

# Water Services Regulation Authority (Ofwat) Annual report and accounts 2011-12

For the period 1 April 2011 to 31 March 2012



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**OFWAT**

# **Water Services Regulation Authority (Ofwat)**

## **Annual report and accounts 2011-12**

**For the period 1 April 2011 to 31 March 2012**

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

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

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This is part of a series of departmental publications which, along with the Main Estimates 2012-13 and the document Public Expenditure: Statistical Analyses 2012, present the Government's outturn for 2011-12 and planned expenditure for 2012-13.

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## About this report

This report sets out our annual report and accounts for the period 1 April 2011 to 31 March 2012.

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

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

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

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

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## Chairman's foreword



Since privatisation more than two decades ago, regulation in England and Wales has helped the water and sewerage sectors deliver £98 billion of investment. This has:

- driven up standards of customer service;
- resulted in stable water and sewerage infrastructure; and
- delivered significant improvements to the environment.

All this has been delivered while – as a result of Ofwat's scrutiny – bills have been kept a third lower than they otherwise would have been.

But the world is changing, and regulation needs to change too.

It is now more than two years since we published 'Delivering sustainable water – Ofwat's strategy'. This set out our vision for the future and described the changes we planned to make. Much has changed within that two-year period, but our vision for sustainable water remains as important as ever.

We have seen an increasing consensus about the challenges facing the sectors, including the volatility we are seeing in weather patterns. As we publish this report, two years of exceptionally low rainfall have been followed by torrential summer downpours. Such volatility, which is in line with predictions of coming climate change, coupled with household growth in the drier regions of England and lifestyle changes, pose a continuing threat to long-term water security.

The large investments that the water companies have made in recent years and improvements in managing their networks have helped to maintain essential supplies. These improvements have included a reduction of more than a third in leakage since a peak in the mid-1990s to a point where in normal times further reductions would add more to customers' bills than the benefit gained from further savings.

When companies fail to hit their leakage targets Ofwat has taken action. In 2010-11, six companies failed following a harsh winter. In the two most serious cases, the companies concerned are paying money back to customers or making additional investment, worth almost £40 million. But customers are understandably concerned that, when they are being asked to reduce water use during a drought, companies should themselves make special efforts to conserve water. For 2011-12, we expect to see evidence of such extra efforts in the companies' record on leakage.

Leakage control is only one aspect of the strategy needed to ensure water sustainability for the longer term. That is why Ofwat, working closely with other

stakeholders, is proposing new ways to incentivise sustainable use of water and encourage the companies to deliver more resilient, adaptable and integrated supplies.

We were pleased that during 2011-12 the review of Ofwat and consumer representation in the water sector, led by David Gray (the 'Gray review'), acknowledged the progress we are making in delivering on our strategy and in delivering better regulation. The review also helpfully highlighted areas where we need to change and improve. And we have already made good progress on this.

Also, the UK Government published two White Papers – on the natural environment and water respectively. These papers provided welcome direction for the sectors in England that set out a clear vision of reforms that will benefit consumers and the environment. We look forward to receiving the Welsh Government's Water Strategy, which we expect during 2012-13. We take account of both the UK and Welsh Governments' priorities in our work, while preserving the independence of our regulatory decisions.

There have been changes to the Ofwat Board over the past year. We said goodbye and thank you to Mike Brooker, Peter Bucks and Jane May, who stepped down as Non-executive Directors, and welcomed Wendy Barnes and Robin Paynter Bryant. We also welcomed Cathryn Ross' successor, Sonia Brown, as an Executive member of the Board and Senior Director of Markets and Economics. I expect to welcome my successor during 2012-13. I am confident that, as I step down myself, I leave an experienced, effective and forward-looking organisation.

I would like to put on record my thanks to all those that served the interests of water consumers over the past year, and throughout my 12 years at Ofwat – first as Director General, then as Chairman. In particular, I would like to thank my colleagues on the Ofwat Board and Ofwat staff. Together, we have achieved a lot. And together, I am sure you will continue to go from strength to strength in helping to deliver sustainable water and sewerage services for consumers now and for future generations.

**We are proposing new ways  
to incentivise sustainable  
use of water and encourage  
the companies to deliver  
more resilient, adaptable  
and integrated supplies**

**Philip Fletcher  
Chairman**

## Chief Executive's report

**O**ur vision is for sustainable water and sewerage sectors that meet the needs of today's customers while ensuring future generations' needs can all be met. That means socially, economically and environmentally sustainable sectors. Over the past year, we have begun to put in place significant changes to the way we regulate to better contribute to that goal.

### To be sustainable, the sectors need to be able to:

- plan effectively for the long term;
- be flexible enough to innovate;
- find new ways of addressing customer needs; and
- be capable of adapting to a more changeable environment.

**Customer legitimacy is essential to the long-term success of the sectors**

The recent short-term challenges posed first by the drought and then by torrential rainfall are an example of the long-term challenges the sectors face. So, over the past year one of the most significant things we have done – by working closely with our stakeholders from across the sectors – is to develop our framework for setting the price and service package ('price limits') that monopoly companies must deliver to all of their customers in the longer term.

In a way that takes account of these challenges, our ['future price limits – statement of principles'](#), which we published in early 2012-13, set out the six principles that will guide how we set price limits in the future – and in particular, how we will next set them in 2014, for each of the five years between 2015 and 2020.

### Our principles and framework are designed to:

- deliver greater opportunity for companies to innovate in how they deliver services;
- reward well-performing companies with well-evidenced spending plans that their customers support to benefit from less regulatory intrusion from us;
- encourage the companies to manage our precious water resources – and the wider water environment – carefully and efficiently;
- give the sectors the credibility and legitimacy in the eyes of their customers and policy makers, that is essential to their stability; and
- enable a more transparent and focused allocation of risk and ownership – and accountability for delivery.



When asked to conserve water during the recent drought, customers responded well. But they rightly challenged their water companies to play their part too – by managing leakage, planning for the long term and managing this precious resource in a more sustainable way. That customer voice must be heard by the companies and acted on. Customer legitimacy is essential to the long-term success of the sectors.

**Using our principles to set price limits will benefit:**

- customers, who will have more say over how the services they receive are delivered and over the price they pay for those services;
- the companies, who will have more freedom to think of new and better ways to deliver services – and focus on the things that matter to their customers;
- the environment, through (for example) more efficient use of water resources; and
- investors, who will (for example) retain the stability and predictability they value in order to lend water companies the money they need to deliver long-term investment in water and sewerage services.

Our risk-based approach to regulation, which we also developed during the year, will underpin our approach to price setting and regulating the sectors overall. This will allow us to direct our resources at areas where customers are most at risk, and ensure our regulation is targeted and proportionate.

