd T/A Veredus Robert Beasley, Interim Senior Director of Corporate Affairs (six months from 25 February 2013)	115-120 (contract value 125-130)	15-20 (contract value 85-90)

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

The 2012-13 contract value disclosure has been updated to include the provision for unrecoverable VAT which is attributable to this contract. Expenses incurred by the interim are in addition to the contract value disclosed above.

Non-executive members of the Water Services Regulation Authority remuneration

The following information was subject to audit.

	Restated salary (£000)		Restated benefits in kind (to nearest £100)		Total (£000)	
	2013-14	2012-13	2013-14	2012-13	2013-14	2012-13
Jonson Cox Chairman (from 1 November 2012)	95-100	40-45 (full year equivalent 95-100)	12,100	2,000	110-115	45-50 (full year equivalent 100-105)
Penny Boys Non-executive Director (until 31 March 2013)	15-20	15-20	1,400	2,900	15-20	15-20
Robin Paynter Bryant Non-executive Director	10-15	10-15	100	1,400	10-15	10-15
Wendy Barnes Non-executive Director	15-20	10-15	2,400	2,000	15-20	10-15
Christopher Burchell Non-executive Director (from 1 May 2013)	15-20 (full year equivalent 15-20)	–	–	–	15-20 (full year equivalent 15-20)	–
Martin Lawrence Non-executive Director (from 1 May 2013)	15-20 (full year equivalent 15-20)	–	600	–	15-20 (full year equivalent 15-20)	–
Catherine Waddams Non-executive Director (from 1 May 2013)	15-20 (full year equivalent 15-20)	–	500	–	15-20 (full year equivalent 15-20)	–
Christine Farnish Non-executive Director (from 1 January 2014)	0-5 (full year equivalent 15-20)	–	–	–	0-5 (full year equivalent 15-20)	–

Ofwat's Chairman, Jonson Cox, received an annual London accommodation allowance of £7,196 (2012-13: £950) in lieu of any claim for London hotel accommodation. This allowance was agreed by Ofwat when he became Chairman in November 2012. At the time, Jonson Cox was assured that necessary approvals had been sought but in fact Ofwat had failed to secure the necessary approvals for this allowance from HM Treasury. The Treasury subsequently declined a business case seeking approval for the accommodation allowance. On principle, Jonson Cox chose to repay the allowance in full as soon as the business case was declined, and overnight subsistence costs in London will now be paid in line with the overnight expenses claimable by staff staying with family and friends. Ofwat's Chairman has been poorly served by the organisation's failure to secure the necessary approvals and Ofwat has apologised to him for this.

2012-13 figures have been restated to reflect the repayment of the allowance and to restate the benefit in kind disclosure for the Chairman's accommodation allowance, which was previously classified incorrectly as salary.

Independent members

The following information was subject to audit.

	2013-14		2012-13	
	Salary	Benefits in kind (to nearest £100)	Salary	Benefits in kind (to nearest £100)
Richard Kennett Independent Member	5-10	200	0-5	600
Philip Marsden* Casework Committee Member (from 1 November 2013)	0-5	–	–	–

* Philip Marsden is remunerated per attendance at committee meetings rather than provided an annual salary.

Salary

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

Benefits in kind

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

Bonuses

Bonuses are based on performance levels attained and are made as part of the appraisal process. Bonuses relate to the performance in the year in which they become payable to the individual. The bonuses reported in 2013-14 relate to performance in 2013-14 and the comparative bonuses reported for 2012-13 relate to performance in 2012-13.

Pay multiples

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 2013-14 was £155 thousand to £160 thousand (2012-13: £165 thousand to £170 thousand). This was 4.2 times (2012-13: 4.7 times) the median remuneration of the workforce, which was £37,741 (2012-13: £35,350).

In 2013-14, no employees received remuneration (2012-13: nil) in excess of the highest-paid director. Remuneration excluding senior managers ranged from £4,440 to £126,250 (2012-13: £3,059 to £104,807).

Total remuneration includes salary, non-consolidated performance related pay and benefits in kind. It does not include severance payments, employer pension contributions and 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 2014 and related lump sum £000	Real increase in pension and related lump sum at age 65 £000	CETV at 31 March 2014 £000	CETV at 31 March 2013 £000	Real increase in CETV £000
Cathryn Ross Chief Executive (from 14 October 2013)	20-25 lump sum: 70-75	0-2.5 lump sum: 0-2.5	324	309	7
Regina Finn Chief Executive (until 8 November 2013)	15-20 lump sum: –	0-2.5 lump sum: –	247	219	10
Sonia Brown Chief Regulation Officer	25-30 lump sum: 75-80	2.5-5 lump sum: 7.5-10	316	261	31
Keith Mason Senior Director of Finance and Networks	25-30 lump sum: 85-90	0-2.5 lump sum: 5-7.5	613	546	28
Claire Forbes Senior Director of Corporate Communications (from 24 October 2013)	5-10 lump sum: –	0-2.5 lump sum: –	86	72	7

	Accrued pension at age 65 at 31 March 2014 and related lump sum £000	Real increase in pension and related lump sum at age 65 £000	CETV at 31 March 2014 £000	CETV at 31 March 2013 £000	Real increase in CETV £000
Richard Khaldi Senior Director of Customers and Casework (from 6 January 2014)	0-5 lump sum: –	0-2.5 lump sum: –	5	–	3
Beverley Messinger Senior Director of Operations (from 2 December 2013)	0-5 lump sum: –	0-2.5 lump sum: –	11	–	7
Stuart Crawford Senior Director of Corporate Services and Programme Management (until 31 December 2013)	15-20 lump sum: –	0-2.5 lump sum: –	280	229	29

Pension liabilities

The main pension scheme for Ofwat staff is the Principal Civil Service Pension Scheme (PCSPS). This is a defined benefit, unfunded scheme. The payment of benefits from the scheme is borne by the Civil Service Superannuation Vote. The pension liabilities arising from Ofwat's employees' membership of the PCSPS are not provided for in these accounts in accordance with HM Treasury's instructions and as described on page 100.

A full provision has been made in the accounts for liabilities arising in respect of the by-analogy pension schemes for both the former Directors General as required by HM Treasury (note 13.2). Claims are made on the Exchequer to cover the pension costs that relate to employment other than with Ofwat.

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

Civil Service pensions

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

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

Employee contributions are salary related and range between 1.5% and 6.25% of pensionable earnings for classic, and 3.5% and 8.25% for **premium**, **classic plus** and **nuvos**. Increases to employee contributions will apply from 1 April 2014. 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 their pensionable earnings during their period of scheme membership. At the end of the scheme year (31 March), the member's earned pension account is credited with 2.3% of their pensionable earnings in that scheme year and the accrued pension is uprated in line with Pensions Increase legislation. In all cases, members may opt to give up (commute) pension for a lump sum up to the limits set by the Finance Act 2004.

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

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

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

Cash Equivalent Transfer Value (CETV)

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement

when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies.

The figures include the value of any pension benefit in another scheme or arrangement 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 effectively funded by the employer. It does not include the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement), and uses common market valuation factors for the start and end of the period.

Compensation for loss of office

Voluntary redundancies

During early 2013-14, three functional areas of the business were reviewed. This resulted in four employees leaving under voluntary redundancy terms. They received a compensation payment of between £21 thousand and £92 thousand. Of the four, none took early retirement.

Two of the four received compensation for additional paid annual leave totalling £60 thousand.

The continued use of the restructuring provision set up in 2009-10 is detailed in note 13.1.

Voluntary exits

Ofwat initiated a Business Transformation Programme in the second half of 2013-14. As a result of the programme, a voluntary exit scheme ran during March 2014. Eleven people were approved to leave under voluntary exit terms on 20 March 2014. They will receive a compensation payment of between £8 thousand and £61 thousand in June 2014.

Of the 11 voluntary exits, two took early retirement. The cost to Ofwat of buying out the actuarial reduction of their pension was between £8 thousand and £47 thousand. They did not receive any additional compensation.

The total cost associated with exits under the voluntary exit scheme have been provided for in 2013-14, as detailed in note 13.1.

Ill health retirement

On 29 March 2014, it was agreed that one member of staff would retire early on ill-health grounds, which resulted in £68 thousand of additional accrued pension liabilities. The full cost of the enhanced pension is accounted for by the pension scheme rather than Ofwat and is not represented within these financial statements.

Ex gratia payments

The former Senior Director of Policy and Communications received additional paid annual leave entitlement of two months, equivalent to additional compensation of £24 thousand, when she left the office in January 2013. This amount was disclosed as salary in the 2012-13 accounts remuneration report.

During 2013-14, two members of staff leaving under voluntary redundancy terms received additional paid annual leave representing additional compensation of £60 thousand. HM Treasury judged one of these severance payments worth £30,289 net (£40,142.68 gross) to be irregular.

Ex gratia payments are included within the cost of exit packages in note 3.1 of the accounts.

Cathryn Ross
Accounting Officer
23 June 2014

Statement of Accounting Officer's Responsibilities

Under section 5 of the Government Resources and Accounts Act 2000, HM Treasury has directed Ofwat to prepare for each financial year resource accounts detailing the resources acquired, held or disposed of during the year and the use of resources by 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 of 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; 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 the Treasury.

The Governance Statement

Scope of responsibility

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

Ofwat's duties are laid down by legislation, in particular the WIA91 and the Water Act 2003. Ofwat is a non-ministerial government department.

The purpose of the governance framework

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

The governance framework has been in place in Ofwat for the year ended 31 March 2014 and up to the date of approval of the annual report and accounts, and accords with HM Treasury guidance. Assurance is provided to the Accounting Officer by each member of the Senior Leadership Team, who have signed an assurance statement covering the period from 1 April 2013 to 31 March 2014.

Key elements of the governance framework

The Board

The Board recognises the importance of leadership to create an environment where performance and risk management are effective. In line with the principles of the Code, Ofwat's Board has a majority of non-executives with a Non-executive Chairman, seven Non-executive Directors and four Executive Directors, including the chief executive. The non-executive members are independent of management. The Board membership provides the necessary balance of experience and expertise covering Ofwat's duties and strategy. The Director of Legal Services is Board secretary and legal adviser. Following a recruitment exercise, Elizabeth Hillman has been appointed as General Counsel and will form part of our Senior Leadership Team from 1 May 2014.

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

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

- procedure for conflicts of interest;
- register of Board members' disclosable interests;
- matters reserved to the Board;
- Audit and Risk Assurance Committee terms of reference;
- Remuneration and People Committee terms of reference;
- PR14 Programme Board Committee terms of reference;
- Open Water Committee terms of reference;
- Casework Committee terms of reference;
- Nominations and Governance Committee terms of reference; and
- code of conduct.

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

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

From April 2013 to March 2014.

	Board meetings/ conference calls	Audit and Risk Assurance Committee Meetings	Remuner- ation and People Committee Meetings	PR14 Programme Board Committee	Casework Committee	Open Water Committee	Transitional Nomin- ations Committee
Number of meetings	(13 – 5)	(5)	(2)	(6)	(2)	(1)	(1)
Board members							
Jonson Cox Chairman	13/13 – 5/5	–	2/2	6/6	–	–	1/1
Penny Boys Non-executive Director (until 31 March 2013)	13/13 – 3/5	2/2	–	–	2/2	1/1	1/1
Wendy Barnes Non-executive Director	12/13 – 5/5	5/5	–	–	–	–	1/1
Robin Paynter Bryant Non-executive Director	13/13 – 4/5	3/3	–	–	–	–	1/1

Annual report and accounts 2013-14

	Board meetings/ conference calls	Audit and Risk Assurance Committee Meetings	Remuner- ation and People Committee Meetings	PR14 Programme Board Committee	Casework Committee	Open Water Committee	Transitional Nomin- ations Committee
Number of meetings	(13 – 5)	(5)	(2)	(6)	(2)	(1)	(1)
Board members							
Martin Lawrence Non-executive Director (from 1 May 2013)	10/12 – 4/4	–	2/2	–	–	1/1	1/1
Christopher Burchell Non-executive Director (from 1 May 2013)	9/12 - 4/4	–	1/2	6/6	–	–	1/1
Catherine Waddams Non-executive Director (from 1 May 2013)	12/12 – 3/4	–	–	6/6	2/2	–	–
Christine Farnish ¹ Non-executive Director (from 1 January 2014)	3/4 – 5/5	–	–	–	–	–	–
Executive Board members							
Cathryn Ross ² Chief Executive (from 14 October 2013)	7/7 – 3/4	2/3	1/1	4/4	1/2	1/1	–
Regina Finn Chief Executive (Until 8 November 2013)	6/6 – 2/2	1/2	1/1	0/2	–	–	–
Sonia Brown Chief Regulation Officer	12/13 – 5/5	–	–	6/6	–	1/1	–
Keith Mason Senior Director of Finance and Networks	13/13 – 5/5	–	–	6/6	–	–	–
Richard Khaldi ³ Senior Director Customers and Casework (from 6 January 2014)	3/4 – 1/1	–	–	2/2	1/1	–	–

1. Christine Farnish attended the December Board meeting as an observer.

2. Cathryn Ross attended the September Board and sub-committee meetings as an observer.

3. Richard Khaldi attended the November and December Board meetings as an observer.

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

The Board met in Wales in June 2013, using the occasion to meet informally with the Welsh Minister for Natural Resources and Food, and officials of the Welsh Government.

