

Office of Water Services

Resource Accounts 2001–02

Office of Water Services Resource Accounts 2001–02

(For the year ended 31 March 2002)

*Ordered by the House of Commons to be printed
16 October 2002*

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Ofwat's Financial Accounts and Review of Activities 2001–02

Annual Report

Introduction

These accounts cover the operation of the Office of Water Services (Ofwat) for the period 1 April 2001 to 31 March 2002. They have been prepared on an accruals basis in accordance with the HM Treasury Resource Accounting Manual. They cover the work carried out by the head office in Birmingham, as well as the 10 WaterVoice Committees (previously known as Customer Service Committees) and the WaterVoice Council (previously known as the Ofwat National Customer Council).

Ofwat's Aims and Objectives

The Director General of Water Services is the economic regulator of the water and sewerage industry in England and Wales. His duties are laid down in section 2 of the Water Industry Act 1991.

Ofwat aims to regulate the water and sewerage companies in a fair and open way in order to secure continuing improvements in quality of service and value for money for their customers. This includes:

- ensuring that companies carry out their functions;
- ensuring that companies can finance their functions;
- protecting customers;
- promoting economy and efficiency;
- facilitating competition; and
- taking regard of environmental issues.

The costs of delivering Ofwat's main objectives are set out at Schedule 5 of the accounts.

Scope of the Accounts

There are no public sector bodies outside the boundary for which the department has lead policy responsibility. Therefore, the accounts cover Ofwat, 10 WaterVoice Committees and the WaterVoice Council only.

Operating and Financial Review

Review of Activities

Ofwat's Annual Report was published on 22 May 2002 (HC 808). Our achievements in the financial year included:

- Effective economic regulation: regulatory ring-fencing has proved to be justified and effective. A number of restructuring proposals to reduce financing costs have been considered; consulted on and resulted in licence changes.
- Progress on services: we have and continue to monitor the services provided to customers following the last price review. Services continue to improve. We will be closely monitoring capital programmes as some slippage has been identified.
- Interim determinations: these help to ensure that efficient companies can continue to finance their functions following material changes in their circumstances. In November 2001 we approved increases for three companies in the price limits set at the last review.
- Periodic review 2004 (PR04): in March 2002 we published our Forward Programme 2002–05. This included the key phases for the PR04 price review, and our proposed timetable.
- Competition: we contributed to the government's thinking on developing competition in the industry. We have fulfilled our responsibilities under the Competition Act 1998. We have issued guidance on access codes for common carriage and for developers connecting new water mains to the existing distribution network.
- Regulatory governance: we are committed to a close working relationship with all our stakeholders. We aim to be transparent, accountable, consistent, proportionate and well targeted in our actions. We have improved governance by appointing four non-executive advisory directors (NEADs) to our Board. One of the NEADs chairs our Audit Committee, and they are also represented on our Remuneration Committee.
- The ten WaterVoice Committees and WaterVoice Council continued their important work investigating complaints, advising customers and representing their views at a regional and national level.

The main financial highlights are summarised below:

Operating Costs Summary	2001–02	2000–01
	<u>£000s</u>	<u>£000s</u>
Receipts of Licence fees	11,900	10,915
Other income	731	637
Income deferred to following year	(2,262)	(1,194)
Income deferred from prior year	1,194	1,196
Total Income	<u>11,563</u>	<u>11,554</u>
Administration costs	(10,832)	(10,918)
Net Operating Surplus	731	636
Balance Sheet Summary		
Total assets	1,702	2,159
Total liabilities	(3,511)	(3,505)
TOTAL NET ASSETS/(LIABILITIES)	(1,809)	(1,346)

Fee income is subject to the constraints set out in Condition N of the companies' Licences and negotiation with HM Treasury. Fees are based on an estimate of costs at the start of the financial year. In anticipation of these costs, fees recovered from the industry were increased by £985K (9%) on the previous year. The extra resources were required to fund preliminary work on the PR04 price review e.g. the Aquarius 3 financial model, customer research and additional staff.

The main reasons for variance against the Estimate were the delay in completing the development of the financial model and a higher level of staff turnover than expected. Savings were achieved in the procurement and presentation of our publications. Some consultancy projects were delayed or not required. The income received but not spent will be offset against future Licence fees.

In terms of investing for the future Ofwat has a relatively low asset base. However, an investment has been made in the Aquarius 3 financial model. This will play a key role in the price review. It has an expected useful economic life of 4 years. As part of our drive for greater transparency it will be made available to the industry.

Other income recovered during the year included £709K from the two companies which had appealed to the Competition Commission (CC) following the 1999 Periodic Review of price limits.

Ofwat is required to make full provision for the previous Director General's pension although 60% of the pension relates to employment prior to Ofwat and will be funded from the Exchequer.

The negative value of total net assets is explained further under 'Going concern'.

The financial statements on pages 12-17 and the Notes to the Accounts pages 18-27 provide further information.

As a government department Ofwat does not have shareholders. However, it is required to achieve a cost of capital return of 6% by HM Treasury. We have to observe parliamentary control totals in relation to administration costs (Schedule 1). Ofwat's costs analysed by objectives are also included in Schedule 5.

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

In November 2000, the Government published a draft Water Bill and in May 2002, it published its response to the consultation on the draft Water Bill. This proposes changes to how Ofwat operates, including separating the representation of customers from the role of the regulator. These changes depend on a Water Act. A Water Bill was not included in the Government's legislative programme in 2001 or 2002. We look forward to a Water Bill when parliamentary time allows.