This has been a challenging and productive year. As well as implementing the first steps to changing the way we regulate in future, we also carried out a significant reorganisation to equip ourselves with the skills and capabilities that we will need to continue to change. A number of staff changed roles or moved on over the past 12 months. I would like to thank them, and their colleagues, for their service and hard work that mean we will continue to be not only an effective and efficient regulator, but also, increasingly, an innovative one. Innovation from everyone – policy makers, regulators, companies and customers – will be crucial if we are to overcome the challenges these sectors face.

Finally, I would like to finish by thanking our stakeholders – for their help, challenge and contributions over the past year. There is more to come in 2012-13, particularly as we begin to focus on how we will implement the next price review. I am confident that by continuing to work together we can deliver sustainable water.



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



# Our strategy – a summary

<p>This is our long-term aspiration.</p>	<p><b>Vision</b></p> <p>A sustainable water cycle in which we are able to meet our needs for water and sewerage services while enabling future generations to meet their own needs (<b>‘Sustainable water’</b>).</p>
<p>Our mission and goals set out how we will contribute towards delivering our vision.</p>	<p><b>Our mission and goals</b></p> <p>To ensure customers continue to receive safe, reliable, efficient and affordable water and sewerage services that promote positive social, economic and environmental impacts today, tomorrow and over the long term (<b>‘Water today, water tomorrow’</b>).</p> <ul style="list-style-type: none"> <li>• Ensuring a fair deal for customers</li> <li>• Keeping companies accountable</li> <li>• Making monopolies improve</li> <li>• Harnessing market forces</li> <li>• Contributing to sustainable development</li> <li>• Delivering better regulation</li> </ul>
<p>Our values describe how our organisation, and individuals in it, will behave in delivering all aspects of our work.</p>	<p><b>Responsibility</b></p> <p>We have values that underpin our vision, mission and goals. We will operate to the highest standards of public office and conduct our business in a responsible and ethical way.</p> <ul style="list-style-type: none"> <li>• Excellence</li> <li>• Leadership</li> <li>• Respect</li> <li>• Integrity</li> </ul>
<p>Our vision, mission and goals provide the basis of our annual priorities, which we set out in our forward programme each year.</p> <p>These annual priorities form the basis of our senior management team’s objectives. These in turn cascade down the organisation to the objectives of all Ofwat staff.</p> <p>This ensures actions required to deliver our strategy are allocated and aligned with individual responsibilities.</p>	<p><b>Delivery</b></p>  <pre> graph TD     A[Vision] --&gt; B[Mission]     B --&gt; C[Goals]     C --&gt; D[Annual Ofwat priorities]     D --&gt; E[Annual team priorities]     E --&gt; F[Annual individual priorities]     </pre>
<p>Our annual report and accounts show what we have delivered each year and report on progress in delivering our strategy.</p>	<p><b>Progress and accountability</b></p> <p>Each year, we review how well we have done in delivering our work programme, and report on the efficiency and effectiveness of our organisation in our annual report and accounts. This document is laid before Parliament.</p>

## Our Board



From left: Keith Mason (Senior Director of Finance and Networks), Wendy Barnes, Gillian Owen, Philip Fletcher (Chairman), Regina Finn (Chief Executive), Sonia Brown (Senior Director of Markets and Economics), Penny Boys, Robin Paynter Bryant

Non-executive Directors: Wendy Barnes, Gillian Owen, Penny Boys, Robin Paynter Bryant

## 2011-12 highlights

Here, we set out some of our main achievements this year. We describe them in more detail in the report, along with our other achievements during 2011-12. Further information is also available on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk).

### Ensuring a fair deal for customers

We gave customers more of a say over how the services they receive from their water company are delivered and the prices they pay. See page 16.

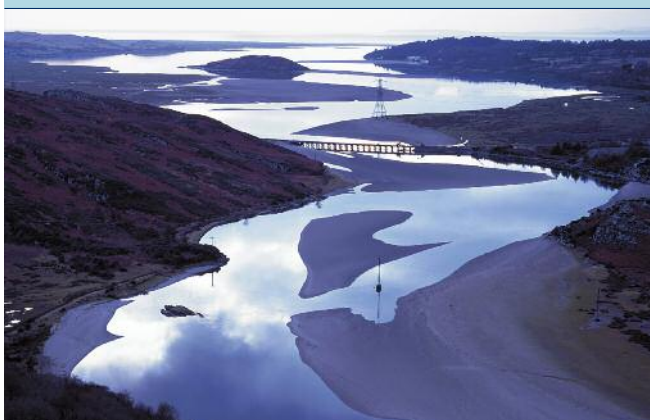
Some customers have problems paying their water bills. We published new research on this issue and used it to advise the UK and Welsh Governments on how water affordability challenges could best be tackled. See page 14.



### Keeping companies accountable

Water companies will focus on being accountable to their customers, rather than us. This is because we made changes to the way that we regulate that will, among other things, put the onus on companies to demonstrate to their customers how they have performed. See page 19.

We took action on behalf of customers against those companies that failed to meet their obligations. This included six companies that failed their leakage targets in 2010-11. In the two more serious cases the companies are paying money back to customers or making additional investment, worth almost £40 million. See page 17.



### Making monopolies improve

In future, we will encourage the companies to deliver more responsive, innovative and sustainable services. Over the past 12 months, we consulted on and developed our principles for setting the price limits that the monopoly companies can charge their customers – and the services they should deliver. See page 21.

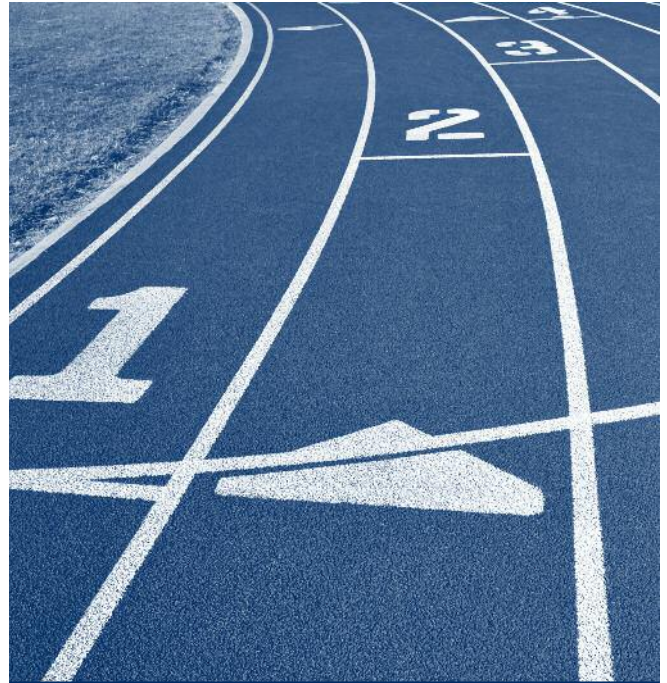
Companies continued to improve customers' experience and get things right first time after we introduced a new service incentive mechanism tool in 2010. As a result, customer satisfaction with the way in which the companies handled their queries and concerns was high. The first results for 2010-11 show companies' average rating was 4.2 on a scale of 1 to 5 (where 5 indicates 'very satisfied'). See page 20.