In addition to its formal meetings, the Board held a number of challenge sessions to test emerging thinking on key policy issues and workshops to receive more advanced draft proposals to facilitate discussion and shaping of new policy and developments. These provide a valuable way for the Board to challenge and shape policy and developments ahead of consultation with stakeholders and final decision making. During the year, there were Board workshops on the price review (five workshops), strategy refresh (three workshops), charging arrangements (two workshops), risk appetite, choice and trading arrangements and Thames Tideway Tunnel.

During the year, the Board had six standing committees:

- Audit and Risk Assurance Committee;
- Remuneration and People Committee;
- PR14 Programme Board Committee (from 16 July 2013);
- Open Water Committee (from 16 July 2013);
- Casework Committee (from 16 July 2013); and
- Nominations and Governance Committee (from 16 July 2013).

Each committee is chaired by a Non-executive Director. The Chairman of each committee reports to the Board after each meeting and the Minutes are circulated for information.

Committees of the Board

Audit and Risk Assurance Committee (previously Audit Committee)

In line with the principles of the Code, the Audit and Risk Assurance Committee is chaired by a Non-executive Director. Penny Boys was Chair until 15 July 2013; Wendy Barnes was appointed as Chair of the Committee from 16 July 2013.

The non-executive members who served during the year are Wendy Barnes (until 15 July 2013 as a member of the Committee, as Chair from 16 July 2013), Robin Paynter Bryant (from 16 July 2013) and Richard Kennett (independent member). The Chief Executive, directors, other staff, the external auditors (National Audit Office), the internal auditors (PwC and Grant Thornton), and the Assistant Board Secretary attend by invitation.

The Committee's role is to support the Board in its responsibilities for issues of risk, internal control, and governance and associated assurance. This is done by reviewing the comprehensiveness of assurances in meeting the Board and Accounting Officer's assurance needs, reviewing the reliability and integrity of these assurances, and providing an opinion on how well the Board and Accounting Officer are supported in decision making and discharging their accountability obligations. The Committee met five times during 2013-14. In June 2013, the Committee submitted its annual report to the Board along with its recommendations to approve the annual accounts.

Matters discussed by the Committee in 2013-14 included:

- lessons learned from budget planning and forecasting;
- future of internal audit services across government;
- development and improvement of risk management in Ofwat; and
- risk management reviews on the Thames Tideway programme and Business Transformation Programme.

All of the scheduled internal audit reviews were completed. The 2013-14 internal audit findings were satisfactory and provided substantial assurance. However, it is recognised that the substantial assurance awarded to the procurement review was marginal and only achieved as a result of the improvement work already completed in 2013-14 to improve the function. Continuation of this improvement work and addressing the internal audit findings will be a key focus for Ofwat in 2014-15.

The risk assessment for the 2014-15 financial year remains high. The main areas of risk are:

- reputation and credibility, particularly linked with the successful delivery of PR14 and dealing with any challenges of our decisions;
- the need to deliver a major business transformation programme to enable Ofwat to operate within the Comprehensive Spending Review settlement from 1 April 2015, at the same time as the organisation faces significant delivery pressures associated with PR14; and
- associated risks of stakeholder engagement – with the price review, Ofwat's refreshed strategy and delivery of the Business Transformation Programme.

The internal audit plan for 2014-15 was agreed by the Audit and Risk Assurance Committee at its meeting on 14 May 2014.

Remuneration and People Committee (previously Remuneration Committee)

In line with the principles of the Code, the Remuneration Committee was chaired by a Non-executive Director, Wendy Barnes up to 15 July 2013 and Martin Lawrence from 16 July 2013. The other non-executive members who served during the year were Jonson Cox, Christopher Burchell (from 16 July 2013) and Robin Paynter Bryant (until 15 July 2013). The Committee's role is considering matters relating to the pay and conditions of employment of Ofwat's staff and succession planning. Issues discussed during the year included:

- consideration of SCS pay and bonus arrangements;
- HR metrics;
- scrutiny of people survey outcomes;
- initial consideration of the People Strategy and plan; and
- revisions to the Remuneration Committee's terms of reference, broadening its remit to cover wider people issues.

During 2014-15, the Committee will be focusing on:

- succession planning and development at a senior level;
- consideration of SCS pay and bonus arrangements, including benchmarking of senior pay and determination of future approach;
- oversight of continued development and implementation of the Business Transformation Programme and the People Strategy;
- in particular, scrutiny and monitoring of the delivery and development conversations (Ofwat's new approach to performance management of staff); and
- oversight of the new arrangements for pay and reward.

PR14 Programme Board Committee

In July 2013, the Board established an advisory committee called the PR14 Programme Board.

In line with principles of the Code, the PR14 Programme Board was chaired by our Non-executive Chairman, Jonson Cox. The other non-executive members who served during the year were Catherine Waddams and Christopher Burchell. The Chief Executive and Chief Regulation Officer are also members.

The Committee's role is to:

- provide challenge, support and advice to the Senior Reporting Officer; and
- monitor whether key elements of the PR14 delivery programme are being efficiently delivered.

The Chair of the Audit and Risk Assurance Committee has a role as Programme Management Office sponsor for PR14, and provides advice and support to the Programme Management Office for the price review.

Open Water Committee

In July 2013, the Board established an advisory committee called the Open Water Committee. In line with the principles of the Code, the Open Water Committee was chaired by a Non-executive Director, Penny Boys. The other non-executive member who served during the year was Martin Lawrence. The Chief Regulation Officer attends by invitation.

The Committee's role is to:

- provide challenge, support and advice to the Choice and Trading Arrangements Programme and any relevant successor programme or project, which includes work directly linked to the Open Water Programme; and
- monitor whether key elements of the Choice and Trading Arrangements Programme are being efficiently delivered.

Casework Committee

In July 2013, the Board established a committee called the Casework Committee to make certain final decisions in strategic cases. In line with the principles of the Code, the Casework Committee was chaired by a Non-executive Director, Penny Boys. The other non-executive members who served during the year were Catherine Waddams and Philip Marsden (independent member). During the year, no decisions in strategic cases were made by the Committee.

Nominations and Governance Committee

In July 2013, the Board established a Nominations and Governance Committee. In line with the principles of the Code, the Nominations and Governance Committee was chaired by Ofwat's Chairman, Jonson Cox. The Board Chairman shall not chair the Nominations and Governance Committee when it is dealing with matters relating to the chairmanship of the Board. The other non-executive members who served during the year were Penny Boys, Christopher Burchell and Martin Lawrence. The Chief Executive attends the Committee by invitation.

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.

Independent members of the Casework and Audit and Risk Assurance Committees are appointed, and their remuneration set, by the Chief Executive in consultation with the Chairman. The appointments of Non-executive Directors of the Board are recommended by the Chairman, with the Defra Minister responsible for Ofwat having a power of veto over the appointment of Non-executive Directors.

Senior Leadership Team (previously Executive Team)

The Senior Leadership Team comprises the executive members of the Board and the senior directors. Its role is to assist the Chief Executive in the day-to-day running of the office. It meets frequently and decides on key matters relating to policy, management and resources, subject to the overall direction,

reserved powers and control of the Board. Progress is fed back to each Board meeting in the Chief Executive's report. During the second half of 2013-14, a new Chief Executive and three new senior directors joined Ofwat's Senior Leadership Team. A General Counsel was also recruited, who joined the Senior Leadership Team on 1 May 2014.

During 2013-14, the key focus of the Senior Leadership Team has been on strategy and transforming Ofwat as an organisation, particularly addressing budgetary issues. The other major area of focus has been finalising our PR14 methodology, and putting in place and monitoring arrangements for programme delivery, including the Delivery Partner contract. Senior Leadership Team has also reviewed progress and informed policy on all of Ofwat's other major programmes.

The Senior Leadership Team has been involved in the creation of Open Water Markets Limited, a company limited by guarantee which has been established by the industry to support preparations for the opening of a market for non-household retail customers, which is due to open in 2017 under the Water Act. Sonia Brown, Ofwat's Chief Regulation Officer, is a Non-executive Director of Open Water Markets Limited.

Audit arrangements

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

Our internal audit service provides an independent appraisal service for management by measuring and evaluating the adequacy, reliability and effectiveness of management and financial control systems. Internal audit makes recommendations based on the appraisal of each system reviewed. An annual assurance report is provided to the Accounting Officer and the Audit and Risk Assurance Committee. We have chosen to outsource the provision of the internal audit service to ensure the delivery of wholly independent assurance and fully professional analysis and recommendations.

In October 2014, Grant Thornton was appointed as our internal audit service provider following a competitive procurement. Their appointment replaced PwC, whose contract we terminated due to conflict of interest risks following the award of the PR14 Delivery Partner contract to PwC. The new contract with Grant Thornton was let for a short interim period to 30 May 2014, reflecting Ofwat's intention to participate in the joint regulators' group procurement for the provision of internal audit services. At the conclusion of this process, Grant Thornton won the joint regulators' contract and was appointed as Ofwat's internal audit supplier under that contract from 1 April 2014.

The 2013-14 internal audit was performed in accordance with the Public Sector Internal Audit Standards (PSIAS).

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

Risk management

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

Each strategic risk is managed by a risk owner who is one of the senior directors. The risk management framework is based on HM Treasury standard guidance in the Orange Book. Its key elements are that:

- the goal of risk management is to support the delivery of our strategy;
- risk ownership responsibilities have been clearly allocated from the Accounting Officer and Board to specific members of staff;
- risk appetite is balanced proportionately between threats, opportunities and resources, and factors such as desired outcomes and maintenance of reputation;
- potential risk areas have been identified with mitigating actions for areas such as decision making, failure of quality assurance, inability to recruit the right staff, failure in business continuity, breaches of security, financial procedures and corporate governance;
- project and operational risk registers are reviewed regularly;
- programme and project directors attend the Audit and Risk Assurance Committee to provide briefings on risk management;
- the strategic risk register is updated regularly and reviewed by the Senior Leadership Team;
- reports on strategic risk are prepared quarterly for Board and Audit and Risk Assurance Committee; and
- actions arising from internal audit studies are followed up to the agreed timetable.

Our risk strategy is reviewed annually and updated as required. During 2013-14, we initiated a project to improve Ofwat's risk management. Building on a self-assessment conducted against the Treasury's Risk Management Assessment Framework in October 2013, the plan aims by the end of the 2014-15 financial year to achieve an improved rating by addressing five key objectives to:

- set out Ofwat's attitudes to risk in a clear risk management strategy;
- build capacity by ensuring people are equipped and supported to manage risks well;
- develop robust processes and co-ordination;
- embed a culture of effective and dynamic risk management across Ofwat; and
- be amongst the best at managing risk by learning from other organisations.

Risk environment

The overall risk environment remained high during the year due to the impact of the need to increase our budgets for 2013-14 and 2014-15, and the delivery pressures associated with the significant changes we

have made for the PR14 and the knock-on effects on other areas of work. At the same time, there has been a significant and high-risk programme of work to support the progress of the Water Bill and make preparations for market opening for non-household customers. Internally, we established a Business Transformation Programme, which will overhaul Ofwat and ensure we are best placed to deliver the new strategy that we have started to develop.

The key risks managed during the year were:

- PR14 has required effective risk management to ensure key strategic goals were progressed, both in terms of finalising the methodology for the price review and developing a robust delivery structure. This required significant additional resources and external engagement to ensure the highest risks were mitigated;
- stakeholder engagement and management of reputational risks, and the effective communication and management of the changes being introduced through PR14; and
- specific risks arising from the organisation's reliance on its Delivery Partner, and the need to implement effective mitigations for conflicts of interest risks across the organisation.