Further details on our spending are included in DEFRA Departmental Report 2002 (CM5422).

Events since 31 March 2002

Since the end of the financial year the Customer Service Committees have been renamed as the WaterVoice Committees and the Ofwat National Customer Council has become the WaterVoice Council.

Financial Instruments

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. Further details are provided at note 19 to the account.

Going Concern

The balance sheet at 31 March 2002 shows negative taxpayers' equity of £1.8M. This reflects the inclusion of liabilities falling due in future years, which are to be financed mainly by drawings from the UK Consolidated Fund. Such drawings will be from grants of supply approved annually by Parliament to meet Ofwat's net cash requirement. Under the Government Resources and Accounts Act 2000, no money may be drawn from the Fund other than that required for the specified year or retained in excess of that need. All unspent monies, including those derived from the department's income, are surrenderable to the Fund.

In common with other government departments, the future financing of Ofwat's liabilities is 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 believe that future approvals will not be forthcoming. We have adopted a going concern basis for the preparation of these financial statements.

Roles and Responsibilities

Ofwat is a non-ministerial central government department with its own Resource Estimate. It is led by the Director General who carries the responsibilities of the Accounting Officer, supported by the Director of Operations who is the Principal Finance Officer. The Director General presented his annual report on the performance of the office to the Rt. Hon Margaret Beckett, MP, Secretary of State for Environment, Food and Rural Affairs and the Rt. Hon Rhodri Morgan AM First Minister of the Welsh Assembly Government on 22 May 2002 (HC 808).

On 1 March 2002 the Director General, following an open competition, appointed four non-executive advisory directors (NEADs) (one of which took effect on 7 July 2002). The Ofwat Board had its inaugural meeting on 11 March 2002. The NEADs' responsibilities include Chairman and membership of the Audit Committee and membership of the Senior Civil Service and Staff Remuneration Committees. The NEADs directors are:

- John Baker CBE

Non-Executive Director Celltech Group, and Royal & Sun Alliance plc. Chief Executive (1989–95) and Chairman (1995–97) of National Power plc; Chairman of English National Opera (1995–2001) and Groundwork Foundation (1996–2000).

- Jane May

Formerly Customer Service Director, Thames Water (1994–2000) and Freemans Customer Relations Director (1992–94).

- Roger Munson (appointed on 7 July 2002)

Member of the Competition Commission; formerly partner, Coopers & Lybrand.

- Martin Cave

Professor and Director, Centre for Management under Regulation, Warwick Business School, University of Warwick (2001-to date); formerly Professor of Economics and Vice-Principal, Brunel University.

The composition of the Senior Management Team in the reporting period was as follows:

Philip Fletcher*	Director General
Mike Saunders*	Director of Consumer Affairs
Bill Emery*	Director of Costs & Performance and Chief Engineer
Keith Mason*	Director of Regulatory Finance
Roger Dunshea*	Director of Operations
Julia Havard	Head of External Relations
Allan Merry	Legal Adviser
Roy Wardle	Head of Consumer Representation

* denotes Board member.

The Director General was appointed on 1 August 2000 by the Secretary of State for the Environment, Transport and the Regions under Section I of the Water Industry Act 1991. The Director General's remuneration is agreed as part of his employment contract. His contract is for a fixed five-year period and can only be terminated due to incapacity or misbehaviour. The contracts of other members of the Senior Management Team can be terminated by the standard process as set out in the Civil Service Management Code.

Members of the Senior Management Team are members of the Senior Civil Service and are appraised and remunerated, (including performance pay) in line with Senior Civil Service requirements. The details of remuneration are included at Note 2 to the Accounts.

Staff Remuneration

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

Pension Liabilities

The main pension scheme for Ofwat staff is the Principal Civil Service Pension Scheme (PCSPS). This is a defined benefit, unfunded scheme. The payment of benefits from the scheme are borne by the Civil Service Superannuation Vote. The pension liabilities arising from Ofwat's employees' membership of the PCSPS are not provided for in these accounts in accordance with the Treasury instructions and as described in Note 2 to the financial statements.

A "By-analogy Scheme" will be established to meet the pension requirements of the Director General. As the scheme will have by-analogy status it will offer similar benefits to the PCSPS. A provision will be made once a scheme has been established.

Full provision has been made in the accounts for the previous Director General's pension as required by HM Treasury. In future years claims will be made on the Exchequer to cover the pension costs that relate to employment other than with Ofwat.

Equal Opportunities Policy

Ofwat recruits staff on merit through fair and open competition. This ensures equal opportunity for employment, regardless of race, sex, physical disability or marital status. All recruitment activity is subject to audit by the Civil Service Commissioners to ensure that Ofwat complies with the guidance set out in its recruitment code.

Payment of Suppliers

Ofwat achieved 99.45% against the Government target for paying invoices within 30 days of receipt in 2001–02 and is committed to achieving the 100% target.

Audit

Deloitte & Touche provided the Internal Audit service for Ofwat during 2001–02 on a contract basis. The external auditor for Ofwat is the Comptroller and Auditor General.

Philip Fletcher
Accounting Officer

28 August 2002

Statement of Accounting Officer's Responsibilities

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

The resource accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of the Department, the net resource outturn, resources applied to objectives, recognised gains and losses, and cash flows for the financial year.

HM Treasury has appointed the Director General as Accounting Officer, with responsibility for preparing Ofwat's accounts and for transmitting them to the Comptroller and Auditor General.