## Harnessing market forces

In December 2011, the UK Government announced its proposals to implement legislation that would extend the level of competition in the water and sewerage sectors in England. We provided advice and evidence to the Government as it considered the changes it would make. See page 25.

We granted six appointment variations during the year, which offered benefits such as discounts to customers and improved services to developers. Appointment variations are where an existing company provides water, sewerage or water and sewerage services to a specific area in place of the previous supplier. See page 23.



## Delivering better regulation

We introduced a risk-based approach to help us deliver more targeted and proportionate regulation. Our approach, which was commended by the Gray review for its ambition, also allows us to direct our resources to deliver new work, without increasing our licence fee. See page 29.

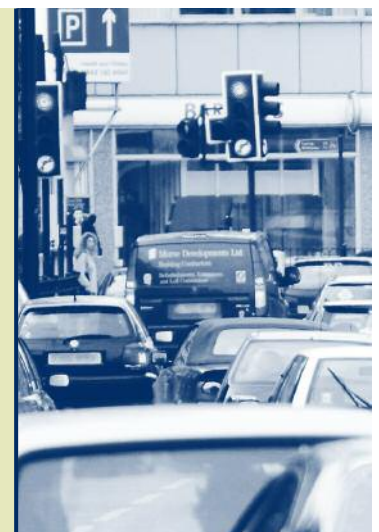
We developed a revised set of annual reporting arrangements to improve the transparency and measurement of our performance. We will consult on this during 2012-13. See appendix 1.



## Contributing to sustainable development

We reported to the Secretary of State for Environment, Food and Rural Affairs on the key risks of climate change to our functions, and how we are dealing with them. Our report received praise from the UK Government on its quality and clarity. See page 26.

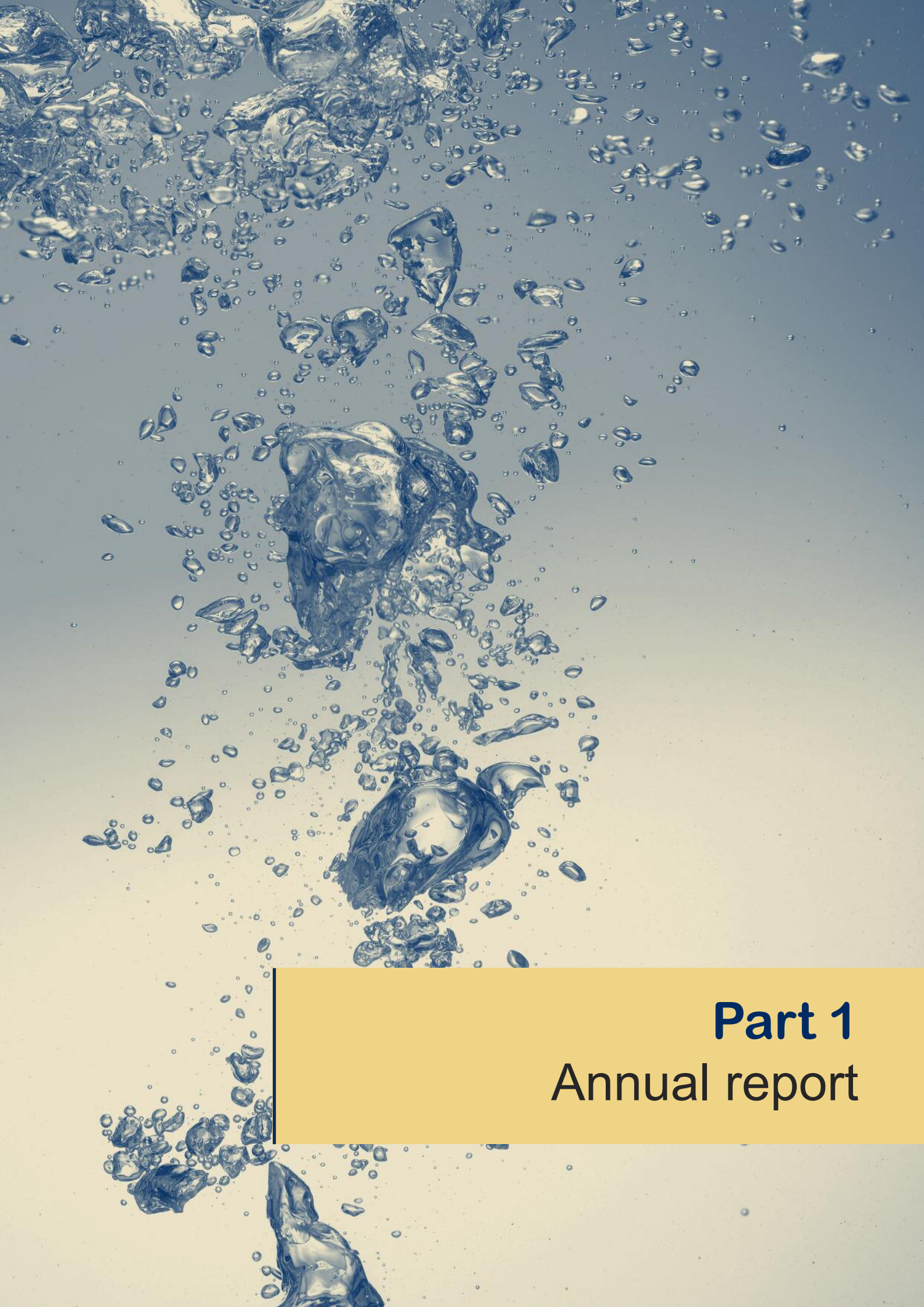
We provided advice to the UK and Welsh Governments as they considered their water policies. For example, we carried out joint work with the Environment Agency on the way water abstraction (taking water out of the environment) is managed. This helped inform the UK Government's plans for long-term reform, which it announced in its Water White Paper. See page 27.











**Part 1**  
Annual report



## Ensuring a fair deal for customers



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

### Taking action now

In January 2012, we announced that the average household water and sewerage bill for 2012-13 would rise broadly in line with inflation. It will increase by 5.7%, or about £20, to £376. This takes account of inflation of 5.2%.