Looking ahead, the risk environment remains uncertain with effective risk management an essential component of delivering PR14, Ofwat's new strategy and the Business Transformation Programme. The cumulative impact of these three activities and their associated risks taken together also features large in the risk environment for the coming year. The new Chief Executive commissioned an internal audit review of procurement upon her arrival. Although this provided substantial assurance, it identified a number of risks which will be addressed by increased scrutiny by the Audit and Risk Assurance Committee, a follow-up internal audit, and a procurement theme within the Business Transformation Programme.

Budget lessons learned

The Senior Leadership Team devoted significant attention to learning lessons from the need, midway through the 2013-14 financial year, to increase Ofwat's 2013-14 budget. The budget increased by £5.6 million (from £21.5 million to £27.1 million) to address an under-estimate of the delivery costs of PR14. The under-estimate in part reflected the challenge of finalising very significant policy change arising from the new price setting methodology while developing a robust delivery plan.

The shortfall was bridged through a combination of a special licence fee of £3.2 million (subsequently offset by a credit note returning £0.85 million to companies to reflect re-profiling of price review activity), and approval from HM Treasury to draw down through the Supplementary Estimate an additional £2.4 million from unspent licence fees from previous years in addition to £1.8 million agreed in the original budget. For 2014-15, a licence modification has been agreed with the sector, which has the effect of increasing the licence fee cap using the provisions of Section 13 of the WIA91.

The Audit and Risk Assurance Committee considered the findings of a lessons learned exercise commissioned by Ofwat's Board on two occasions (in September and November 2013). The final report was considered by the Board in December 2013 and published on our website.

The Audit and Risk Assurance Committee is monitoring progress in implementing the report's recommendations, and the Board has been fully engaged in the process of setting the 2014-15 budget, which drew on the changes made in the light of the issues that emerged in the 2013-14 financial year. Ofwat has shared the lessons it has learned with key stakeholders, including HM Treasury, the National Audit Office and Defra, and is grateful for the constructive advice and support they have provided to the Senior Leadership Team and Board.

Information security statement

Ofwat holds a range of information, the majority of which is policy and commercial with a small number of personal information assets. We have an Information Risk Policy (IRP) and related procedures in place which are reviewed through the Security and Information Assurance Group, which provides clear directions and visible management support for security initiatives.

Although the internal audit review did not highlight any significant concerns for 2012-13, it was recognised that the Security and Information Assurance Group had failed to meet in the period. In 2013-14, the group met twice and it our intention that the group meets quarterly from 2014-15. This group provides governance of security, information risk and information assurance and follows up actions on behalf of the Senior Information Risk Owner.

It was identified as a follow up action in 2012-13, that our business continuity policy and plan required updating. This work is now critical for 2014-15, having delayed its implementation due to an unforeseen relocation of our London office. Now we have a permanent London office, we can now develop and agree a comprehensive business continuity policy that covers both the organisation's Birmingham and London sites.

The lack of a comprehensive information asset register in Ofwat was raised in last year's SRMO. The organisation has an information asset schedule in place, which has been reviewed by internal audit, delivering a 'substantial assurance' rating. The schedule and policy have been updated to reflect the recommendations of internal audit. During 2014-15, we will need to conduct a full information asset audit and develop, deliver and put in place robust arrangements to manage all information assets, including those relating to PR14 at the expiry of the Delivery Partner contract.

Our annual security return for 2013-14 was signed by the Accounting Officer (Senior Information Risk Owner) on 9 June 2014 and submitted to the Cabinet Office.

There are no information risk incidents in 2013-14 which require reporting to the Information Commissioner.

Ofwat's effectiveness

Organisational capability

During the 2013-14 financial year, a number of concerns about Ofwat's organisational capability and effectiveness were highlighted. In particular, the budget forecasting problems and the need to raise an

additional licence fee were symptomatic of problems with corporate planning and an organisation in which accountabilities for delivery and budgets within programmes and projects were not always clear. In addition, the administrative errors that led to the need to seek retrospective HM Treasury approval for expenditure in two areas was symptomatic of underlying cultural factors, also identified by Ofwat's internal auditors, of a culture where – at times – delivery took precedence over compliance. Further, it has been necessary to develop a new strategy that will take Ofwat forward, which has prompted a reassessment of the organisation's needs.

These underlying capability issues are currently being addressed: the organisation's leadership has been transformed during the year with a substantially strengthened Board, including four new Non-executive Directors. A new Chief Executive and Accounting Officer started work in October 2013, and she has appointed a largely new and strengthened Senior Leadership Team.

Business Transformation Programme

Without significant transformation, it is unlikely that Ofwat will be a high performing organisation well placed to fulfil its vision and refreshed strategy to deliver for customers and the sector. In addition, Ofwat becomes subject to the Comprehensive Spending Review from April 2015, and significant transformation is required to enable it to deliver within a substantially reduced budget. Although a re-organisation took place as recently as 2011, its benefits have not been as extensive as the organisation required and so a further change programme is needed. During the second half of 2013-14, Ofwat initiated a major Business Transformation Programme focusing on:

- what we do: clarity about areas of work, priorities and strategic alignment;
- how we work: structures for managing people and delivery, in particular addressing weaknesses in planning, programme and project management; and
- who we are: values, capabilities and experience.

The Business Transformation Programme is a key priority, intended to change Ofwat's culture to embed delivery through programmes and projects, with clear accountabilities for outputs, financial planning and management, as well as a better understanding and management of risk.

We made good progress on the programme during the latter stages of 2013-14 by running a successful voluntary exit scheme, delivering significant work to change our people management, programme management, risk management and business planning systems and by conducting an audit of governance arrangements to improve clarity about roles, responsibilities, delegations and decision making. This early progress provides a strong foundation for further transformation during 2014-15.

There is still further work to do. This includes work to develop and implement a new target operating model that addresses the shape of the organisation and its skill mix; that embeds more effective programme and project management; that delivers a major leadership and management development programme; that addresses issues in procurement, budgeting and financial management; that develops our infrastructure and smarter ways of working; and that develops improved internal governance, particularly improved business and operational planning and compliance and assurance.

The pressure to transform Ofwat at the same time as delivering PR14 will demand excellent management of a number of strategic and operational risks. In particular, the scale of the internal and external change agenda will mean we will need to prioritise rigorously, and ensure we do a few critical things really well. As well as delivering changes in systems, we will need to fully embed them across the organisation's culture. The Business Transformation Programme is a major opportunity for Ofwat to develop its capability and confidence in line with its ambition.

Reviewing Ofwat's effectiveness

The Accounting Officer and Board have responsibility for reviewing the effectiveness of the system of performance management and internal control. The evidence of performance and risk management is informed by the work of the internal auditors and the senior managers within Ofwat who have a responsibility for developing and maintaining the internal control framework, and comments made by the external auditors in their management letter and other reports.

The Accounting Officer has been advised on the implications of the result of her review of the effectiveness of the system of internal control by the Board and the Audit and Risk Assurance Committee and has ensured that the Business Transformation Programme will address weaknesses, deliver continuous improvements of the systems that are in place and provide assurance on compliance and governance.

As an Accounting Officer taking over halfway through the financial year, the Chief Executive took assurance for the first part of the year by:

- having a good general awareness of the organisation's internal control systems having worked at Ofwat as recently as 2011 as Director of Markets and Economics; before taking up post, she held numerous meetings relevant to internal control and assurance, particularly with key internal staff, and both our internal and external auditors;
- becoming involved and engaged in key issues before her arrival, particularly early development of the 2014-15 budget and active involvement in the final budget lessons learned report and action plan;
- based on her understanding of internal control and assurance, shaping and initiating the Business Transformation Programme (see below) to address areas requiring improvement;
- ensuring that each Senior Director has completed an assurance questionnaire confirming the existing of appropriate controls for their areas of responsibility;
- discussing the governance statement with the Senior Leadership Team as part of her assurance process prior to signing the governance statement for the year as a whole; and
- based on the engagement before her arrival, commissioning an immediate internal audit review of procurement and initiating a governance audit as part of the Business Transformation Programme.

The vision, mission and goals of Ofwat's strategy provide the basis of its annual priorities, which are set out in and consulted on, in the forward programme each year. This sets out our high-level objectives for the coming financial year plus a look forward to the following two years. This forward programme drives programme and project plans and ultimately each member of staff's objectives. Directors, project managers and team leaders regularly review progress on programme, project and team plans. The Senior Leadership Team and the Board review progress on the strategy and key projects each quarter.

We have a process of individual performance reviews for staff, which we have enhanced as part of our People Strategy and the wider Business Transformation Programme. The resource requirements for Ofwat are assessed regularly in the context of our rolling three-year Strategic Business Plan and the annual forward programme. The Non-executive Directors also provide the Accounting Officer with an independent view of our performance.

The Board, Audit and Risk Assurance Committee and Senior Leadership Team regularly assess and monitor our performance and related systems of internal control. Our internal auditors in 2013-14, PwC and Grant Thornton, review and advised on our risk management processes and internal controls and during the year reviewed systems and procedures in respect of finance and information security.

PwC and Grant Thornton operate to standards defined in the Public Sector Internal Audit Standards and submit regular reports, which include an independent opinion by the Head of Internal Audit on the adequacy and effectiveness of our systems of internal control together with recommendations for improvement. The opinion of the Head of Internal Audit is that Ofwat has adequate and effective risk management, control and governance processes to manage the achievement of its objectives.

The new Accounting Officer has also had to tackle a number of administrative failings that pre-date her arrival. In particular, this has involved seeking retrospective HM Treasury approval for two areas of historical expenditure, which, while relatively low value, were deemed material by their novel and contentious nature and so were outside Ofwat's delegations. HM Treasury did not approve one business case and rejected one severance payment and issued a penalty for Ofwat's failure to seek the necessary approvals. More detail on the business cases is included within the Remuneration Report. Reflecting the Accounting Officer's commitment to addressing the legacy issues which underpinned this irregular expenditure, a Compliance and Assurance Programme has been initiated within Ofwat's 2014-15 programme.

This has been a challenging financial year for Ofwat, particularly as a result of the issues that arose with the budget and irregular legacy expenditure. We have strengthened our internal controls to reflect these issues, and have shared transparently the actions we have taken to address the lessons learned from the budget issues. Despite these specific issues, internal audit reports have covered a wide range of internal control issues, all of which delivered 'substantial assurance'. On that basis, while recognising the issues that need to be addressed through the Business Transformation Programme, and the action already taken to clear up historical poor practice, we are able to conclude that overall internal control is effective.

Cathryn Ross
Accounting Officer
23 June 2014

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 Ofwat for the year ended 31 March 2014 under the Government Resource Accounts Act 2000. The financial statements comprise: the Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity; and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

Respective responsibilities of the Accounting Officer and auditor

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Chief Executive as 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 Resource 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 mis-statement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to Ofwat's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by Ofwat; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the Chief Executive's report and Part 1: 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 mis-statements 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 2014 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 Ofwat's affairs as at 31 March 2014 and of the net expenditure for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Resource Accounts Act 2000 and the Secretary of State directions issued thereunder.

Opinion on other matters

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with Secretary of State directions made under the Government Resource Accounts Act 2000; and
- the information given in the Chief Executive's report, Part 1: Annual report and the Management Commentary 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 part of the Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- I have not received all of the information and explanations I require for my audit; or
- the Governance Statement does not reflect compliance with HM Treasury's guidance.

Report

My report on these financial statements is on pages 77 to 82

Sir Amyas C E Morse
Comptroller and Auditor General
National Audit Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP
23 June 2014

The Report of the Comptroller and Auditor General to the Houses of Parliament

Introduction

The Water Services Regulation Authority (Ofwat) is the non-ministerial government department responsible for the economic regulation of the water and sewerage industry in England and Wales. Ofwat is independent of government and water companies, and is accountable both to Parliament and the Welsh Assembly. Ofwat's remit is to incentivise water companies to provide household and business customers with a good quality service and deliver value for money by:

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

Ofwat's statutory role and duties are currently laid out in the Water Industry Act 1991. These include the need to conduct a price review exercise on the industry every five years. The price review sets the price, investment and service package that water companies can charge to consumers each year. Ofwat is currently undertaking a review which is due to be completed by the end of the year that will set prices for the period 2015-2020.