In preparing the accounts, the Accounting Officer is required to comply with the Resource Accounting Manual prepared by HM Treasury, and in particular to:

- observe 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 Resource Accounting Manual, have been followed, and disclose and explain any material departures in the accounts; and
- prepare the accounts on a going concern basis.

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

Statement on Internal Control 2001–02

As Accounting Officer, I have responsibility for maintaining a sound system of internal control, which supports the achievement of Ofwat's policies, aims and objectives as set out by the relevant statements. I do this whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in 'Government Accounting'.

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

The system of internal control is designed to identify the principal risks to the achievement of departmental policies, aims and objectives, to evaluate the nature and extent of those risks and to manage them efficiently, effectively and economically. I expect to have the procedures in place in March 2003 necessary to implement the Treasury's guidelines.

In February 2002, I strengthened our corporate governance and decision making by appointing four non-executive advisory directors.

Risk Management

During 2001–02, we revised and updated the Ofwat and divisional risk registers. The Ofwat Board, Management Committee and Audit Committee received reports summarising key messages from the risk registers with the associated commentary on assurance activities. The risk assessment was particularly useful in finalising our budget priorities for 2002–03 based on the forward programme of outputs and objectives. Risk assessment is becoming more embedded into the work of the office. Senior managers and their staff realise the importance of reinforcing risk management. This is reviewed in six monthly reports to the Ofwat Board, Management Committee and Audit Committee.

We still have more work to do embedding risk management into our policy development. This will be addressed through workshops, briefings and monitoring. The planned work includes:

1. Project, divisional and Ofwat risk registers will be regularly updated to reflect risk changes and events.
2. A six monthly review of registers will be reported to Management Committee, Ofwat Board and Audit Committee.
3. Annual risk management workshops will take place with each division.
4. Follow up actions arising from treasury internal audit strategy.
5. Follow up action from the HM Treasury of risk management.

Organisational Performance

Annually, we consult on and publish our forward programme. This sets out the high level objectives for the organisation for the coming financial year plus a look forward to the following two years. The forward programme drives divisional plans and ultimately individual staff objectives. On a monthly basis the Management Committee reviews progress against key outputs and projects. There is also a monthly assessment of achievement of the forward programme. In addition to this, there are formal divisional reviews by the Director General plus the processes that underpin staff performance management. On a regular basis, the resource requirements for Ofwat are assessed against the forward programme and developing priorities. The non-executive advisory directors will also provide an independent view to me on our performance. In May 2002 Ofwat issued its annual report 2001–02 to Government and Parliament.

WaterVoice, the customer representation arm of Ofwat has similar systems of performance management including publication of its own forward plan and annual report.

Internal Audit

The role of internal audit in the past has been largely focussed on finance, human resources and IT systems. Over the past two years, its role has developed by reviewing processes in regulatory policy areas. During 2001–02, our Internal Auditors reviewed the following policy areas in addition to core human resources and finance functions:

1. The appointment of company Reporters.

2. Competition Act 1998 cases.

In the coming year, they will be reviewing the interim determination price setting spreadsheet model, price review 2004 processes and handling of customer complaints by the WaterVoice offices. This will be in addition to their important work looking at financial systems. During 2002–03 an internal audit strategy will be developed covering the audit issues up to 2006 focussing on topics arising from our risk assessments.

Deloitte and Touche, our Internal Auditors operate to standards defined in the Government Internal Audit Manual. They submit regular reports, which include an independent opinion by the Head of Internal Audit on the adequacy and effectiveness of our system of internal control together with recommendations for improvement.

My review of the effectiveness of this system of internal control is informed by the work of the Internal Auditors and our senior managers who have responsibility for the development and maintenance of the internal control framework. It is also informed by comments made by external auditors in their management letter and other reports.

Philip Fletcher
Accounting Officer

28 August 2002

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

I certify that I have audited the financial statements on pages 12 to 27 under the Government Resources and Accounts Act 2000. These financial statements have been prepared under the historical cost convention as modified by the revaluation of fixed assets and the accounting policies set out on pages 18 to 19.

Respective Responsibilities of the Accounting Officer and Auditor

As described on page 8 the Accounting Officer is responsible for the preparation of the financial statements in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder and for ensuring the regularity of financial transactions. The Accounting Officer is also responsible for the preparation of the other contents of the Account. My responsibilities, as independent auditor, are established by statute and guided by the Auditing Practices Board and the auditing profession's ethical guidance.

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

I read the other information contained in the Accounts, and consider whether it is consistent with the audited financial statements. I consider the implications for my certificate if I become aware of any apparent misstatements or material inconsistencies with the financial statements.

I review whether the statement on page 9 and 10 reflects the Department's compliance with Treasury's guidance "Corporate governance: statement on internal control". I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information of which I am aware from my audit of the financial statements.

Basis of Audit Opinion

I conducted my audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Department in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Department's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by error, or by fraud or other irregularity, and that, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I have also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In my opinion:

- the financial statements give a true and fair view of the state of affairs of the Office of Water Services at 31 March 2002 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the year then ended, and have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by the Treasury; and
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.