In 2009, we made our decisions on how much the water companies could charge their customers between 2010 and 2015. Our challenge of the companies' proposed bill rises meant that across England and Wales average bills are set to remain broadly flat before inflation until 2015, and about 10% lower than what companies asked for. The bills customers pay will allow the companies to make sure that customers continue to see improvements and receive a safe, reliable supply of drinking water. This includes the companies replacing or improving more than 10,000 km of water mains – more than the equivalent of the distance from London to Cape Town – and addressing sewer flooding problems for more than 6,300 properties.

Some customers, because of their personal circumstances, may struggle to pay their water and sewerage bills. But the companies and policy-makers do not always understand how best to target help.

In 2011-12, we published new research on water affordability. We used this research to help advise the UK and Welsh Governments as they considered what

to do to help customers. We developed a new method – and provided analysis – for identifying customers at risk of experiencing difficulty paying their water and sewerage bills. Both Governments will be publishing guidance to the companies and Ofwat on creating social tariffs, so that the companies can create schemes in consultation with their customers. We responded to consultations from both Governments on what this guidance should contain. In both instances, we emphasised the importance of involving customers and their representatives in the development of social tariffs. We also emphasised the need for clear guidance so that the companies and Ofwat are able to deliver the policy aims of the UK and Welsh Governments.

We also provided technical advice to the UK Government on providing help to customers of South West Water. Historically, these customers have had the highest average combined water and sewerage bills in England and Wales. In the Water White Paper, the UK Government confirmed that it would fund South West Water to enable it to cut bills by £50 a year for all household customers until at least the end of the next Spending Review period. The Water Industry (Financial Assistance) Act 2012, which provides Government with the power to make this payment, received Royal Assent in May 2012 and bills will be reduced from April 2013.

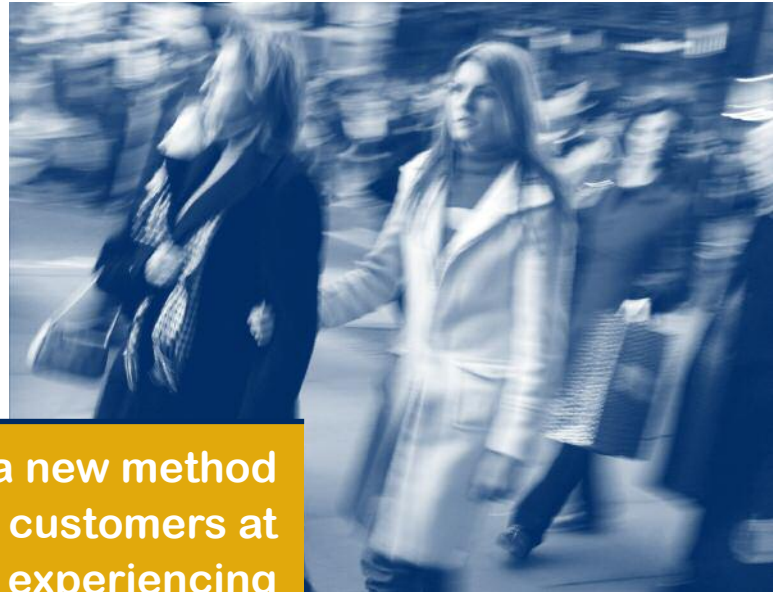
When three companies – Bristol Water, Cambridge Water and Northumbrian Water – changed hands, we

updated their licence conditions. The changes we made safeguard customers' interests by making sure the companies keep their regulated activities separate from their other business interests. This means that water customers do not have to pay for anything they should not.

Cambridge Water's initial change of ownership was a short-term arrangement. It was subsequently acquired by South Staffordshire Water's owners. This transaction resulted in a mandatory reference to the Competition Commission. We provided our initial

submission to the Competition Commission's inquiry in February 2012. Any reduction to the number of companies affects our ability to make comparisons between them, and deliver value for customers. While we do not think this merger should be prevented, we said that customers should see a financial benefit from it. Nor should they see a detriment to the service they currently receive. The Competition Commission published its final decision in May 2012. It concluded that the arguments in the case were finely balanced, but that the merger may not be detrimental to our task of setting price controls and incentivising the companies' performance.

On 1 October 2011, regulations introduced by the UK Government transferred the ownership of existing private sewers and lateral drains to regulated sewerage companies in England and Wales. In total, they took on responsibility for an estimated 224,500 km of private gravity sewers and lateral drains. Before this transfer took place, we consulted on and published guidance for customers who wished to appeal the transfer of specific private sewers, lateral drains and pumping stations. About 350 customers contacted us because they felt they had grounds to appeal the transfer. We will report back on the outcome of these cases next year.



**We developed a new method for identifying customers at risk of experiencing difficulty paying their water and sewerage bills**





We continued to check that Thames Water's customers receive value for money from the company's 'Thames Tideway' project

## Planning for the future

In August 2011, we announced a new policy that will increase significantly the say that customers have over the prices and services they receive when we next set price limits in 2014 for each year between 2015 and 2020. We have introduced a three-tiered approach that will allow customers to influence the price limits they receive through:

- direct engagement with their water company on a range of issues, including local services and tariffs;
- challenging the shape of their company's overall business plan and the way they meet their legal obligations (for example, on drinking water quality and the environment); and
- informing our decisions through our sector-wide customer advisory panel.

When we next set price limits, evidence from customers on the effectiveness of a company's engagement with them – and their views of the company's spending plans – will be an important factor in determining our scrutiny of a company's business plan.

During the year, the Department for Business, Innovation and Skills (BIS) consulted on possible changes to the way consumers are represented across the economy. Currently, the Consumer Council for Water (CCWater) is the statutory representative for water and sewerage consumers in England and Wales. We responded to say that – among other things – whatever arrangements are in place, water

consumers continue to need strong representation. The UK Government announced in its Water White Paper, 'Water for Life', that no changes will be made to CCWater until after our price review is concluded in 2014. The future of CCWater in England will then be subject to review. The Welsh Government has confirmed that CCWater will continue in Wales after the price review.

We continued to check that Thames Water's customers receive value for money from the company's 'Thames Tideway' project. The project, which could take a further ten years to complete, involves constructing two super sewers beneath London and making improvements to a sewage treatment works. It is by far the largest project that the UK water industry has carried out since privatisation. Our role is to ensure that Thames Water's customers will receive value for money. In 2011-12, to make sure that the costs to customers are justified, we:

- continued to challenge and review Thames Water's processes for managing risk and estimating costs;
- commented on the company's approach to planning and property;
- checked that the significant resources it is using are procured competitively and managed effectively; and
- discussed alternative options for financing the project with the company, Defra and HM Treasury.



# Keeping companies accountable



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

## Taking action now

In October 2011, we reported that companies received about 9,000 (or 4.5%) fewer written or emailed complaints from their customers in 2010-11 than the previous year. This means that complaints have fallen by 20% in the past two years. Also, in September 2011, CCWater announced that it had recorded a 27% decrease in complaints about the companies during the year. It also carried out 80% fewer investigations into customer complaints.