Under the Government Resources and Accounts Act 2000, I am required to examine, certify and report on Ofwat's financial statements. This involves gathering evidence to satisfy myself that, in all material respects, the expenditure and income shown in the financial statements have been applied to the purposes intended by Parliament.

The purpose of my report

The 2013-14 financial statements cover a period of significant change and challenge for Ofwat. There has been substantial change to the Board and the senior management team including a new Chief Executive Officer. Ofwat is conducting a periodic price review, which has resulted in a significant increase in the Department's workload and additional pressure on the systems of internal control.

The Water Bill 2014, which received Royal Assent on 14 May 2014, has implications for Ofwat and the sector that it regulates. One of the changes is a new retail market for all

non-domestic customers in England. The Open Water programme has been set up to support delivery of the UK Government's vision for the future of water management in England.

My report explains:

- How I have gained sufficient assurance to support my audit opinion at a time of significant change at Ofwat and when Ofwat has seen failures in the systems of internal control;
- How I have assured myself that the additional funds provided by Parliament to support the price review have been properly applied;
- How I have examined regularity concerns in respect of the Chairman's remuneration package and a small number of ex-gratia severance payments;
- The steps taken by the new senior management team and board to address the weaknesses in internal control;
- Significant areas of judgment; and
- The implications of changes as a result of the Water Act 2014.

Failures in the systems of internal control governing financial planning and forecasting

When preparing for the 2014 price review, Ofwat's new senior management team identified that the Department lacked the necessary skills and capacity to complete the required work effectively. The Board therefore agreed that Ofwat should develop an outsourced delivery partner role to provide greater flexibility to deliver the review. The partnership arrangement was put out for tender, which was subsequently won by PricewaterhouseCoopers. As well as lacking the necessary skills and capacity, Ofwat had also failed to include budgetary cover for the partnership element of the price review exercise when it agreed its budget with HM Treasury to cover its published forward programme covering the financial years 2011-12 to 2014-15. The value of the delivery partner contract to support the price review, which will be incurred in 2013-14 and 2014-15, is up to £6.45 million.

Parliament approved a 2013-14 main estimate for Ofwat, allowing the Department to spend £21.325 million of resource and £0.500 million of capital. This budget was insufficient to fund the price review work, Ofwat's normal regulatory activity, and the cost of moving to a new London office, following the early termination of their lease at the Headquarters of the Department for Communities and Local Government. Ofwat therefore requested a supplementary estimate from Parliament to increase the approval

to spend up to £28.525 million of resource and £0.850 million of capital, in aggregate an increase of £7.550 million or 34.6 per cent. Parliament subsequently approved this additional resource, funded from the Treasury reserve, in part by £2.4 million of unspent licence fees which had previously been surrendered to the Consolidated Fund, and an additional special licence fee levied on the industry. The need for such a large supplementary estimate indicates a significant failure in Ofwat's financial planning. Ofwat's Board has set a gross budget for 2014-15 of £29.940 million to cover the remaining costs of the price review and to fund a business transformation exercise to change Ofwat's structure, embed effective systems and processes and improve organisational culture. The net licence fee will be £0.85 million lower, reflecting unspent resources from 2013-14 being returned to the industry.

The failure to properly plan and budget for the costs of what is a regular periodic activity has caused significant financial pressure for Ofwat. In conducting my audit, I have examined in detail the major liabilities which Ofwat is required to meet, to ensure that all those which relate to activities carried out in 2013-14 are reported in the financial statements. I have also examined Ofwat's year-end cut off procedures to ensure that expenditure incurred in 2013-14 has not been deferred to future years. In carrying out my audit, I have also considered the results of the lessons learned exercise carried out by Ofwat, and reported publicly on the Department's website in January 2014.

Failures in the systems of internal financial controls not delegated to Ofwat

Ofwat has undergone periodic restructuring exercises in recent years. This has resulted in staff leaving the Department under voluntary severance arrangements. My work identified that severance payments made to three staff were over and above those permitted by the Civil Service Compensation Scheme and Ofwat's standard contract of employment. The power to grant extra-contractual payments is not delegated to departments, and requires approval by HM Treasury as set out in Managing Public Money. Consequently Ofwat had to make a retrospective application to HM Treasury to gain approval for the extra-contractual element of the payments which totalled £63,000. Without HM Treasury approval, these payments would have been irregular.

HM Treasury granted retrospective approval for two of the cases, however did not approve one case, where a former staff member (but not a member of the Board or Executive Team) received an ex-gratia benefit to the value of £30,000. The benefit comprised a five month period of gardening leave paid in addition to that individual's contractual notice period. I do not consider this to be material in the context of Ofwat's

financial statements and have therefore not qualified my opinion on regularity in this respect.

My audit of the Department's remuneration report identified allowances paid to the Chairman of Ofwat's Board totalling £16,651 including tax and national insurance, in lieu of hotel costs in 2013-14. These allowances were agreed by a former member of Ofwat's Executive Management Team, and were intended to contribute towards the costs of a flat owned by the Chairman in London when he used it on Ofwat business. I considered these payments to be novel and contentious as defined in Managing Public Money, and as a result Ofwat had no delegated authority to make these payments without HM Treasury approval. Ofwat requested retrospective approval for these payments and for an ongoing accommodation allowance for the Chairman both of which were refused. HM Treasury's refusal to approve the payments meant that they were an irregular charge to Ofwat's budget and would have affected my audit opinion on the regularity of Ofwat's financial statements. Having received the payments in good faith, the Chairman has subsequently repaid the accommodation allowances received by him since his appointment. This is disclosed both in the remuneration report and Accounting Officer's Governance Statement. Ofwat takes responsibility for the arrangements that were put in place. The repayment of these amounts means that there are no irregular transactions in this respect.

Governance Statement and actions of the Board and Chief Executive

The matters on which I have reported reflect significant internal control failures during the financial year. It is important that Ofwat learns from the issues experienced this year and develops robust systems of internal control. I therefore welcome the lessons learned review, which examined in detail the failures of the financial planning and forecasting processes. The report has been published on Ofwat's website and shared with stakeholders and other regulators. It includes an action plan to address the causes of the issues that emerged during this reporting year. This is a welcome plan and crucial for Ofwat, as it is likely to face tighter budgetary constraints in the next spending round period. Ofwat has also exhausted the deferred income that it surrendered to HM Treasury in 2012-13, which represented unspent licence fees that it was no longer permitted to retain following the implementation of the alignment project.

Since her appointment in September 2013, the Accounting Officer has begun to set out a revised strategy for the Department to be delivered through a business transformation programme. She has also worked to address the weaknesses in internal control, as well as carrying out the price review. In my view, the Governance Statement provides a

transparent assessment of the difficulties that Ofwat has faced in the financial year. The statement is also supported by assurances provided by Ofwat's management, and by the new Internal Auditor.

Significant areas of judgment

My audit has also examined in detail, some of the main areas of judgment that have impacted on the financial statements in 2013-14. The largest of these relates to the provision in the financial statements for the performance incentive payment that PricewaterhouseCoopers are eligible to earn for the satisfactory delivery of the price review. The contract includes a delivery milestone for the completion of the risk based review by 30 April 2014 at which point a performance payment of up to 15 per cent of the total value of work invoiced in 2013-14 falls due. As a result of my audit, I am content that Ofwat has correctly provided for the incentive payment in accordance with International Accounting Standard 37 (Provisions, Contingent Liabilities and Contingent Assets). I am also content that this expenditure has been incurred in accordance with Parliamentary authority.

In 2014-15, Ofwat may be liable to pay a second element of the contractual performance incentive payment if the price review exercise is successfully completed by December 2014. As the work has yet to be completed, these costs are not reflected in the financial statements.

A further material area of judgment relates to the capitalisation of costs incurred by Ofwat in fitting out new office accommodation in London, following the early termination of their lease for accommodation in the headquarters of the Department for Communities and Local Government, which paid Ofwat £150,000 towards the cost of fitting out new accommodation. The Statement of Parliamentary Supply shows that the Department came within £25,000 of its capital Parliamentary control total. I have, therefore, examined all costs relating to the office fit-out to ensure that costs have been correctly classified between resource and capital. I am able, as a result of my work, to provide assurance that costs have been correctly classified reported in the financial statements.

Open Water

The 2014 Water Act requires the implementation of market reform in the water sector. This will involve the creation of a new market for retail water and sewerage services for non-domestic customers in England. To allow preparatory work to be undertaken the Department for Environment, Food and Rural Affairs (DEFRA) set up the Open Water

Programme. The water industry, with Ofwat's participation has set up a 'High Level Group' of stakeholders, Chaired by DEFRA and a company, Open Water Market Limited, funded by the industry to deliver this work.

Open Water Market Limited (OWM) is a company limited by guarantee, established by the industry to undertake preliminary work on the Open Water programme. Ofwat provides no direct funding to OWM. The members of OWM are: Ofwat; the Water Industry Commission for Scotland (WICS); and water companies.

The Accounting Officer is considering how to implement a governance structure which will protect her position as being accountable to Parliament for Ofwat's activities, when the accounts of OWM are consolidated with Ofwat's in future years. These proposals have been discussed with my staff, and I have been provided with all of the information and explanations necessary to allow me to undertake my audit of Ofwat's financial statements.

Sir Amyas C E Morse
Comptroller and Auditor General
National Audit Office
157-197 Buckingham Palace Road
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23 June 2014

Statement of Parliamentary Supply

For the year ended 31 March 2014.

Summary of Resource and Capital Outturn 2013-14

£000		Estimate			Outturn			2013-14	2012-13	
		Note	Voted	Non-voted	Total	Voted	Non-voted	Total	Voted outturn compared with Estimate: saving/ (excess)	Total
	Departmental expenditure limit	SOSP3								
	– Resource		3,975	–	3,975	3,898	–	3,898	77	1,148
	– Capital		850	–	850	825	–	825	25	268
	Annually managed expenditure									
	– Resource		–	–	–	–	–	–	–	–
	– Capital		–	–	–	–	–	–	–	–
	Total budget		4,825	–	4,825	4,723	–	4,723	102	1,416
	Total resource		3,975	–	3,975	3,898	–	3,898	77	1,148
	Total capital		850	–	850	825	–	825	25	268
	Total		4,825	–	4,825	4,723	–	4,723	102	1,416

The variance between outturn Resource DEL and Estimated Resource DEL is £77 thousand and is mainly attributable to additional income received, and an unspent contingency budget held for late expenditure adjustments.

The variance between outturn Capital DEL and Estimated Resource DEL is £25 thousand and reflects an unspent contingency budget for leasehold improvement overrun costs for fitting out a new London office.

Net cash requirement 2013-14

£000				2013-14	2012-13
	Note	Estimate	Outturn	Outturn compared with Estimate: saving/ (excess)	2010-11 Outturn
	SOSP4	4,730	1,722	3,008	406

The variance between outturn Net Cash Requirement and Estimated Net Cash Requirement is £1.7 million, reflecting larger than forecast working capital balance at 31 March 2014. As a result, we expect a greater net cash requirement in 2014-15 to settle our creditor balances.

Administration costs 2013-14

£000	2013-14 Estimate	2013-14 Outturn	2012-13 Outturn
	3,975	3,898	1,148

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

Notes to the Departmental Resource Accounts (Statement of Parliamentary Supply)

SOPS1. Statement of accounting policies

The Statement of Parliamentary Supply and supporting notes have been prepared in accordance with the 2013-14 Government Financial Reporting Manual (FReM) issued by HM Treasury. The Statement of Parliamentary Supply accounting policies contained in the FReM are consistent with the requirements set out in the 2013-14 Consolidated Budgeting Guidance and Supply Estimates Guidance Manual.

SOPS1.1 Accounting convention

The Statement of Parliamentary Supply and related notes are presented consistently with HM Treasury budget control and Supply Estimates. The aggregates across government are measured using National Accounts, prepared in accordance with the internationally agreed European System of Accounts (ESA95) framework. ESA95 is in turn consistent with the System of National Accounts (SNA93), which is prepared under the auspices of the United Nations.

The budgeting system, and the consequential presentation of Supply Estimates and the Statement of Parliamentary Supply and related notes have different objectives to IFRS-based accounts. The system supports the achievement of macro-economic stability by ensuring that public expenditure is controlled, with relevant Parliamentary authority, in support of the Government's fiscal framework. The system provides incentives to departments to manage spending well so as to provide high quality public services that offer value for money to the taxpayer.