John Bourn
Comptroller and Auditor General

6 September 2002

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SCHEDULE 1

Summary of Resource Outturn
for the year ended 31 March 2002

	Estimate			Outturn			Net Total Outturn Compared with Estimated Saving/ (excess)	Prior- year outturn
	Gross Expenditure	A-in-A	Net Total	Gross Expenditure	A-in-A	Net Total		
	1	2	3	4	5	6		
	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s
Request for Resources 1	12,146	12,111	35	10,832	10,832	0	35	1
Non Operating Cost A-in-A	—	—	—	—	—	—	—	—
Net Cash Requirement	—	—	35	—	—	35	—	193
Reconciliation of Resources to Cash Requirement		Note	£000s			£000s	£000s	£000s
Net total resources			35			0	35	1
Capital:								
Acquisition of fixed assets								
Cash purchases		7.1&7.2	300			536	(236)	98
Investments			—			—	—	—
Non-operating A-in-A								
Accruals adjustments:								
Non-cash items		3	(300)			(211)	(89)	(296)
Prior Period Adjustment			—			—	—	414
Prior Period Adjustment			—			—	—	(414)
Changes in working capital other than cash		6	—			(833)	833	(37)
Changes in Creditors falling due after more than one year			—			—	—	—
Use of provision		11	—			88	(88)	238
Disposal of fixed assets		7.1&7.2	—			—	—	(4)
Excess Cash receipts to be surrendered to the Consolidated Fund			—			455	(455)	193
Net Cash Requirement (Schedule 4)			35			35	—	193

Explanation of the variation between Estimate and Outturn (Net Total Resources):

The difference between the Estimate and the Resource Outturn arises from the £35k that is required from the Exchequer as part funding of the previous Director General's pension. This relates to a period of service prior to Ofwat. This amount was included in the 2001–02 request for resources but was subsequently provided for in the 2000–01 Resource Accounts. This meant that the estimated £35k of resources requested were not required.

The underspend was related to the financial model delays, higher than expected staff turnover, savings on publications and a reduced consultancy requirement.

Analysis of income payable to the Consolidated Fund

In addition to Appropriations-in-Aid (A-in-A) the following income relates to the office and is payable to the Consolidated Fund (*cash receipts being shown in italics*):

	2001–02 Forecast		2001–02 Outturn	
	Income	Receipts	Income	Receipts
	£000s	£000s	£000s	£000s
Operating income and receipts not classified as A-in-A (see note 4)	870	870	731	731
Non-operating income and receipts—excess A-in-A	—	—	—	—
Other operating income and receipts not classified as A-in-A	—	—	—	—
Other non-operating income and receipts not classified as A-in-A	—	—	—	—
Other amounts collectable on behalf of the Consolidated Fund (see note 1.11)	—	—	—	101
Excess cash receipts to be surrendered to the Consolidated Fund	—	—	—	—
	870	870	731	832

Actual Outturn—resource

Request for resource 1: Actual net resource outturn is nil.

Actual Outturn—cash

Net cash requirement: Outturn net requirement £35,000.00, which is the same as the Estimate.

The actual receipts were (surrenderable to the Consolidated Fund) £832,493.80.

SCHEDULE 2**Operating Cost Statement**

for the year ended 31 March 2002

		2001–02		2000–01	
	Note	£000s	£000s	£000s	£000s
Administration Costs					
Staff costs	2	6,407		5,897	
Other administration costs	3	4,425		5,021	
Gross Administration Costs			10,832		10,918
Operating income	4		(11,563)		(11,554)
Net Administration Costs			(731)		(636)
Net Operating Cost	5		(731)		(636)
Net Resource Outturn	5		—		1

All income and expenditure are derived from continuing operations

Statement of Total Recognised Gains and Losses

for the year ended 31 March 2002

	2001–02	2000–01
	£000s	£000s
Net operating cost	(731)	(636)
Unrealised surplus arising on revaluation of tangible fixed asset	(7)	(13)
Total recognised gains and losses for the financial year	(738)	(649)
Prior period adjustment	—	414
Total recognised gains and losses for the financial year	(738)	(235)

The notes on pages 18 to 27 form part of these accounts.

SCHEDULE 3**Balance Sheet**

as at 31 March 2002

	Notes	31 March 2002		31 March 2001	
		£000s	£000s	£000s	£000s
Fixed Assets					
Tangible assets	7.1	343		422	
Intangible assets	7.2	435		18	
			778		440
Current Assets					
Debtors	8	466		844	
Cash at bank and in hand	9	458		875	
		924		1,719	
Creditors (amounts falling due within one year)					
Creditors	10	(2,906)		(2,867)	
Net Current Assets			(1,982)		(1,148)
Total Assets less Current Liabilities			(1,204)		(708)
Provision for Liabilities and Charges	11	(605)		(638)	
			(605)		(638)
Total Net Assets			(1,809)		(1,346)
Taxpayers' Equity					
General Fund	13	(1,916)		(1,446)	
Revaluation reserve	12	107		100	
			(1,809)		(1,346)

Philip Fletcher
Accounting Officer

28 August 2002

Further details on the negative taxpayers' equity is included in the annual report (page 6).

SCHEDULE 4

Cash Flow Statement

for the year ended 31 March 2002

		2001–02	2000–01
	Notes	£000s	£000s
Net cash inflow from operating activities (Note a)		2,258	731
Capital expenditure and financial investment (Note b)		(536)	(94)
Payments of amounts due to the Consolidated Fund		(2,174)	(847)
Financing		35	611
(Decrease)/Increase in cash in the period		(417)	401
Note a: Reconciliation of operating cost to operating cash flows			
Net Operating Cost	5.1	(731)	(636)
Adjustment for non-cash transactions	3	(211)	(296)
Adjustment for movements in working capital other than cash	6	(1,404)	(37)
Use of Provisions	11	88	238
Net cash inflow from operating activities		(2,258)	(731)
Note b: Analysis of capital expenditure and financial investment			
Intangible fixed asset additions	7.2	432	4
Tangible fixed assets additions	7.1	104	94
Proceeds from disposal of fixed assets	7.1	–	(4)
Net cash outflow from investing activities		536	94
Analysis of financing, and reconciliation to the net cash requirement			
From the Consolidated Fund (Supply)—current year ^{1&2}		35	611
Advance from the Contingencies Fund		2,000	2,000
Repayment to the Contingencies Fund		(2,000)	(2,000)
Net Financing		35	611
Increase/(Decrease) in cash	9	417	(401)
Net cash flows other than financing		452	210
Adjustment for payments and receipts not related to Supply:			
Amounts due to the Consolidated Fund received in a prior year and paid over		(1,344)	(847)
Amounts due to the Consolidated Fund received and not paid over		458	830
Transitional adjustment	6	469	–
Net cash requirement (Schedule 1)		35	193

¹Amount of grant actually issued to support the net cash requirement = £35,000.00.