**Complaints have fallen by 20% in the past two years**

But while there were positive aspects to the companies' performance, we also took action during 2011-12 against those that failed in the previous year (2010-11) to deliver the level of service their customers expect.

We had particular concerns about Severn Trent Water's performance because of the high number of water supply interruptions that its customers continued to suffer. We agreed with the company's action plan to address the high number of interruptions and its

offer to provide additional customer redress. Under the guaranteed standards scheme (GSS), customers already receive payment for extensive interruptions to their water supply. Severn Trent Water has improved the conditions under which customers are eligible for payments. From 1 November 2011, it also increased the size of each payment from £20 to £30.

We required seven companies – Yorkshire Water, Veolia Water Central, Severn Trent Water, Anglian Water, United Utilities, Northumbrian Water and Southern Water – to deliver action plans to restore stable serviceability of their assets. ('Serviceability' means they must show that their assets are capable of delivering the right level of service to consumers and the environment now and in the future.)

Six companies – Southern Water, Yorkshire Water, Northumbrian Water in its north-east operating area, Severn Trent Water, Anglian Water and Dŵr Cymru – failed their annual leakage targets in 2010-11. We required all of the companies to increase reporting to us on their performance. As well as

making sure that they get back on track, this allows us to take further action quickly if their performance does not improve.

Also, Yorkshire Water will continue to deliver the informal undertaking (a written agreement to put things right) it provided us in March 2011. This requires the company to meet its leakage targets for the next three years at no extra cost to its customers. The company has committed to spend an extra £33 million – at its shareholders' expense – on reducing leakage and improving the resilience of its pipes.

Southern Water has provided us with a formal undertaking (a legal agreement to put things right) that requires it to meet new leakage targets. We will also be requiring the company to pay back £5 million as compensation to its customers for failing to deliver its planned reduction in leakage.

In December 2011, we announced an investigation into whether Anglian Water has abused its dominant position and infringed the Competition Act 1998. This is in relation to its pricing for providing water and sewerage services to the 'Fairfields' development sites at Milton Keynes, which are in Anglian's supply area. The ability to provide water and sewerage services to new developments is open to competition within the water and sewerage sectors. Potential new entrants must generally obtain off-site supplies from the surrounding appointed monopoly company, which in the case of the Fairfields sites is Anglian Water. We are investigating whether Anglian's pricing for the Fairfields sites may have resulted in a margin squeeze



**We required seven companies to deliver action plans to restore stable serviceability of their assets**

and excluded competition – meaning customers may have missed out. No assumption should be made at this stage that there has been an infringement of competition law. We will make our final decision during 2012-13 after we have received and reviewed Anglian's response to our initial findings.

Where there is a dispute between water companies and customers (including developers), we can make determinations on the level of charges that companies can make for providing water and sewerage infrastructure, connections to their infrastructure or both. During the year, we consulted on the policy principles we propose to use when making our determinations on disputes in order to increase transparency for all parties. We will publish our final principles in 2012-13.

## Planning for the future

Protecting consumers will continue to be central to our role as the economic regulator of the water and sewerage sectors in England and Wales. To carry on protecting consumers in the light of the challenges facing the sectors, we need to ensure we have the capability to be agile in responding to emerging or changing risks, taking swift and decisive action where necessary.

So, we have developed a more effective way to ensure that companies are held accountable for meeting their customers' expectations and their legal obligations ('regulatory compliance').

In March 2012, following extensive discussions and consultation with our stakeholders, we published 'Delivering proportionate and targeted regulation – Ofwat's risk-based approach'. This set out our framework for holding the companies accountable. Our new approach:

- places the onus on the companies to be accountable to their customers and put problems right;
- guides how we ensure the sectors meet their legal obligations and customers' expectations; and
- ensures we regulate in a proportionate and targeted way.

It also means two significant shifts in the way we approach regulatory compliance.

- The first is to the current system of regulatory reporting. We have moved away from detailed regulatory monitoring of compliance. We will no longer collect the annual regulatory submission (the 'June return'). Instead, the companies will submit a

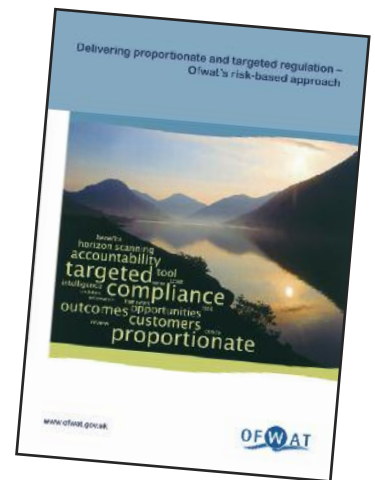
risk and compliance statement (which sets out their main risks and how they are managing them), their regulatory (financial) accounts and publish a suite of key indicators. They will also take responsibility for assurance of their data and systems. This change puts the companies firmly in charge of managing their risks, and redefines our role as holding them to account for the results, not the processes they adopt to ensure compliance.

- Second, we have adopted a risk-based framework. This will help us to target our resources, so we have the capability to act swiftly and decisively where there is a real risk to outcomes for water consumers. It is already helping us to deliver better regulation in practice (see page 29).

We have also been working closely with our fellow regulators to understand how we can streamline and integrate the regulatory environment for water and sewerage companies. For example, each company's risk and compliance statement incorporates areas that are the responsibility of the Environment Agency.

Our approach will mean changes in culture for both us and the companies – and in our relationship with them. We will keep our risk-based approach under review and assess regularly how well our approach is

working. We will use any lessons learned to help us decide whether it could evolve further. We will then work with the sectors to determine the best way forward.



**We have adopted a risk-based framework to help us target our resources**



# Making monopolies improve



Most people receive their water and sewerage services from one of 22 monopoly suppliers. In the absence of customer choice, we challenge these companies to deliver improved services, innovation and value for money.

## Taking action now

**D**uring 2011-12, we announced that customer satisfaction with the overall manner in which the companies handled their queries and concerns was high. We asked 17,000 customers to give us their view of how well their company did during 2010-11 on a scale of 1 to 5 (where 5 indicates they were 'very satisfied'). Scores ranged from 3.79 (United Utilities) to 4.59 (Veolia Water East). The average for all the companies was 4.2.

Satisfaction with the overall manner in which the companies handled customers' queries was high

- reducing the number of complaints they receive by improving their services overall.

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

As well as incentives to the companies to deliver better services to customers, we also try to encourage them to find better ways to do things (to 'innovate') to deliver improvements to customer service and the environment or cost efficiency.