The Government's objectives for fiscal policy are set out in the Charter for Budget Responsibility. These are to:

- ensure sustainable public finances that support confidence in the economy, promote intergenerational fairness, and ensure the effectiveness of wider government policy; and
- support and improve the effectiveness of monetary policy in stabilising economic fluctuations.

SOPS1.2 Provisions

As per requirements specified in the 2013-14 Consolidated Budgeting Guidance and Supply Estimates Guidance Manual for regulators that are wholly or substantially funded from income, Ofwat's provisions score exceptionally within Departmental Expenditure Limits (DEL).

SOPS2. Net Outturn

For the year ended 31 March 2014.

SOPS2.1 Analysis of net resource outturn by section

£000	Administration						Programme			2013-14	2012-13
	Gross Income		Net	Gross Income		Net	Total	Net total	Estimate	Net total compared to Estimate, adjusted for virements	Estimate
Spending in departmental expenditure limit											
Voted:											
A	27,939	(24,041)	3,898	–	–	–	3,898	3,975	77	–	1,148
Total	27,939	(24,041)	3,898	–	–	–	3,898	3,975	77	–	1,148

Section A – Water Services Regulation Authority.

SOPS2.2 Analysis of capital outturn by section

£000	Administration				Programme		2013-14	2012-13
	Gross Income	Net	Net total	Net total compared to Estimate	Estimate	Net total compared to Estimate, adjusted for virements	Estimate	Total
Spending in departmental expenditure limit								
Voted:								
A	825	–	825	850	25	–	268	
Total	825	–	825	850	25	–	268	

Section A – Water Services Regulation Authority.

SOPS3. Reconciliation of outturn to net operating cost against Administration Budget

For the year ended 31 March 2014.

SOPS3.1 Reconciliation of net resource outturn to net operating cost

			2013-14 £000	2012-13 £000
	Note	Outturn	Supply Estimate	Outturn compared to Estimate
Total resource outturn in Statement of Parliamentary Supply	SOSP2.1	3,898	3,975	77
Net operating costs in Consolidated Statement of Comprehensive Net Expenditure		3,898	3,975	77

SOPS3.2 Outturn against final Administration Budget

	2013-14 £000 Outturn	2012-13 £000 Outturn
Estimate – Administration costs limit	3,975	3,126
Outturn – Gross administration costs	27,939	20,098
Outturn – Gross income relating to administration costs	(24,041)	(18,950)
Outturn – Net administration costs	3,898	1,148

SOPS4. Reconciliation of Net Resource Outturn to Net Cash Requirement

For the year ended 31 March 2014.

	Note	Estimate	Outturn	2013-14 £000 Net total outturn compared to Estimate: saving/ (excess)
Resource outturn	SOPS2.1	3,975	3,898	77
Capital outturn	SOPS2.2	850	825	25
Accruals to cash adjustments, of which:		(95)	(3,001)	2,906
Adjustments to remove non-cash items:				
Depreciation	4	(390)	(374)	16
New provisions and adjustments to previous provisions	4	(140)	(1,086)	(946)
Other non-cash items	4	(45)	(146)	(101)
Adjustments to reflect movements in working balances:				
Increase/(decrease) in receivables	11	–	160	160
(Increase)/decrease in payables	12	272	(2,024)	(2,296)
Use of provisions	13.1, 13.2	208	469	261
Net cash requirement		4,730	1,722	3,008

Statement of Comprehensive Net Expenditure

For the year ended 31 March 2014.

	Note	2013-14 £000	2012-13 £000
Administration costs			
Staff costs	3	12,164	10,607
Other costs	4	15,775	9,491
Income	5	(24,041)	(18,950)
Net operating costs for the year ended 31 March 2014		3,898	1,148
Total expenditure		27,939	20,098
Total income		(24,041)	(18,950)
Income deferred from prior years		–	–
Net operating costs for the year ended 31 March 2014		3,898	1,148
Other comprehensive Net Expenditure			
Items that will not be reclassified to net operating costs:			
Non-cash charges – actuarial (gain)/loss		204	99
Total comprehensive expenditure for the year ended 31 March 2014		4,102	1,247

Statement of Financial Position

For the year ended 31 March 2014.

	Note	31 March 2014 £000	31 March 2013 £000
Non-current assets:			
Property, plant and equipment	6	1,047	619
Intangible assets	7	215	192
Trade and other receivables	11	3	–
Total non-current assets		1,265	811
Current assets:			
Trade and other receivables	11	604	447
Cash and cash equivalents	10	898	1,712
Total current assets		1,502	2,159
Total assets		2,767	2,970
Current liabilities:			
Trade and other payables	12	(5,448)	(4,234)
Total current liabilities		(5,448)	(4,234)
Total assets less current liabilities		(2,681)	(1,264)
Non-current liabilities:			
Provisions	13	(1,184)	(392)
Pension liabilities	13	(2,785)	(2,651)
Other payables	12	(5)	(9)
Total non-current liabilities		(3,974)	(3,052)
Assets less liabilities		(6,655)	(4,316)

	Note	31 March 2014 £000	31 March 2013 £000
Taxpayers' equity:			
General Fund		(6,657)	(4,354)
Revaluation Reserve		2	38
Total equity		(6,655)	(4,316)

Cathryn Ross
Accounting Officer
23 June 2014

Statement of Cash Flows

For the year ended 31 March 2014.

	Note	2013-14 £000	2012-13 £000
Cash flows from operating activities			
Net operating cost	SOSP3	3,898	1,148
Adjustments for non-cash transactions	4	(1,606)	(769)
Increase/(decrease) in trade and other receivables		160	(108)
Increase in trade payables		(1,210)	(571)
Less movements in payables relating to items not passing through the Comprehensive Statement of Net Expenditure		(858)	(40)
Use of provisions	13	469	403
Net cash outflow from operating activities		853	63
Cash flows from investing activities			
Purchase of property, plant and equipment		719	248
Purchase of intangible assets		106	20
Net movement in capital receivables		48	77
Net cash outflow from investing activities		873	345
Cash flows from financing activities			
From the Consolidated Fund (Supply) – current year		(2,620)	(2,118)
Advance from the Contingencies Fund		5,500	4,500
Repayment to the Contingencies Fund		(5,500)	(4,500)
Capital element of payments in respect of finance leases		(4)	(2)
Net financing		(2,624)	(2,120)
Net increase in cash and cash equivalents in the period before adjustment for receipts and payments to the Consolidated Fund		898	1,712
Receipts due to the Consolidated Fund which are outside the scope of the Department's activities		–	–
Payment of amounts due to the Consolidated Fund		(1,712)	(1,679)
Net increase/(decrease) in cash and cash equivalents in the period after adjustment for receipts and payments to the Consolidated Fund		(814)	33
Cash and cash equivalents at the beginning of the period	10	1,712	1,679
Cash and cash equivalents at the end of the period	10	898	1,712

Statement of Changes in Taxpayers' Equity

For the year ended 31 March 2014.

	Note	General Fund £000	Revaluation Reserve £000	Total Reserves £000
Balance at 1 April 2012		(3,554)	38	(3,516)
Changes in taxpayers' equity for 2012-13				
Total comprehensive Net Expenditure for the year		(1,247)	–	(1,247)
Non-cash charges – auditor's remuneration	4	41	–	41
Net Parliamentary Funding – drawn down		2,118	–	2,118
Amounts issued from Consolidated Fund but not spent at year end	10	(1,712)	–	(1,712)
Balance at 31 March 2013		(4,354)	38	(4,316)
Changes in taxpayers' equity for 2013-14				
Total comprehensive Net Expenditure for the year		(4,066)	(36)	(4,102)
Non-cash charges – auditor's remuneration	4	41	–	41
Net Parliamentary Funding – drawn down		2,620	–	2,620
Amounts issued from Consolidated Fund but not spent at year end	10	(898)	–	(898)
Balance at 31 March 2014		(6,657)	2	(6,655)

Notes to the Departmental Accounts

1. Statement of accounting policies

These financial statements have been prepared in accordance with the 2013-14 Government Financial Reporting Manual (FReM) issued by HM Treasury. The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of Ofwat for the purpose of giving a true and fair view has been selected. The particular policies adopted by Ofwat are described below. They have been applied consistently in dealing with items that are considered material to the accounts.

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

1.1 Accounting convention

These accounts have been prepared under the historical cost convention modified to account for the revaluation of property, plant and equipment and intangible assets at fair value to the business by reference to their valuation in existing use.

1.2 Property, plant and equipment

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

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

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

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

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

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

1.3 Intangible assets

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

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

1.4 Amortisation

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

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

1.5 Financial instruments

Owat does not hold any complex financial instruments. Financial instruments included within these accounts are receivables and payables (notes 11 and 12). Trade receivables are recognised initially at fair value less provision for impairment. A provision for impairment is made when Owat is unable to collect an amount due in accordance with the agreed terms.

1.6 Financing

Owat is primarily resourced by licence fees. Licence fees are charged to companies that Owat regulates in the water sector. The licence fees levied are subject to a ceiling governed by condition N of the WIA91.

1.7 Operating income

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

Since all costs are recovered through the licence fees and are invoiced in advance based on estimated costs, any income from licence fees that exceeds the level of operating costs is to be surrendered to the Consolidated Fund.

1.8 Cash

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

1.9 Trade receivables

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

1.10 Fines and penalty income

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

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

1.11 Administration and programme expenditure

Administration costs are recorded in the Statement of Comprehensive Net Expenditure. They include the costs of running Ofwat, as determined under the administration cost-control framework. There was no programme expenditure between 1 April 2013 and 31 March 2014 (2012-13: nil).

1.12 Leases

Rentals due on operating leases are charged over the lease term on a straight line basis or on the basis of actual rental payable where this fairly reflects usage.

Equipment purchased under a finance lease is charged to the Statement of Comprehensive Net Expenditure through depreciation on a straight line basis over

the minimum term of the lease. An annual interest charge is calculated at either the rate explicit in the lease or the Bank of England base rate as at the contractual date if no rate is explicit in the lease.

1.13 Pensions

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

The retired Directors General are covered by 'by-analogy pension schemes' that offer similar benefits to the PCSPS. However, unlike the PCSPS a pension liability is included in the accounts as required by IAS19.

1.14 Value Added Tax

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

1.15 Provisions

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

The discount rate for pension liabilities changed from to 2.35% per annum to 1.8% per annum with effect from 31 March 2014.

1.16 Contingent liabilities

In addition to contingent liabilities disclosed in accordance with IAS37, Ofwat discloses for Parliamentary reporting and accountability purposes certain statutory and non-

statutory contingent liabilities where the likelihood of a transfer of economic benefit is remote, but which have been reported to Parliament in accordance with the requirements of Government Accounting.

Where the time value of money is material, contingent liabilities which are required to be disclosed under IAS37 are stated at discounted amounts and the amount reported to Parliament separately noted. Contingent liabilities that are not required to be disclosed by IAS37 are stated at the amounts reported to Parliament.

1.17 Going concern

The Statement of Financial Position at 31 March 2014 shows negative taxpayers' equity of £6.7 million. In common with other government departments, the future financing of the Ofwat's liabilities are accordingly to be met by future grants of Supply and the application of future income, both to be approved annually by Parliament. There is no reason to think that future approvals will not be forthcoming. Accordingly, it has been considered appropriate to adopt a going concern basis for the preparation of these financial statements.

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

1.18 Staff costs

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

1.19 Accounting estimates

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

2. Operating costs

2.1 Statement of operating costs by strategy strand

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

Description of strands	2013-14 £000	2012-13 £000
Ensuring a fair deal for consumers	4,475	2,796
Keeping companies accountable	4,651	3,047
Making monopolies improve	3,801	3,509
Harnessing market forces	4,695	3,912
Contributing to sustainable development	3,671	2,073
Delivering better regulation	5,377	3,526
Thames Tideway project regulation	1,269	1,235
Total expenditure	27,939	20,098
Total income	(24,041)	(18,950)
Net expenditure	3,898	1,148

3. Staff costs

3.1 Staff numbers and related costs

Staff costs comprise:

	2013-14 £000				2012-13 £000
	Total	Permanently employed staff	Others	Non-exec Directors	Total
Wages and salaries	9,303	8,917	177	209	8,221
Social Security costs	842	821	–	21	741
Other pension costs	1,800	1,800	–	–	1,581
Other staff costs	219	219	–	–	64
Sub-total	12,164	11,757	177	230	10,607
Less recoveries in respect of outward secondments	(27)	(27)	–	–	–
Total net costs*	12,137	11,730	177	230	10,607

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

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded multi-employer defined benefit scheme but Ofwat is unable to identify its share of the underlying assets and liabilities. The scheme actuary valued the scheme as at 31 March 2007. Details can be found in the accounts of the Cabinet Office: Civil Service Superannuation (www.civilservice.gov.uk/pensions).