²Amount of grant actually issued to support the prior-year net cash requirement = £126,000.00.

SCHEDULE 5**Resources by Departmental Aims and Objectives**

for the year ended 31 March 2002

Aim: To regulate the water and sewerage companies in a fair and open way in order to secure continuing improvements in quality of service and value for money for their customers.

	2001–02			2000–01		
	Gross £000s	Income £000s	Net £000s	Gross £000s	Income £000s	Net £000s
Objective 1 Quality and Security of Supply and Customer Representation	3,869	—	—	3,712	—	—
Objective 2 Annual monitoring	3,190	—	—	3,494	—	—
Objective 3 Set Prices	2,027	—	—	1,638	—	—
Objective 4 Competition and Tariffs Policy	1,746	—	—	2,074	—	—
Net operating costs	10,832	(11,563)	(731)	10,918	(11,554)	(636)

Note:

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

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

The department's capital is employed exclusively for administration purposes. Its distribution between objectives is therefore not markedly different from the related gross administration cost.

Notes to the Accounts

1. Statement of Accounting Policies

The financial statements have been prepared in accordance with the Accounts Direction, the Resource Accounting Manual issued by HM Treasury and the relevant accounting standards. The particular accounting policies adopted by the Department are described below. They have been applied consistently in dealing with items considered material in relation to the accounts.

1.1 Accounting Convention

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

1.2 Fixed Assets

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

Intangible assets consist of proprietary software licences and bespoke software. The development of the financial model has been capitalised as this asset will have a useful economic life of four years.

With the exception of PCs and office furniture, individual assets must exceed a capitalisation threshold for inclusion as fixed assets. PCs and office furniture items falling below the threshold are capitalised as groups.

Assets are revalued using indices supplied by the Office of National Statistics in the publication "Current Cost Accounting".

1.3 Depreciation and Amortisation

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

Asset Classification	Asset Life
Furniture, fixtures and fittings	10 years
IT equipment	5 years
Office machinery	5 years
Telecommunications	5 years

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

1.4 Stocks

Stocks consist of low value office consumables and publications. The full costs of stock purchases are charged in the year of purchase.

1.5 Leases

Assets held under finance leases are included under tangible fixed assets at their capital value and depreciated over their useful economic lives. Leasing payments consist of capital and interest elements with the interest element charged to the Operating Cost Statement. Rentals due under operating leases are charged over the lease term on a straight-line basis or on the basis of actual rental payable where this fairly reflects usage.

1.6 Research and Development

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

1.7 Operating Income

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

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

1.8 Administration and Programme Expenditure

Administration costs are recorded in the operating cost statement. They include the costs of running the Department, as defined under the administration cost-control regime, together with associated operating income. There was no programme expenditure.

1.9 Capital Charge

A non-cash charge, reflecting the cost of capital utilised by the department, is included in operating costs. The charge is calculated at the government's standard rate of 6% in real terms on all assets less liabilities, except for:

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

1.10 Pensions

Present and past employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS) which is non-contributory and unfunded. Although the Scheme is a defined benefit scheme, liability for payment of future benefits is charged to the PCSPS. Departments covered by the PCSPS meet the cost of pension cover provided for the staff they employ by payment of charges calculated on an accruing basis. There is a separate scheme statement for the PCSPS as a whole.

1.11 Taxation

In 2000–01 other administration costs were stated inclusive of Value Added Tax (VAT). Ofwat recovered VAT on allowable items of expenditure but this income was then paid over to the Consolidated Fund. As Ofwat received no benefit from the VAT recovered, expenditure was stated gross of VAT. In 2001–02 other administration costs are stated exclusive of recoverable VAT as this income is now retained.

1.12 Comparative Amounts

Comparative amounts are restated where necessary to conform to current presentation.

2. Staff Numbers and Costs

Staff costs consist of:

	2001–02	2000–01
	<u>£000s</u>	<u>£000s</u>
		Restated
Wages and salaries	5,321	4,864
Social security costs	364	371
Other pension costs	722	662
Total	<u>6,407</u>	<u>5,897</u>

The PCSPS is an unfunded multi-employer defined benefit scheme but Ofwat is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out at 31 March 1999 and details can be found in the resource accounts of the Cabinet Office Civil Superannuation Fund. (www.civilservice-pensions.gov.uk)

For 2001–02 contributions of £721,756 were payable to the PCSPS (2000–01 £662,469) at one of four rates in the range 12 to 18.5% of pensionable pay, based on salary bands. Rates will remain the same for the next two years, subject to revaluation of the salary bands. Employer contributions are to be reviewed every four years following a full scheme valuation by the Government Actuary. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme.