In May 2011, we published [work we carried out with Defra and other stakeholders](#) – including the Technology Strategy Board – as part of the Water Sector Leadership Group, to highlight the areas of water and wastewater delivery where innovation should be a priority. It is intended to encourage individuals and organisations to develop innovative solutions in these areas. We are continuing to work with the group to identify further opportunities to promote and encourage innovation.

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

- identifying and meeting their customers' expectations;
- getting things right first time; and

## Planning for the future

One of our tools for making monopoly companies improve the services they deliver is setting limits on the prices they can charge their customers. We last set them in 2009 for the period 2010-15, and we will set them again in 2014 for 2015-20.

Through our [future price limits project](#) we have defined the overall approach we use to set price controls for monopoly services in future. We want the approach we use to:

- make the companies more responsible and accountable for delivering services to customers and the environment;
- provide incentives to encourage the most efficient use of water resources;
- engage customers effectively;
- encourage innovation; and
- incentivise the delivery of the right investment at the right price, in the right time and place.

We published a [consultation on our draft framework for setting price limits in future](#) in November 2011. Our approach complements the UK Government's vision for the sectors in England, which it set out in its Water White Paper.

As well as the written consultation, we held a series of workshops with the companies and other stakeholders on different aspects of our proposals. We also held individual meetings with companies that requested them. We received constructive feedback that reflected the diverse range of views among our stakeholders. We took account of all the feedback we received and, just after the end of the reporting year, we published our [statement of principles for setting price limits](#).

Our principles recognise the issues the sectors face and focus on addressing them by taking a long-term



view, making the most of scarce water resources, encouraging innovation and seeking greater customer involvement. Our approach will:

- encourage the companies to set high-level outcomes in consultation with their customers and stakeholders, and give the companies the responsibility and accountability for delivering those outcomes;
- include proportionate, targeted and tailored incentives to encourage delivery of those outcomes efficiently and effectively;
- be supported by strengthened customer engagement;
- encourage companies to meet different customer needs by setting separate retail and wholesale price limits;
- ensure the sectors can continue to raise the finance needed to invest in ongoing improvements at a reasonable cost; and
- be flexible enough to adapt to emerging challenges and new information.

We aim to make sure that the right incentives are in place so that the companies do not focus on investment-heavy and carbon-intensive engineering solutions where better value, more environmentally sustainable alternatives may exist. This includes encouraging more efficient water trading between companies. This has the potential to reduce the costs

**More efficient water trading  
between companies has the  
potential to reduce the costs  
of supplying services to  
customers**

of supplying services to customers, while also protecting the environment by encouraging more sustainable choices about how water is used.

A key element of our principles is that companies will develop and propose in their business plans the outcomes they will deliver rather than the outputs. Outcomes are higher-level objectives that company actions, activities and achievements are intended to help deliver. They represent what customers and society really value, such as the reliability, availability and safety of water supplies. The benefits of this approach are:

- a focus on what matters to customers (such as the quality of service), not outputs (such as installing additional capacity at a particular treatment works);
- a more proportionate, risk-based approach to regulation;
- companies that can focus on longer-term outcomes that are relevant to their specific – and sometimes unique – circumstances and customers; and
- companies that are incentivised to find the best and most cost-beneficial ways of delivering their agreed outcomes, and to adapt their programmes in the light of circumstances and experience.

Our approach to customer engagement (see page 16) will also mean that customers are central to the way future price controls will be agreed. Customers need to know that bills are fair and legitimate. This framework will enable the sectors to deliver sustainable solutions for their customers. That means the companies can keep bills down, continue to attract further investment, and deliver safe, reliable supplies for decades to come.

In response to [‘Future price limits – a consultation on the framework’](#), our stakeholders raised a number of issues and concerns relating to how our principles would be implemented for the next price review in 2014. We acknowledged these concerns and are continuing to engage with stakeholders on key areas

of work. This will determine the scale and pace of change for the next price review. So, alongside our statement

of principles, we published [‘From principles to price setting – next steps’](#). This sets out the work that we think needs to be carried out in the summer of 2012 so that we and our stakeholders are sufficiently prepared for the next price review. We will then consult on and finalise our methodology for setting price limits for 2015-20 – based on our principles – during 2012-13.

In December 2011, we published a [consultation on making changes to water companies’ licences](#) that would enable us to implement our future approach to price setting, and some of the UK Government’s Water White Paper proposals.

The licences of all appointed water and sewerage companies and water only companies currently specify that each time we set prices, we must set a single price limit for a five-year period. The companies’ licences will need to change if we are to have more flexibility to set price limits in a way that will help the sectors meet the challenges they face. Our proposals for ‘enabling’ changes to one part of the companies’ licences (condition B) would allow us to decide on the nature, form, number and duration of the price limits at each review after consulting on issues and methodologies. But they would not change the substance and stability of the regulatory framework.

We held discussions with the companies and other stakeholders during the consultation period. We also held a company workshop to explore our proposals in more detail. The responses we received expressed high-level concerns about the proposals, but not always with detail on the specific issues of concern. So, in April 2012, we announced that we were extending the consultation period to better understand our stakeholders’ concerns. We will report on the outcome next year.

# Harnessing market forces



We make sure that where markets for water and sewerage services exist they operate efficiently and effectively, and deliver benefits to consumers and the environment. We have our own powers under the Competition Act 1998. We also make recommendations to the UK and Welsh Governments where we consider there would be benefits from changing legislation to introduce further competition.

## Taking action now

New appointments and variations allow companies to provide water, sewerage or water and sewerage services to a specific area in place of the previous supplier. This can deliver benefits to customers and developers as new appointments can bring innovations that mean better, cheaper services. When we assess applications, we make sure customers will be no worse off than if the former service provider was still supplying them.

We granted six appointment variations during 2011-12. All of them were to SSE Water. More than 3,500 household customers will be supplied at the sites we approved. Customers will benefit in the following ways.

- Three of the six variations offered customers a discount on the charges they would have paid to their previous supplier.
- At one of the sites, SSE Water is proposing to use its own source of water – this is the first time this has happened.
- At most of these sites, developers are being supplied with water, sewerage, gas and electricity infrastructure by a single company. This means developers have only one supplier to deal with. It can also mean that the infrastructure is installed together, which is quicker and sometimes cheaper.

We also successfully defended an appeal by Thames



Water of a judicial review judgment that upheld our decision to grant Independent Water Networks Limited a variation to its appointment to serve the King's Cross redevelopment in London. Thames Water appealed the previous judgment on the grounds that the criteria that allowed us to grant the variation had not been met. Thames argued that:

- the site should not be considered a single premises;
- the site should not be considered "unserved" as parts of it had once been supplied; and



- the customer consent required needed to be sought from the site occupiers, not the developer.

The case highlighted that our decision to grant the variation, in the interest of customers, was correct. It also has important implications for potential new appointments and variations at other similar development sites – and could encourage this form of competition.