For 2013-14, employer's contributions of £1,758,171 were payable to the PCSPS (2012-13: £1,538,824) at one of four rates in the range 16.7% to 24.3% (2012-13: 16.7% to 24.3%) of pensionable pay, based on salary bands. The Scheme Actuary reviews employer contributions usually every four years following a full scheme valuation. The salary bands and contribution rates are set to meet the cost of the benefits accruing during 2013-14 to be paid when the member retires and not the benefits paid during this period to existing pensioners.

Employees can opt to open a partnership pension account, a stakeholder pension with an employer contribution. Employers' contributions of £22,038 (2012-13: £32,693) were paid to one or more of the panel of three appointed stakeholder pension providers. Employer contributions are age-related and range from 3% to 12.5% of pensionable pay. Employers also match employee contributions up to 3% of pensionable pay. In addition, employer contributions of £1,561, 0.8% (2012-13: £2,269; 0.8%) of pensionable pay, were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service or ill health retirement of these employees.

Contributions due to the partnership pension providers at the date of the Statement of Financial Position were £1,377 (2012-13: £2,576). Contributions prepaid at that date were nil (2012-13: nil).

3.2 Average number of persons employed

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

	Permanently employed staff		2013-14 number		2012-13 number
	Total	Others	Non-exec	Directors	Total
Ensuring a fair deal for consumers	34.04	33.89	–	0.15	31.35
Keeping companies accountable	35.89	35.74	–	0.15	33.78
Making monopolies improve	27.09	26.94	–	0.15	21.98
Harnessing market forces	33.33	33.18	–	0.15	33.95
Contributing to sustainable development	28.42	25.27	3.00	0.15	24.58
Delivering better regulation	26.30	26.15	–	0.15	31.90
Thames Tideway project regulation	3.15	3.00	–	0.15	2.12
Total	188.22	184.17	3.00	1.05	179.66

3.3 Reporting of Civil Service and other compensation schemes – exit packages

Redundancy and other departure costs have been paid in accordance with the provisions of the Civil Service Compensation Scheme, a statutory scheme made under the Superannuation Act 1972. Exit costs are accounted for in the year that obligation has arisen. Where the department has agreed early retirements, the additional costs are met by the department and not by the Civil Service pension scheme. Exit costs do not include the balance of any annual leave due at the date of exit and are not included in this table.

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

Cost band	2013-14	2013-14	2013-14	Restated 2012-13
	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	–	1	1	–
£10,000 – £25,000	–	4	4	1
£25,001 – £50,000	–	5	5	1
£50,001 – £100,000	–	4	4	–
£100,001 – £150,000	–	1	1	2
£150,001 – £200,000	–	–	–	1
Total resource cost (£000)	–	717	717	482

The 2012-13 disclosure has been restated to include the cost of payments in lieu of notice that formed part of the exit packages.

Ex gratia payments paid during the period are included in the table above and disclosed on page 58 of the Remuneration Report.

4. Other administration costs

	2013-14 £000 Outturn	2012-13 £000 Outturn
Rentals under operating leases:		
Accommodation	1,489	1,073
Office equipment	37	36
	1,526	1,109
Non-cash items:		
Depreciation	291	244
Amortisation	83	87
Loss on disposal of assets	–	3
Restructuring provisions	385	271
Incentive payment provisions	701	–
Other finance costs	105	123
External auditor's remuneration	41	41
	1,606	769
Other expenditure:		
Consultancy and professional services	7,425	4,057
Contingent labour	2,643	1,321
Training	77	109
Travel and subsistence	521	400
Taxation charges	43	50
Rates	268	205
Computer hire and maintenance	392	354
Other hire and maintenance	71	85
Seminars, meetings and conferences	112	159
Minor items and stationery	32	21
Publications	45	45
Books and periodicals	36	33

	2013-14 £000 Outturn	2012-13 £000 Outturn
Postal services and couriers	18	11
Telecommunications	124	142
Recruitment costs	220	199
Office consumables	195	58
Accommodation expenses	96	141
Internal audit fees	52	38
Professional subscriptions	26	51
Transfer allowance – relocation	2	–
Payroll and pension services	21	29
Business continuity	25	23
Record management	15	19
Pay case penalty	120	–
Other	64	63
	12,643	7,613
Total	15,775	9,491

Rentals under operating lease expenditure during 2013-14 include overlapping Memorandum of Terms and Occupation (MOTO) in relation to our London office for the period 1 September 2013 to 31 March 2014. This covers the period of leasehold improvement works at the new permanent office and relocation following early termination of our previous agreement by the Department of Communities and Local Government.

The new MOTO has a 15-month rent-free period, which is spread over the life of the lease in line with accounting standard IAS 17 – Leases, and is recorded as deferred income in note 12.

Office consumables includes the revenue costs associated with fitting out the new London office in 2013-14.

5. Income

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

	2013-14 £000 Outturn	2012-13 £000 Outturn
RfR1		
Licence fees	23,848	18,934
Licence fees received in advance – prior year	–	3
Miscellaneous	193	13
Total	24,041	18,950

Ofwat is mandated to collect licence fees from the appointed companies and licensed suppliers in respect of the Consumer Council for Water's operating costs. In 2013-14, we collected £5.1 million, which was transferred to the Department for Environment, Food and Rural Affairs. In accordance with HM Treasury guidance, we do not record these transactions in our financial statements.

6. Property, plant and equipment

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

	£000	£000	£000	£000	£000	£000
	Furniture and fittings	Office machinery and telecomms	Leasehold improve- ments	Information technology payments on account	Information technology	Total
Cost or valuation						
At 1 April 2013	65	327	550	–	1,555	2,497
Additions	–	3	643	14	59	719
Disposals	–	(259)	–	–	–	(259)
At 31 March 2014	65	71	1,193	14	1,614	2,957

	£000	£000	£000	£000	£000	£000
	Furniture and fittings	Office machinery and telecomms	Leasehold improve- ments	Information technology payments on account	Information technology	Total
Depreciation						
At 1 April 2013	20	290	228	–	1,340	1,878
Charged in year	6	12	145	–	128	291
Disposals	–	(259)	–	–	–	(259)
At 31 March 2014	26	43	373	–	1,468	1,910
Carrying amount at 31 March 2014						
	39	28	820	14	146	1,047
Carrying amount at 31 March 2013						
	45	37	322	–	215	619
Asset financing:						
Owned	39	20	820	14	146	1,039
Finance leased	–	8	–	–	–	8
Carrying amount at 31 March 2014	39	28	820	14	146	1,047
Cost or valuation						
At 1 April 2012	58	350	381	102	1,517	2,408
Additions	7	16	176	–	49	248
Reclassifications	–	–	–	(102)	102	–
Disposals	–	(39)	(7)	–	(113)	(159)
At 31 March 2013	65	327	550	–	1,555	2,497

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	£000	£000	£000	£000	£000	£000
	Furniture and fittings	Office machinery and telecomms	Leasehold improve- ments	Information technology payments on account	Information technology	Total
Depreciation						
At 1 April 2012	14	267	153	–	1,357	1,791
Charged in year	6	62	79	–	96	243
Disposals	–	(39)	(4)	–	(113)	(156)
At 31 March 2013	20	290	228	–	1,340	1,878
Carrying amount at 31 March 2013	45	37	322	–	215	619
Carrying amount at 31 March 2012	44	83	228	102	160	617
Asset financing:						
Owned	45	26	322	–	215	608
Finance leased	–	11	–	–	–	11
Carrying amount at 31 March 2013	45	37	322	–	215	619

7. Intangible assets

Purchased software licences.

	£000	£000	£000
	Purchased software licences	Assets under development	Total
Cost or valuation			
At 1 April 2013	375	13	388
Additions	106	–	106
At 31 March 2014	481	13	494

	£000	£000	£000
	Purchased software licences	Assets under development	Total
Amortisation			
At 1 April 2013	196	–	196
Charged in year	83	–	83
At 31 March 2014	279	–	279
Carrying amount at 31 March 2014			
	202	13	215
Carrying amount at 31 March 2013			
	179	13	192
Cost or valuation			
At 1 April 2012	409	26	435
Additions	20	–	20
Reclassifications	13	(13)	–
Disposals	(67)	–	(67)
At 31 March 2013	375	13	388
Amortisation			
At 1 April 2012	176	–	176
Charged in year	87	–	87
Disposals	(67)	–	(67)
At 31 March 2013	196	–	196
Carrying amount at 31 March 2013			
	179	13	192
Carrying amount at 31 March 2012			
	233	26	259

8. Capital and other commitments

8.1 Capital commitments

	2013-14 £000	2012-13 £000
Contracted capital commitments at 31 March not otherwise included in these financial statements		
Property, plant and equipment	–	9
Intangible assets	–	149
	–	158

8.2 Operating leases

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

	2013-14 £000	2012-13 £000
Obligations under operating leases comprise:		
Buildings		
Not later than one year	1,525	1,131
Later than one year and not later than five years	4,492	2,874
Later than five years	2,255	–
	8,272	4,005
Other		
Not later than one year	40	–
Later than one year and not later than five years	143	–
Later than five years	–	–
	183	–

8.3 Finance leases

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

	2013-14 £000	2012-13 £000
Obligations under finance leases comprise:		
Other		
Not later than one year	4	4
Later than one year and not later than five years	5	9
Later than five years	–	–
	9	13
Less interest element	(1)	(1)
	8	12

9. Financial instruments

Ofwat is not exposed to the degree of financial risk faced by commercial entities because of the largely non-trading nature of its activities and the way in which government departments are financed. Ofwat has no powers to borrow or invest surplus funds. Financial assets and liabilities are generated by day-to-day operational activities and are not held to change the risks facing the office in carrying out its activities.

9.1 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 liquidity risks.

9.2 Interest rates and foreign currency risks

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

9.3 Fair values

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

10. Cash and cash equivalents

	2013-14 £000	2012-13 £000
Balance at 1 April	1,712	1,679
Net change in cash and cash equivalent balances	(814)	33
Balance at 31 March	898	1,712
The following balances are held at:		
Government Banking Services (GBS)	898	1,712
Balance at 31 March	898	1,712

11. Trade receivables and other current assets

11.1 Analysis by type

	2013-14 £000	2012-13 £000
Amounts falling due within one year		
Trade receivables	27	17
Deposits and advances	153	55
HM Revenue and Customs (VAT)	69	53
Prepayments and accrued income	355	322
	604	447
Amounts falling due after more than one year		
Prepayments and accrued income	3	–
	3	–

11.2 Intra-government balances

	Amounts falling due within one year		Amounts falling due after more than one year	
	£000		£000	
	2013-14	2012-13	2013-14	2012-13
Balances with other central government bodies	69	53	–	–
Balances with local authorities	49	20	–	–
Intra-government balances	118	73	–	–
Balances with bodies external to government	486	374	3	–
Total receivables at 31 March	604	447	3	–

12. Trade payables and other current liabilities

12.1 Analysis by type

	2013-14 £000	2012-13 £000
Amounts falling due within one year		
Trade payables	1,390	175
Other payables	206	174
Accruals	2,294	1,894
Deferred income	374	15
Current part of finance leases	3	3
Other taxation and Social Security	283	261
Excess cash due to be paid to the Consolidated Fund	898	1,712
	5,448	4,234
Amounts falling due after more than one year		
Finance leases	5	9
	5	9

12.2 Intra-government balances

	Amounts falling due within one year		Amounts falling due after more than one year	
	£000		£000	
	2013-14	2012-13	2013-14	2012-13
Balances with other central government bodies	1,318	2,018	–	–
Balances with other public bodies	152	–	–	–
Intra-government balances	1,470	2,018	–	–
Balances with bodies external to government	3,978	2,216	5	9
Total payables at 31 March	5,448	4,234	5	9

13. Provisions for liabilities and charges

13.1 Provisions

	Restructure costs	Incentive payment costs	2013-14	2012-13
			£000	£000
			Total	Total
Balance at 1 April 2013	392	–	392	354
Provided in the year	385	701	1,086	271
Provisions utilised in the year	(294)	–	(294)	(233)
Balance at 31 March 2014	483	701	1,184	392
Analysis of expected timing of discounted flows				
Not later than one year	416	701	1,117	294
Later than one year and not later than five years	67	–	67	98
Later than one year and not later than five years	–	–	–	–
Balance at 31 March 2014	483	701	1,184	392

The Strategic Report provides further information in respect to new provisions and movements in provisions for 2013-14.