Notes to the Accounts (*continued*)

The average number of whole-time equivalent persons employed (including senior management) by objective during the year was as follows:

	2001–02	2000–01
Objective 1—Quality and Security of Supply and Customer Representation	106	103
Objective 2—Annual Monitoring	52	54
Objective 3—Set Prices	31	26
Objective 4—Competition and Tariffs Policy	30	30
Total	219	213

The salary and pension entitlements of the most senior managers of the department were as follows:

Name and title	Age Years	Salary* ^a	Real increase	Total accrued	Benefits in
		(as defined below)	in pension at	pension at	kind ^c
		£000s	age 60 ^b	at 31 March	(Rounded
			£000s	2002	to the
				£000s	nearest £100)
Philip Fletcher Director General	55	125-130	—	— <i>Note d</i>	£7,600
Keith Mason Director Regulatory Finance	44	70-75	0.0-2.5	5-10	—
Mike Saunders Director of Consumer Affairs	58	85-90	0.0-2.5	10-15	—
Roger Dunshea Director of Operations	46	75-80	0.0-2.5	0-5	—
Bill Emery Director of Cost and Performance and Chief Engineer	50	80-85	0.0-2.5	10-15	£300
Roy Wardle Head of Consumer Representation	50	65-70	2.5-5.0	25-30 <i>Note e</i>	—
Julia Harvard Head of External Relations	47	55-60	0.0-2.5	15-20	—
Allan Merry Legal Adviser	57	60-65	0.0-2.5	5-10	—

*Actual payments made in the period

Non-Executive Advisory Directors:

Name	Age Years	Salary* ^a (as defined below)
		£000s
John Baker CBE (<i>appointed 1 March 2002</i>)	64	0-5
Martin Cave (<i>appointed 1 March 2002</i>)	53	0-5
Jane May (<i>appointed 1 March 2002</i>)	45	0-5

Roger Munson was appointed as a Non-Executive Advisory Director on 7 July 2002.

*Actual payments made in the period

These appointments do not receive a pension entitlement.

Notes:

- a. "Salary" includes gross salary, performance pay or bonuses; overtime; reserved rights to London weighting or London allowances; recruitment and retention allowances; private office allowances and any other allowance to the extent that it is subject to UK taxation.

- b. Officials' pension benefits are provided through the Principal Civil Service Pension Scheme (PCSPS). This is a statutory scheme which provides benefits on a "final salary" basis at a normal retirement age of 60. Benefits accrue at the rate of 1/80th of pensionable salary for each year of service. In addition, a lump sum equivalent to three years' pension is payable on retirement. Members pay contributions of 1.5% of pensionable earnings. Pensions are increased in payment in line with the Retail Price Index. On death, pensions are payable to the surviving spouse at a rate of half the member's pension. On death in service, the scheme pays a lump-sum benefit of twice pensionable pay and also provides a service enhancement on computing the spouse's pension. The enhancement depends on length of service and cannot exceed 10 years. Medical retirement is possible in the event of serious ill health. In this case, pensions are brought into payment immediately without actuarial reduction and with service enhanced as for widow(er) pensions.
- c. The estimated monetary value of benefits in kind covers any benefits provided and treated by the Inland Revenue as taxable income. Payments to the Director General covered relocation costs and to the Director of Costs & Performance, home IT equipment.
- d. The pension arrangements have yet to be established for Philip Fletcher, the Director General.
- e. The total accrued pension takes into account previous employment with other government departments in addition to the period of employment with Ofwat.

3. Other Administration Costs

	2001–02	2000–01	2000–01
	<u>£000s</u>	<u>£000s</u>	<u>£000s</u>
		Restated	
Rentals under operating leases:			
Accommodation	984	968	1,002
Office equipment	101	77	77
Other	10	10	10
	<u>1,095</u>	<u>1,055</u>	<u>1,089</u>
Non cash items:			
Depreciation of tangible fixed assets	112	194	194
Amortisation of intangible fixed assets	6	21	21
Loss/(Profit) on disposal of fixed assets	1	(4)	(4)
Cost of capital charge	(77)	17	17
Auditors remuneration	27	34	34
Increase in provision	55	12	12
Permanent diminution of fixed asset	87	22	22
	<u>211</u>	<u>296</u>	<u>296</u>
Other expenditure:			
Consultancy services	613	603	696
Agency staff	99	111	129
Training	226	290	327
Travel and subsistence	300	296	296
Rates	257	246	246
Computer hire and maintenance	102	119	119
Other hire and maintenance	30	36	61
Seminars, meetings and conferences	103	137	137
Publications	243	299	327
Books and periodicals	174	161	161
Postal services and couriers	76	73	73
Telecommunications	120	129	129
Recruitment costs	156	238	253
Other	620	642	682
VAT recovered	—	290	—
	<u>3,119</u>	<u>3,670</u>	<u>3,636</u>
	<u>4,425</u>	<u>5,021</u>	<u>5,021</u>

The restated comparatives show 2000–01 expenditure net of VAT for comparative purposes (see Note 1.11 for details).

Notes to the Accounts (*continued*)

4. Income and Appropriations in Aid (A-in-A)

Operating Income

Operating income not appropriated in aid (i.e. transferred to the Consolidated Fund) is analysed for resource budget purposes between that which is included in public expenditure and that which is not (see note 5). In 2001–02, all operating income not classified as appropriations in aid was within public expenditure.

Appropriations-in-Aid represent income due to Ofwat that can be retained for offset against other public expenditure. This contrasts with Consolidated Funds Extra Receipts (CFERs), which are remitted by Ofwat to the Consolidated Fund.