Water supply licensing is another means by which some non-household customers can choose their water supplier. In December 2011, the UK Government put in place changes to regulations to allow non-household customers in England using more than five million litres of water a year to choose their supplier. The change will increase the number of customers eligible to switch their water supplier from about 2,200 to more than 25,000. In Wales, customers must continue to use more than 50 million litres a year to be eligible.

To ensure the effectiveness of this expanded market we:

- published [revised guidance](#) to make it easier for new companies wishing to enter the market to apply for a water supply licence from us;
- published [guidance on eligibility](#) to make the circumstances under which customers can switch their supplier clearer for companies and customers; and
- standardised the process that appointed water companies and licensees must follow to ensure that

**The UK Government has approved changes to regulations to allow non-household customers in England using more than five million litres of water a year to choose their supplier**



customers are transferred between suppliers in a timely and efficient manner.

We also reduced barriers to competition by introducing an [operational code and common contract into our access codes guidance](#). This removes the need for licensed water suppliers to negotiate a new contract with the appointed water company every time they wish to switch a customer – and, ultimately, make it quicker and easier for customers to switch supplier. The access codes guidance sets out what each water company's access code must contain. The access code is a document that each company holds that describes how other companies can access its supply systems and the terms and conditions on which it will grant access.

## Planning for the future

In its Water White Paper, the UK Government announced its intention to introduce legislation that would extend the level of competition across all aspects of water and sewerage services. This includes:

- allowing all non-household customers in England to choose both their water and sewerage supplier for retail services; and
- introducing changes to allow competition in the supply of wholesale water and sewerage services.

We provided advice and evidence to the Government as it considered the changes it would make. This included reviewing the evidence for retail competition.

These changes are dependent on legislation, which is a matter for government. Following the UK Government's announcement of its intentions, we have begun preparatory work with it and other stakeholders. This will inform the detail of the legislation and begin to develop the arrangements that will be necessary to implement it. We will report on the outcome of this next year.

Over the past 12 months, we have also been exploring how we can encourage the companies to make the best use of resources by trading more water, rather than – for example – building their own reservoirs. We consulted on water trading incentives as part of our future price limits framework consultation (see page 21), and – along with the Environment Agency – on changes that will allow third parties to offer their own supplies to the companies (see page 27). We also held working groups with the companies and other stakeholders on these and other measures – such as creating a model contract to reduce negotiating time between companies in trading supplies. We consider that using these tools can help encourage the

companies to deliver better outcomes for customers and the environment.

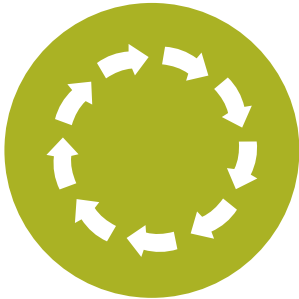
During the year, we responded to the BIS consultation on changes to the UK competition framework. We currently have powers to regulate competition in the water and sewerage sectors, alongside those of the main competition regulators – the Competition Commission and Office of Fair Trading (OFT). We supported the UK Government's view that this concurrency of powers should remain as this is in the interests of water customers.

Following our request and with support from us, during 2011-12 the OFT carried out and published a market study on the treatment of organic waste. The OFT considered whether the market for treating, recycling and disposing of sewage sludge and organic waste is working effectively to deliver the best outcomes for customers. It made a number of recommendations designed to encourage increased competition and greater efficiency in the treatment of organic waste. We are using the recommendations as we consider the best way to regulate the sludge services – along with the other services that water companies provide – as part of our approach for setting price limits for 2015-20.

**We consulted on water trading incentives as part of our future price limits framework consultation**



# Contributing to sustainable development



**We have a duty to contribute to the achievement of sustainable development. We consider social, environmental and financial issues together. And taking a long-term view is central to our strategy of sustainable water.**

## Taking action now

**T**he Climate Change Act 2008 introduced a new power for the Secretary of State for Environment, Food and Rural Affairs to direct 'reporting authorities' (including companies with functions of a public nature such as water and energy utilities) to prepare reports on how they are assessing and acting on the risks and opportunities from a changing climate.

So, at the start of the year we reported to the Secretary of State on the key risks of climate change to our functions and to explain what we are doing to deal with those risks. Our report highlighted the following issues.

- In the water and sewerage sectors, the most important risks relate to water availability, flooding and the capacity of the sewer system to cope with future weather.
- Ultimately, it is the companies' responsibility to plan for adaptation and deliver services efficiently so that customers do not pay more than they have to. Our role in tackling these risks is to provide the right regulatory incentives to allow the companies to adapt.
- Our regulatory system already enables water and sewerage companies to adapt in a number of ways, but the changes we are making to the way we regulate will help to better enable efficient adaptation to climate change.

Our report received praise from the UK Government on its quality and clarity. And we have used the

findings of our work to help inform our future approach to regulation. We are carrying out the actions we explained in the report, and have also continued to improve our understanding. For example, the way that the water and sewerage sectors respond to climate change could potentially have a big impact on the services customers receive and the bills they pay. So, we commissioned research to explore customers' attitudes to water and sewerage services in a changing climate. The research told us that customers:

- accept that collectively we need to respond to changing weather patterns and reduce greenhouse gas emissions – irrespective of the cause of climate change;
- would prefer to pay a little bit more in their water and sewerage bills now for climate change-related investment, in order to avoid paying a lot more in future;
- think metering is the fairest form of charging;
- have no interest in higher cost 'green water tariffs' (which would involve them paying more for lower-carbon water services) because addressing climate change should be something that all customers contribute to; and
- are not prepared to accept a reduced level of service in the future as a result of climate change even if costs rise. But they were open to changing their own behaviour to help maintain levels of service and keep bill increases as small as possible.

We continued to advise the UK and Welsh Governments as they considered their water policies. This included joint work we carried out with the Environment Agency on the case for changing the way that water abstraction (taking water out of the environment) is managed. This work informed the UK Government's plans for long-term reform as announced in the Water White Paper.

**Metering all of their customers will help Southern Water and South East Water ensure there is enough water for customers today and in the future**

During the year, we made changes to the licences of Southern Water and South East Water to allow them to provide support to their customers as part of their universal metering programmes. Both companies plan to install a meter at the homes of all of their customers. This will help them ensure there is enough water for customers today and in the future. But it could also mean that some customers could face significant bill increases as they move to bills based on how much water they use. We agreed with the companies that they will:

- put in place arrangements to provide advice and support to customers – for example, on saving water to keep costs down; and
- offer their customers a transition tariff that gives them time to adapt before their new metered bill takes full effect.

Also, we carried out further work to explore the costs and benefits of faster, more systematic water metering in England and Wales. This is to help other companies examine the case for metering, and choose the most efficient and sustainable options for balancing the supply and demand for water.