13.2 Pension liabilities

	2013-14 £000	2012-13 £000
Balance at 1 April 2013	2,651	2,600
Analysis of the amount charged to the Statement of Comprehensive Net Expenditure:		
Interest costs	105	122
Benefits paid	(175)	(170)
Analysis of the amount recognised in the Statement of Changes in Taxpayers' Equity:		
Experience (gain)/loss	61	24
Actuarial (gain)/loss	143	75
Balance at 31 March 2014	2,785	2,651

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 2014.

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

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

members of the same age and gender. Husbands are assumed to be three years older than their wives.

The main financial assumptions (used to assess liabilities at 31 March 2014) are as follows.

- The gross discount rate is assumed to be 4.35 % a year (31 March 2013: 4.10%).
- The rate of increase in salaries is assumed to be 4.50% (31 March 2013: 3.95%).
- The rate of increase in pensions payments is assumed to be 2.50% (31 March 2013: 1.70%).
- Consumer price inflation 2.50% (31 March 2013: 1.70%).

A cumulative actuarial loss of £1.9 million has been incurred by the scheme since 1 April 2004.

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 5.0% or £139 thousand.
- Decreasing the CPI inflation assumption by 0.5% would result in a corresponding decrease in liabilities of approximately 5.0% or £139 thousand.
- Increasing assumed life expectancies in retirement to be equal to those of people one year younger, would result in a corresponding increase in liabilities of approximately 4.0% or £111 thousand.

The opposite changes in assumptions to those set out above 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.

Analysis of actuarial loss

	2013-14 £000	2012-13 £000	2011-12 £000
Experience (gains)/losses arising on the scheme liabilities	61	24	71
Changes in assumptions underlying the present value of scheme liabilities	143	75	39
Per Statement of Changes in Taxpayers' Equity	204	99	110

History of experience losses

	2013-14	2012-13	2011-12	2010-11	2009-10
Experience (gains)/losses arising on the scheme liabilities					
Amount (£000)	61	24	71	15	63
Percentage of the present value of the scheme liabilities	2.2%	0.9%	2.7%	0.6%	2.2%
Total amount recognised in Statement of Taxpayers' Equity					
Amount (£000)	204	99	110	(103)	546
Percentage of the present value of the scheme liabilities	7.3%	3.7%	4.2%	(4.1)%	18.8%

14. Contingent liabilities disclosed under IAS37

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

Open Water Markets Limited is company limited by guarantee of which Ofwat is a member. Ofwat holds a £1 liability that would become payable should the company become insolvent.

15. Related party transactions

Ofwat transferred £5.1 million to the Department for Environment, Food and Rural Affairs in respect of the Consumer Council for Water's operating costs for 2013-14.

Open Water Markets Limited is company limited by guarantee of which Ofwat is a member; since incorporation (26 November 2013) Sonia Brown, Ofwat's Chief Regulation Officer, is a Non-executive Director of Open Water Markets Limited. Ofwat has provided support to the company as prudent preparation ahead of the Water Bill receiving Royal Assent. Services provided to Open Water Markets Limited total £98 thousand, and include the secondment of three members of staff and provision of refreshments for business meetings. In addition, Ofwat has provided services in kind, which include use of our meeting rooms.

During 2013-14, Ofwat spent £271 thousand with Lucerna Partners Ltd on two contracts, which expired on 31 July 2013. The former Chief Executive, Regina Finn, became a director of Lucerna Partners on 10 November 2013.

Ofwat also has a small number of immaterial transactions with other government departments. There are no related party transactions between Ofwat and any of its Directors.

16. Events after the reporting period

There are no events that materially impact on the financial statements.

The Accounting Officer duly authorised the issue of these financial statements on the date of the Comptroller and Auditor General's audit certificate.

Appendix 1

Measuring our performance

In 2012-13, we published 'A consultation on measuring and reporting our performance' alongside the consultation on our forward work programme for 2013-14 to 2015-16. It set out our proposed performance framework for measuring our 'Delivering sustainable water' strategy, which we published in 2010. It also set out our intention to trial our performance framework and report on the results in this year's annual report.

During 2013-14, we began to develop a new strategy. We plan to use our draft performance framework, and the responses we received to our consultation, as we develop a performance framework for our new strategy. This will include our proposals for publishing regular information about our performance so that we continue to be accountable to:

- customers;
- taxpayers; and
- other stakeholders.

Appendix 2

Having regard to guidance from Government

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

Guidance from the Secretary of State

In May 2013, and following consultation, the UK Government published a strategic policy statement (SPS) to us, including revised social and environmental guidance. This sets out ten priority areas to which the UK Government expects us to have regard in carrying out our work.

The SPS makes it a requirement:

- for us to report on a regular basis to the Secretary of State on how we have reflected these priorities in our regulatory decisions;
- for our Chairman to agree a reporting timetable with the Secretary of State – and review it every year;
- for us to summarise what action we have taken to support the delivery of the priorities in our annual report and accounts; and
- for us to summarise the steps we propose to take to further the delivery of the priorities in our forward work programme each year.

We have written to the Secretary of State setting out that alongside reporting in our annual report against the ten priorities in the SPS, we will publish specific reports each year on agreed specific priorities. For 2013-14, this comprises:

- a contribution to the UK Government's sustainable development objectives;
- evidence of sufficient company action to help customers struggling to pay bills; and
- progress on competition.

Below, we summarise what action we have taken to support the delivery of the priorities.

Priority and contribution

1. Impacts of regulatory changes on sector investment prospects

We developed our PR14 methodology (see pages 13-14) in close consultation with our stakeholders, including investors. Our methodology will benefit customers, the environment, companies and investors. For example, we maintained the stable, transparent and predictable regulatory framework that investors need to have the confidence to invest. We did this by committing to:

- set companies' wholesale price controls using tried and tested tools – including using the familiar concept of the regulatory capital value (RCV) – that investors value;
- provide more opportunities for companies to innovate and outperform our assumptions in price controls – and investors to benefit as a result; and
- place clear accountability for the quality of each company's business plan on its directors – and the opportunity to earn rewards by submitting an enhanced plan.

2. Proportionality of the regulatory framework

Our PR14 methodology included us taking a risk-based – and more proportionate – approach to reviewing companies' business plans (see page 20).

Our approach to Board leadership, transparency and governance (see page 17) will encourage companies and their owners to take a self-regulatory approach, rather than imposing new burdens. We welcome the support we have had from companies' boards to this approach.

Our principles-based approach to customer information (see page 14) also gave companies more freedom and responsibility to meet their customers' needs.

3. Impacts of the regulatory framework on sector investment profile / 4. Contribution to the UK Government's sustainable development objectives / 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 / 7. Impacts of the regulatory approach on sector resilience and sustainable water resource management / 10. Effectiveness of the 2014 price review in delivering outcomes sought by customers and other stakeholders

Our PR14 methodology has:

- focused companies on delivering the services their customers want (see page 14);
- allowed companies the flexibility to deliver innovative solutions that meet these outcomes in the most cost-efficient way (see page 26);

Appendix 2

- tackled the perceived bias companies had towards building new large-scale capital solutions, allowing them to propose more innovative and sustainable solutions such as catchment management, water trading and water efficiency (see page 26);
- maintained a stable regulatory framework to enable investment into the sector (see priority 1); and
- placed the onus on company Boards to own and be accountable for their business plans, including providing assurance that their plan was high quality and will deliver good outcomes for current and future customers and the environment (see page 20).

Our work on the Thames Tideway (see page 14) has supported the development of a long-term investment proposition which will enable the delivery of a major infrastructure project. This project will bring the River Thames into compliance with the Urban Wastewater Treatment Directive and provide necessary resilience in the sewer network for future generations.

We have contributed to preparations to implement an effective market to allow all non-household customers to choose their supplier (see page 23). Based on the experience of a similar market in Scotland, retail competition is expected to increase water efficiency by non-household customers significantly, which will also help reduce their bills and carbon emissions.

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

Our PR14 methodology has encouraged companies, among other things, to consider wider affordability to all of their customers and specific help to vulnerable customers.

In their business plans (see page 20), only two companies in England proposed an increase in their average household bills for their customers between 2015 and 2020 before inflation. And every company proposed a social tariff as part of their engagement with customers. Only two companies were unable to secure customer acceptability for their social tariff in their business plan so have no plans to introduce one.

A key part of company action to help customers struggling to pay bills is to make these customers aware to the support that already exists. Our principles-based approach to customer information (see page 14) gave companies more freedom and responsibility to meet their customers' needs, including those struggling to pay.

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

The UK Government's Water Bill will allow all non-household customers in England to choose their water and wastewater services supplier. We have contributed to preparations to implement these reforms (see page 22).

Appendix 2

Guidance from the Welsh Government

In December 2013, and following consultation, the Welsh Government laid before the Assembly new social and environmental guidance (SEG) to us, including the priority areas to which they expect us to have regard in carrying out our work. In February 2014, this was confirmed by the Assembly. The SEG includes an expectation that we will provide feedback on the management of these overarching priorities as part of our annual reporting process.

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

Appendix 2

Priority and contribution

Regulatory proposals: assess impacts of regulatory changes on consumers and investors / Research and evidence-based decisions and policy making: take account of research and costs in making decisions

We developed our PR14 methodology (see page 19) in close consultation with our stakeholders, including customer representatives and investors. Our methodology will benefit customers, the environment, companies and investors.

Our approach to Board leadership, transparency and governance (see page 17) has encouraged a self-regulatory approach, rather imposing new burdens.

Our principles-based approach to customer information (see page 14) also gave companies more freedom and responsibility to meet their customers' needs.

Sustainable development: contribute to the Welsh Government's sustainable development objectives / Efficiency and cost effective solutions: drive innovation within the boundaries set by the Welsh Government to ensure improvements in efficiency / Resilience and joined up outcome-based solutions: enable resilience against natural and other hazards / Integrated water management solutions: encourage sustainable and innovative water management solutions / Future resource management: encourage integrated long term planning and solutions

Our PR14 methodology has:

- focused companies on delivering the services their customers want (see page 14);
 - allowed companies the flexibility to deliver innovative solutions that meet these outcomes in the most cost-efficient way (see page 26);
 - tackled the perceived bias companies had towards building new large-scale capital solutions, allowing them to propose more innovative and sustainable solutions such as catchment management, trading water and water efficiency (see page 26);
 - maintained a stable regulatory framework to enable investment into the sector (see priority 1); and
 - placed the onus on company Boards to own and be accountable for their business plans, including providing assurance that their plan was high quality and will deliver good outcomes for current and future customers and the environment (see page 20).
-

Appendix 2

Affordability: take account of affordability issues in Wales

Our PR14 methodology has encouraged companies, among other things, to consider wider affordability to all of their customers and specific help to vulnerable customers.

In its December business plan (see page 20), Dŵr Cymru proposed to reduce the average household water and wastewater bill for its customers between 2015 and 2020 by 4.8% before inflation. Dee Valley Water proposed an increase of 8.9% before inflation.

We will challenge both companies' plans during 2014-15 to get the best deal for customers in Wales, while making sure that the service they receive from their water company improves. In its revised business plan, submitted in May 2014, Dŵr Cymru proposed a bill reduction of 6% in real terms.

Both Dŵr Cymru and Dee Valley Water have also proposed introducing a social tariff between 2015 and 2020, which will help customers who are struggling to pay their bills. While Dŵr Cymru proposes to introduce a social tariff in 2015-16, Dee Valley Water has stated that it would introduce one during the next five years.

A key part of company action to tackle affordability is to make these customers aware of the support that already exists. Our principles-based approach to customer information (see page 14) gave companies more freedom and responsibility to meet their customers' needs, including those struggling to pay.

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

In Wales, Natural Resources Wales is responsible for regulating and ensuring compliance with environmental obligations. The Drinking Water Inspectorate (DWI) regulates and ensures compliance with drinking water quality.