	2001–02			
	Resource outturn		Operating cost statement	
	Netted off gross expenditure in sub-head	Appropriated-in-Aid	Payable to Consolidated Fund	Income included in operating cost statement
	£000s	£000s	£000s	£000s
Operating income analysed by classification and activity, is as follows:				
Administration income:				
Allowable within admin cost limit				
Licence fees	—	11,900	—	11,900
Licence fees received in advance—prior year	—	1,194	—	1,194
Licence fees received in advance—current year	—	(2,262)	—	(2,262)
Publication sales	—	—	21	21
Miscellaneous	—	—	1	1
Competition Commission	—	—	709	709
Total	—	10,832	731	11,563

	2000–01			
	Resource outturn		Operating cost statement	
	Netted off gross expenditure in sub-head	Appropriated-in-Aid	Payable to Consolidated Fund	Income included in operating cost statement
	£000s	£000s	£000s	£000s
Operating income analysed by classification and activity, is as follows:				
Administration income:				
Allowable within admin cost limit				
Licence fees	—	10,915	—	10,915
Licence fees received in advance—Prior year	—	1,196	—	1,196
Licence fees received in advance—Current year	—	(1,194)	—	(1,194)
Publication sales	—	—	25	25
Miscellaneous	—	—	321	321
Competition Commission	—	—	291	291
Total	—	10,917	637	11,554

In 2000–01 included in miscellaneous income was £300,000 relating to Ofwat's cost for the Competition Commission references, consequently recovered from two water companies. The £290,566 Competition Commission income was money recovered from the two water companies on the Commission's behalf relating to their costs for the references, which were surrendered to the Consolidated Fund in 2001–02.

In 2001–02 £709,434 Competition Commission income money was recovered from the two water companies on the Commission's behalf relating to their costs for the references, which had been surrendered to the Consolidated Fund.

4.1. Administration Costs Limits

The outturn within the administration costs control regime shown against individual administration costs limits is as follows:

	2001–02		2000–01	
	Outturn	Limits	Outturn	Limits
	£000s	£000s	£000s	£000s
Request for resources 1 (Net limit)	—	35	1	612

5. Reconciliation of Net Operating Costs to Control Total and Net Resource Outturn

	2001–02	2000–01
	£000s	£000s
Net operating cost	(731)	(636)
Operating income not classified as A-in-A	731	637
Adjust for the effects of prior period adjustment in the current and prior years	—	414
Net Resource Outturn (Note a)	—	415

Note a:

Net operating cost is the total of expenditure and income appearing in the operating cost statement (Schedule 2). Net resource outturn is the total of those elements of expenditure and income that are subject to parliamentary approval and included in the Department's Supply Estimate. The outturn against the Estimate is shown in the summary of resource outturn (Schedule 1).

6. Movement in Working Capital Other Than Cash

	2001–02	2000–01
	£000s	£000s
Movement in Working Capital Other Than Cash		
(Decrease)/Increase in debtors (see note 8)	(377)	(9)
(Increase)/Decrease in creditors (see note 10)	(1,027)	46
Total movement in working capital	(1,404)	37
Adjustments:		
Movements not relating to voted Resource consumption (net), being movements on debtors/creditors not related to Supply Transitional adjustment, being adjustment for outstanding balance relating to the department's Appropriation Accounts for 2000–01	102	—
	469	—
Working capital movement recognised in Schedule 1	(833)	—

Notes to the Accounts (*continued*)

7.1 Tangible Fixed Assets

	Furniture Fixtures and Fittings	Office Machinery	Telecom- munications	IT Equipment	Total
	£000s	£000s	£000s	£000s	£000s
Cost or valuation					
At 1 April 2001	732	163	110	540	1,545
Additions	42	6	—	56	104
Disposals	(4)	(7)	—	(1)	(12)
Revaluation	12	(1)	—	(92)	(81)
At 31 March 2002	782	161	110	503	1,556
Depreciation					
At 1 April 2001	527	98	102	396	1,123
Charged in year	53	21	2	36	112
Disposals	(4)	(7)	—	(1)	(12)
Revaluation	5	—	—	(15)	(10)
At 31 March 2002	581	112	104	416	1,213
Net book value at 31 March 2002	201	49	6	87	343
Net book value at 31 March 2001	205	65	8	144	422

Assets originally purchased to the value of £12,233 were disposed of during 2001–02. Those assets had a net book value of £501 for which £40 was received. The resulting loss on disposal of £461 was charged to the operating cost statement.

7.2 Intangible Fixed Assets

	Purchased Software Licences	Assets Under Development	Total
	£000s	£000s	£000s
Cost or valuation			
At 1 April 2001	87	—	87
Additions	23	409	432
Revaluation	(10)	—	(10)
At 31 March 2002	100	409	509
Amortisation			
At 1 April 2001	69	—	69
Charged in year	6	—	6
Revaluation	(1)	—	(1)
At 31 March 2002	74	—	74
Net book value at 31 March 2002	26	409	435
Net book value at 31 March 2001	18	—	18

Assets under development consists of the financial model, which will be transferred to bespoke software once brought in to service.

8. Debtors

	2001–02	2000–01
	<u>£000s</u>	<u>£000s</u>
Amounts falling due within one year:		
Trade debtors	30	10
Deposits and advances	24	472
Undrawn grant	—	1
Prepayments and accrued income	368	259
HM Customs and Excise (VAT)	44	102
	<u>466</u>	<u>844</u>

Deposits and advances comprise:

- (a) Standing payroll deposit with Chessington Computer Services Ltd. Chessington provide payroll services to Ofwat and the deposit is held against payments that Chessington may need to make on Ofwat's behalf. In 2001–02 Ofwat transferred to a direct debit scheme with Chessington and the deposit of £450,000 was refunded.
- (b) Staff advances. At 31 March 2002 loans were outstanding for season tickets in respect of 21 employees and housing advances in respect of 1 employee.