Our PR14 methodology required companies to prepare business plans for the next five years (see page 20) that, among other things, delivered their drinking water and environmental obligations. For example, Dŵr Cymru included a specific outcome of 'Safe drinking water' in its December business plan, while Dee Valley Water's December business plan had a similar outcome to 'Provide excellent water quality'.

Both Natural Resources Wales and the DWI have played an active part in the PR14 process. For example, they were members of companies' customer challenge groups (see page 14), which challenged each company's engagement with customers and other stakeholders in developing its business plan.

Appendix 3

List of impact assessments carried out during 2013-14

'Updated Price Limits Impact Assessment, Water Services Regulation Authority (Ofwat)', October 2013.

Appendix 4

Review of Board effectiveness

Following my appointment as Ofwat's Chairman in November 2012, the Board engaged in a 'real time' programme to review its own effectiveness and that of the Board Committees. Together with Defra, which sets water policy, we concluded that it would be timely to strengthen the non-executive membership of the Board.

During 2013-14, we welcomed four new colleagues who were selected in a process designed to strengthen our breadth of skill and expertise, and to complement the skills of existing Board members. Appointments are made by the Secretary of State on the recommendation of the Chairman of Ofwat and the interviewing panel. Christopher Burchell, Martin Lawrence and Catherine Waddams joined us in May 2013, and Christine Farnish joined us in January 2014 in anticipation of Penny Boys' retirement.

In May 2013, we embarked on a process to find a new Chief Executive, Cathryn Ross, and at the same time promoted Sonia Brown to the position of Chief Regulation Officer. Cathryn joined us as CEO and an Executive Director in November 2013. We also appointed and welcomed several new Senior Directors to the Senior Leadership Team, including the appointment of Richard Khaldi, Senior Director of Customers and Casework. Richard joined the Board as an Executive Director.

During the year, we carried out a review of the Board Committees, resulting in new appointments to the Remuneration and Audit Committees, both now operating under new Chairs, respectively Martin Lawrence and Wendy Barnes. We created new committees for PR14, Nominations, and Casework as detailed elsewhere in this report.

In view of this real time succession management, we concluded that formal processes of evaluation should be delayed into 2014 so that the Board had at least six months of experience of working as a team. As an interim measure, a number of informal discussions were held to review the effectiveness and working style of the Board. The Board and Board Committees will be carrying out an annual review of effectiveness in quarter 3 this year. We will report the outcome in next year's annual report.

Jonson Cox
Chairman

Appendix 5

Progress in reducing regulatory burdens

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 set out below.

Report on progress

Our more targeted and proportionate price setting methodology has meant we have been able to reduce the regulatory burden on companies in a number of areas.

- We changed our approach in respect of what each company included in its plan. We looked to companies to deliver high-quality business plans based on providing the services their customers wanted and meeting their legal obligations as opposed to meeting our regulatory information requirements.
- Where we considered that plans were of a high quality we committed to stepping back and allowing those companies to get on with delivering for customers. So, South West Water and Affinity Water will face reduced scrutiny as a result of them delivering the highest quality ('enhanced') business plans.

During the year, we adopted a new, less prescriptive regulatory approach for ensuring that companies meet their obligations to customers in terms of the information they receive. Our principles-based approach gives companies the freedom to be more innovative, and significantly more responsive, to customers' rapidly changing information needs. Among other things, it will also:

- reduce unnecessary regulatory burdens by requiring less frequent routine scrutiny of how companies are meeting their obligations; and
- target our regulatory oversight on the more risky areas or companies.

Appendix 6

Performance against stated levels of service

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

We set out our performance for 2013-14 against our standards of service below.

General enquiries

In 2013-14, we replied to more than 5,300 enquiries, including phone calls and written correspondence. This compares with 4,700 in 2012-13.

Performance standard for general enquiries

Standard	2013-14	2012-13
At least 95% of all enquiries to be dealt with within ten working days	98.3%	97.3%

Information requests

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

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

Over the past year, we received 265 information requests that we dealt with under the FOIA and EIR. We responded to 97.35% within deadlines.

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.

Appendix 6

Disputes and complaints about water and wastewater services

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

We are responsible for the following disputes and complaints.

- Complaints about regulatory policy.
- Allegations of breach of duty by a company.
- Water supply and sewer connection charges.
- Requisitioning of water mains, sewers and lateral drains.
- Adoption and financial arrangements in respect of self-laid mains.
- Sewer transfer appeals.
- Refusals by the companies to install an optional meter.
- Guaranteed standards scheme (GSS) payments.
- Trade effluent appeals.
- Pipe-laying in streets and across private land.

The time taken to resolve disputes and complaints depends on the nature and complexity of individual cases.

In 2013-14, we introduced new performance measures, to complement our existing measures, to monitor and improve our performance. We continue to keep all aspects of our performance under review.

Initial response to disputes and complaints

We aim to respond to all disputes and complaints efficiently and effectively. We aim to meet our performance standard.

In 2013-14, we received 221 disputes and complaints. We set out our performance against our performance standard below.

Performance standard for general enquiries		
Standard	2013-14	2012-13
Initial response to 95% of all complaints within ten working days	94%	96%

Appendix 6

Initial assessment of disputes and complaints

Before we investigate a dispute or complaint we carry out an initial assessment to decide whether:

- it falls within our jurisdiction; and
- we should investigate.

In 2013-14, we closed 84% of the 221 complaints we received within our initial assessment phase target. This is the first year we collected this information.

Investigations we carry out

We aim to investigate as quickly and thoroughly as possible. Where we investigate a dispute or complaint we estimate when we will resolve it (the 'case closure phase'). The complexity of some cases can change after we begin an investigation, so sometimes we are unable to resolve them in the case closure phase.

In 2013-14, we resolved 71% of 34 complaints within the case closure phase. This is the first year we collected this information.

Resolved complaints

We resolved 223 complaints during the year. Of these:

- 87% were resolved within three months (compared with 80% in 2012-13); and
- 90% were resolved within six months (compared with 82% in 2013-13).

Complaints to the Parliamentary and Health Service Ombudsman

If anyone is unhappy with how we have handled their dispute or complaint, we carry out an internal review to review whether we handled it correctly. If the complainant remains dissatisfied with our handling of their complaint, they can ask the Parliamentary and Health Service Ombudsman (PHSO) to investigate.

During 2013-14, one complaint was investigated by the PHSO. This complaint is still under investigation. We will report on the outcome in next year's annual report.

Appendix 7

Resource management 2013-14

Staff recruitment (by gender and ethnic group)

Level and salary range	2013-14			2012-13		
	Full-time equivalent staff appointed ¹	Proportion of women (%) ²	Proportion from ethnic minorities (%) ²	Full-time equivalent staff appointed ¹	Proportion of women (%) ²	Proportion from ethnic minorities (%) ²
Band 1 – £15,623 to £22,220	1	0	100	2	0	50
Band 2 – £22,221 to £31,448	3	67	0	7	85	44
Band 3 – £31,449 to £47,146	12	25	0	10	31	16
Band 4 – £47,147 to £72,114	7	57	0	8	49	25
Band 5 – £72,115 to £108,171	4	50	0	6	0	0
Total	27	48	4	33	40	25

Notes:

1. We introduced a new pay banding system during 2012-13, so data for 2011-12 is not comparable, which is why there are only two years reported.

2. Rounded to the nearest whole number.

Staff in post

Type	31 March 2014	31 March 2013	31 March 2012
Employed head count	199	185	181
Non-payroll head count	20	17	2

Appendix 7

Employed staff information

Area	As at 31 March 2014	As at 31 March 2013	As at 31 March 2012
Full-time equivalent staff	191	177	174
Proportion of women (%)	48	47	49
Proportion from ethnic minorities (%)	12	18	17.5
Proportion disabled (%)	3	2.3	1.7
Members of the Senior Civil Service	8	11	9
Number of fixed-term and casual contracts	13	13	7
Number of staff working part-time	28	30	26
Staff turnover (%)	12	16	24

Staff training attendance (by ethnic group)

Ethnic group	2013-14		2012-13		2011-12	
	Number of training days (rounded up)	Percentage (%) (rounded to nearest whole number)	Number of training days (rounded up)	Percentage (%) (rounded to nearest whole number)	Number of training days (rounded up)	Percentage (%) (rounded to nearest whole number)
White	318	78	418	77	166	86
Other ethnic groups	48	12	89	17	27	14
Unknown	42	10	32	6	–	–
Total number of training days	407	100	539	100	193	100

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 to have due regard to the need to:

- eliminate discrimination;
- advance equality of opportunity; and
- foster good relations between different people when carrying out their activities.

The equality duty is supported by specific duties set out in regulations, which came into force on 10 September 2011. 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 further equality is largely through our general regulatory approach. We seek to ensure these approaches do not have unintended or disproportionate impacts.

In 2012, we set an objective to continue to ensure that equality and diversity issues are reflected in our policies. One of the ways in which we do so is through impact assessments (which are also a way in which our performance can be measured).

Impact assessments are a tool that helps us to make decisions that are soundly based and well informed. We have published a policy on impact assessments. This sets out that we will consider producing an impact assessment if, among other things, the action we propose to take will have a significant impact on water or sewerage customers generally or on specific types of customer.

During 2013-14, we published an impact assessment of Ofwat's methodology for setting price limits for the period from 2015 to 2020 (see appendix 3).

In 2012, we also set an objective to respond to any new social and environmental guidance from the UK or Welsh Governments. In appendix 2, we summarise the actions we have taken in 2013-14 in relation to the UK Government's strategic policy statement to us, including revised social and environmental guidance, and the Welsh Government's social and environmental guidance.

Appendix 8

During the year, we identified potential risks to consumers from the activity of some billing agents with unsustainable business models, or false or dubious claims. Concerns about billing agents in the water sector feature in customer contacts to Citizens Advice, as well as Ofwat and CCWater. Elderly customers or those without access to support seem to be particularly affected.

We want to enable customers to make informed choices about billing agents. We have discussed with independent organisations such as Citizens Advice and Age UK how best to communicate with the groups they serve, and intend to work with them to raise awareness. This work is ongoing.

Also, we are working with companies, CCWater and Water UK (the representative body for water companies) to help the industry set up an independent alternative dispute resolution (ADR) scheme by the end of the 2014-15 financial year. This scheme will enable customers to resolve disputes they have with their water company without the need for litigation, which is not a viable option for many customers. The scheme will be free of charge to customers and will give them the opportunity to seek redress if they have suffered detriment as a result of the actions of their water company and the company has not resolved the complaint to the customer's satisfaction.

As an organisation, we offer a range of services in relation to publications and correspondence to help advance equality of opportunity through access to information. For example, we make publications available in large print and braille formats and are committed to a website that complies with Government guidance on accessibility. We have a Welsh language scheme and use a scoring system to objectively identify any material which need not be published in Welsh or bilingually. We will issue a reply in Welsh when someone writes to us in Welsh. We will also, if practicable, reply in the same language to correspondence we receive in languages other than Welsh or English.

Internal

In 2013, we put in place a People Strategy to deliver our objectives by adopting strong people management practices and ultimately by becoming an employer of choice – one that is recognised as being attractive to existing employees and prospective candidates because our work, culture, environment and rewards make it a great place to be. It includes a commitment to put our values of respect, integrity, leadership and excellence at the forefront of everything we do. We also want a working environment that, among other things, provides a welcoming culture that is free from discrimination and values diversity and opinions.

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

Appendix 8

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

All recruitment activity is subject to audit by the Civil Service Commissioners to ensure that we comply with the guidance set out in its recruitment principles.

We actively support events, such as Black History Month, that raise awareness of our diverse population.

In 2012, we set an objective for the 2012-14 period to continue to be recognised for equality and diversity good practice. One of the ways in which our performance is measured is by our staff survey results. We committed to maintaining more than 80% agreement with our equality question in staff surveys. In our 2013 staff survey, 80% agreed that staff were treated fairly. This is similar to results in previous years and compares favourably with the equivalent question in the Civil Service People Survey 2013.

Equality objectives for 2014-18

Objectives	Measured by	Due date
To put our values (respect, integrity, leadership and excellence) at the forefront of everything we do	There are year-on-year improvements in our performance against our key performance indicators.	By the end of 2016
To provide a working environment that is welcoming and diverse and that supports effective working	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.	
	We are recognised as an employer of choice and people seek out opportunities to work here.	By the end of 2018
	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.	