9. Cash at Bank and in Hand

	2001–02	2000–01
	<u>£000s</u>	<u>£000s</u>
Balance at 1 April	875	474
Net cash flow	(417)	401
Balance at 31 March	<u>458</u>	<u>875</u>
The following balances are held at:		
Office of HM Paymaster General (OPG)	452	861
Commercial banks and cash in hand	6	14
	<u>458</u>	<u>875</u>
The balances at 31 March comprise:		
Cash due to be paid to the Consolidated Fund:		
Consolidated Fund extra receipts received and due to be paid to the Consolidated Fund	3	
Excess cash receipts to be surrendered to the Consolidated Fund	<u>455</u>	
	<u>458</u>	

10. Creditors

	2001–02	2000–01
	<u>£000s</u>	<u>£000s</u>
Amounts falling due within one year:		
Trade creditors	44	109
Accruals	142	118
Deferred income	2,262	1,194
Consolidated Fund:		
Excess cash to be surrendered to the Consolidated Fund	455	193
Actual surplus to be surrendered	—	486
Competition Commission	—	291
Other	3	313
VAT	—	163
	<u>2,906</u>	<u>2,867</u>

Notes to the Accounts (*continued*)

11. Provision for Liabilities and Charges

	D G Pension Commitments	Early Retirement	2001–02 Total	2000–01 Total
	£000s	£000s	£000s	£000s
Balance at 1 April 2001	500	138	638	864
Provided in year	47	8	55	12
Provision utilised in year	(57)	(31)	(88)	(238)
Balance at 31 March	490	115	605	638
Of which:				
Payable within one year	57	30	87	86

Early Retirement

The department meets the additional cost of benefits beyond the normal PCSPS benefits in respect of employees who retire early by paying the required amounts annually to the PCSPS over the period between early departure and normal retirement date. The department provides for this in full when the early retirement programme becomes binding on the department by establishing a provision for the estimated payments discounted by the Treasury discount rate of 6% in real terms.

DG's Pension

Total liabilities take into account that Ofwat is required to make full provision for the previous Director General's pension. This is an HM Treasury requirement even though 60% of the pension relates to employment prior to Ofwat and will be funded from the Exchequer.

The retired Director General is covered by a "by-analogy pension scheme" which offers similar benefits to the PCSPS. It is an unfunded, defined benefit scheme. An actuarial assessment of the scheme was completed as at 31 March 2002. The assessment uses a discount rate of 3.5% per annum.

12. Revaluation Reserve

	2001–02	2000–01
	£000s	£000s
Balance at 1 April 2001	100	87
Arising on revaluation during the year (see note 7)	7	13
Balance at 31 March	107	100

The revaluation reserve reflects the unrealised element of the cumulative balance of indexation and revaluation adjustment of tangible and intangible fixed assets.

13. Reconciliation of Net Operating Cost to changes in the General Fund

	2001–02	2001–02	2000–01
	£000s	£000s	£000s
Net operating cost for the year (Schedule 2)	731		636
Correction of prior years CFER creditor	—		8
Income not appropriated in aid paid to the Consolidated Fund	(728)		(33)
Correction of prior years depreciation	—		17
		3	628
Net Parliamentary funding		35	612
Consolidated Fund creditor for cash unspent		(458)	(1,283)
Non-cash charges:			
Cost of capital charge	(77)		17
Auditor's remuneration	27	(50)	34
Net increase in the General Fund		(470)	8

General Fund at 1 April		
Prior period adjustment	—	(264)
	<u>(470)</u>	<u>(256)</u>
General fund at 1 April as restated	(1,446)	(1,190)
General Fund at 31 March (Schedule 3)	<u>(1,916)</u>	<u>(1,446)</u>

The negative value of total net assets arises because the funds owed to the industry are correctly shown as a liability. However, under Government Accounting rules Ofwat is required to surrender surpluses to the Consolidated Fund, which are reclaimed under HM Treasury's end of year flexibility arrangements in subsequent years. This allows Ofwat to refund to companies underspends from previous years. This is achieved by reducing the annual fee charged under Condition N of the licence.

14. Related-Party Transactions

Ofwat has had a small number of transactions with other government departments and other central government bodies. Most of these transactions have been with the Department of Transport, Local Government and the Regions in respect of accounting services. None of the senior management team or other related parties has undertaken any material transactions with Ofwat during the year.

15. Capital and Other Commitments

At 31 March 2002 Ofwat had commitments of £586,000 to develop information systems.

16. Commitments Under Operating Leases

At 31 March 2002 the department was committed to making the following annual payments in respect of operating leases.

	Buildings	Other	2001–02 Total	2000–01 Total
	£000s	£000s	£000s	£000s
Expiry within 1 year	—	—	—	56
Expiry within 2 to 5 years	491	64	555	356
Expiry thereafter	554	—	554	496
	<u>1,045</u>	<u>64</u>	<u>1,109</u>	<u>908</u>

17. Contingent Liabilities

There were no contingent liabilities at 31 March 2002.

18. Post Balance Sheet Events

Since 31 March 2002 Ofwat has entered into a financial commitment of £237,211 with regard to the development of information technology systems.

19. Financial Instruments

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

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