Metering is just one way of achieving this. During the past 12 months, we also consulted on and implemented some minor changes to the ways in which the companies calculate their water efficiency

targets for 2012-13 to 2014-15. Our changes are designed to give them better incentives and more flexibility to reduce water use, as part of a solution to balance water supply and demand in the best interests of customers and the environment.

And we worked with Defra and the Environment Agency to consult on updates to the water resources planning guideline. This is the guidance we expect the companies to follow when they prepare their plans to balance water supply and demand over the following 25-year period.

Subject to the responses to the consultation, we intend to work with the Environment Agency to improve this guidance in several ways. For example, it now requires the companies to consider trading water with their neighbours and to make information about water supply deficits and surpluses available. It also makes more explicit the need for the companies to reduce demand for water – for example, through leakage reduction and water efficiency. Third party individuals and organisations can also offer solutions to balance supply and demand, which the companies must consider and only turn down if they can achieve the same results more efficiently. This should lead to solutions that provide better value for customers and the environment.



## Planning for the future

The challenges the sectors face will mean we have to manage our precious water resources more carefully and sustainably. For example, droughts – such as the one much of England has experienced during 2011-12 – could become more frequent as climate change alters our weather patterns. This could leave us with even less water where and when we need it. Population growth and changing lifestyles will also increase demand in some regions, which will make the problem worse.

In ‘Valuing every drop – how can we encourage efficiency and innovation in water supply?’, which we published in February 2012, we highlighted the work we have been doing – and will continue to do – to tackle the root causes of water inefficiency. We also suggested both long- and short-term changes that would enable more efficient use of water resources.

For example, as part of our future approach to setting price limits, we are consulting on incentives to encourage more water trading between companies (see page 21). But this could result in increased abstraction from some sites. So, we have been developing a tool to avoid potentially environmentally-damaging abstraction of water from places where it is already scarce. Our abstraction incentive mechanism (AIM) would use price limits to reward the companies for abstracting less than a specified (or baseline) volume of water, if that abstraction was likely to cause environmental damage. It would also penalise them for abstracting more than their specified volumes in those cases. We will be consulting on the AIM in detail in 2012-13.

The AIM is not a substitute for more fundamental reforms to the abstraction framework that the UK Government outlined in its Water White Paper, which we welcomed. We are continuing to work with Defra and the Environment Agency to develop these longer-term solutions.



Population growth and changing lifestyles will also increase demand in some regions

In the past 12 months, we have also been considering the issue of water quality. In ‘From catchment to customer – can upstream catchment management deliver a better deal for water customers and the environment?’, which we published in October 2011, we described how the more sustainable approaches that some companies are trialling can help to:

- ensure good quality drinking water;
- tackle pollution; and
- meet environmental standards at an affordable cost and with reduced carbon emissions.

But we made clear that water customers should only meet the cost of such schemes, if there were clear benefits to water and sewerage services, such as reduced treatment costs. Over the past year, we have been asking the companies to improve the evidence for the effectiveness of such schemes and share best practice of what works and what does not. This is so that they can propose better schemes when we next set price limits in 2014. We and the Environment Agency held a joint conference with the companies in February 2012 to share good practice and encourage them to do more.

# Delivering better regulation



**Delivering better regulation means targeting our efforts on the biggest risks to consumers and taking 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

**D**uring the year, we completed a two-year programme of work to review our approach to regulatory compliance. Our approach, which was commended by the Gray review for its ambition, has resulted in us implementing some far-reaching changes to enable a more risk-based approach to regulation (see page 19). While the primary purpose was to place the onus on the companies to be accountable to their customers, it has also helped us deliver more targeted and proportionate regulation. We highlight examples of this below.

We have changed our system of regulatory reporting to reduce significantly the amount of information that we require the companies to send us each year (see page 19 and appendix 5).

Adopting a risk-based framework has allowed us to focus the allocation of our own resources on the areas of greatest risks to consumers. Through our 'gateway system' for prioritising what we do, we:

- assess whether we are best placed to act;
- weigh up the likely costs and potential benefits of the work; and
- decide whether the proposal would go about the work in the right way.

This means we have been able to reallocate resources to new work (some required by the UK Government's Water White Paper) while continuing to freeze our

licence fee to companies for 2012-13 – the third year in a row. With inflation running at close to 5% over the past two years, this equates to a real terms cut of about 10%.

Following consultation, we stopped the process of individually checking the companies' charges before we approve them each year. Instead, we now seek assurance from each company that it has complied with its obligations and with our published principles and guidelines on charges. This will make better use of resources, reduce the regulatory burden and maintain protection for customers (see appendix 5).

In developing our risk-based framework we engaged extensively with our stakeholders to take account of their views. For example, in 2011-12 alone we held 66 one-to-one meetings and five industry-wide, topic-specific workshops, which were attended by almost 150 people in total. The approach we used to engage with our stakeholders was widely praised by them and we will be seeking to apply the lessons we have learned from this to our other work.

To help us deliver our strategy, we carried out a significant internal reorganisation during the year. The aim was to ensure that we have the right skills, capabilities and structure to regulate the water and sewerage sectors successfully. Once all the vacancies are filled, the reorganisation will reduce the total number of staff from 234 (on 1 May 2011) to 200 people.



This will help us improve our effectiveness, increase our flexibility, tackle the challenges of the future and continue to operate efficiently.

While the reorganisation had a significant impact on the roles of many staff and the structure of our organisation, we continued to deliver against our statutory duties.

Over the past 12 months, we have continued to work closely with our fellow regulators to strengthen our working relationships, join up our processes and deliver better regulation in practice.

For example, during the year we met regularly with other members of the Joint Regulators Group (JRG), which brings together the Heads of the various regulators, to discuss issues of mutual concern and to report on recent developments in their own particular sector. This year, the group consulted together on the technical issue of discounting in cost-benefit analysis (a tool for judging whether something is a sound investment) in cases where a firm finances the investment, but it mainly benefits consumers and/or the wider public. This is an issue many sector regulators face in delivering their duties, so it is an area where the JRG members benefit from sharing and promoting good regulatory practice. The JRG also established four working groups to explore areas where there should be scope for common approaches across regulators.

As part of delivering better regulation, we are committed to the highest standards of openness and accountability. To emphasise our commitment to these standards, over the past 12 months we have published:

- our [publication scheme under the Freedom of Information Act 2000](#), which sets out the type of information available to the public about us and our work (appendix 6 sets out how many FOI requests we received this year and our performance in responding to them); and
- our [policy on impact assessments](#), which sets out when we will carry them out and what they will contain. Impact assessments set out options for any action we are taking – and what our preferred option is. They are a useful way for anyone with an interest

**We are committed to the highest standards of openness and accountability**

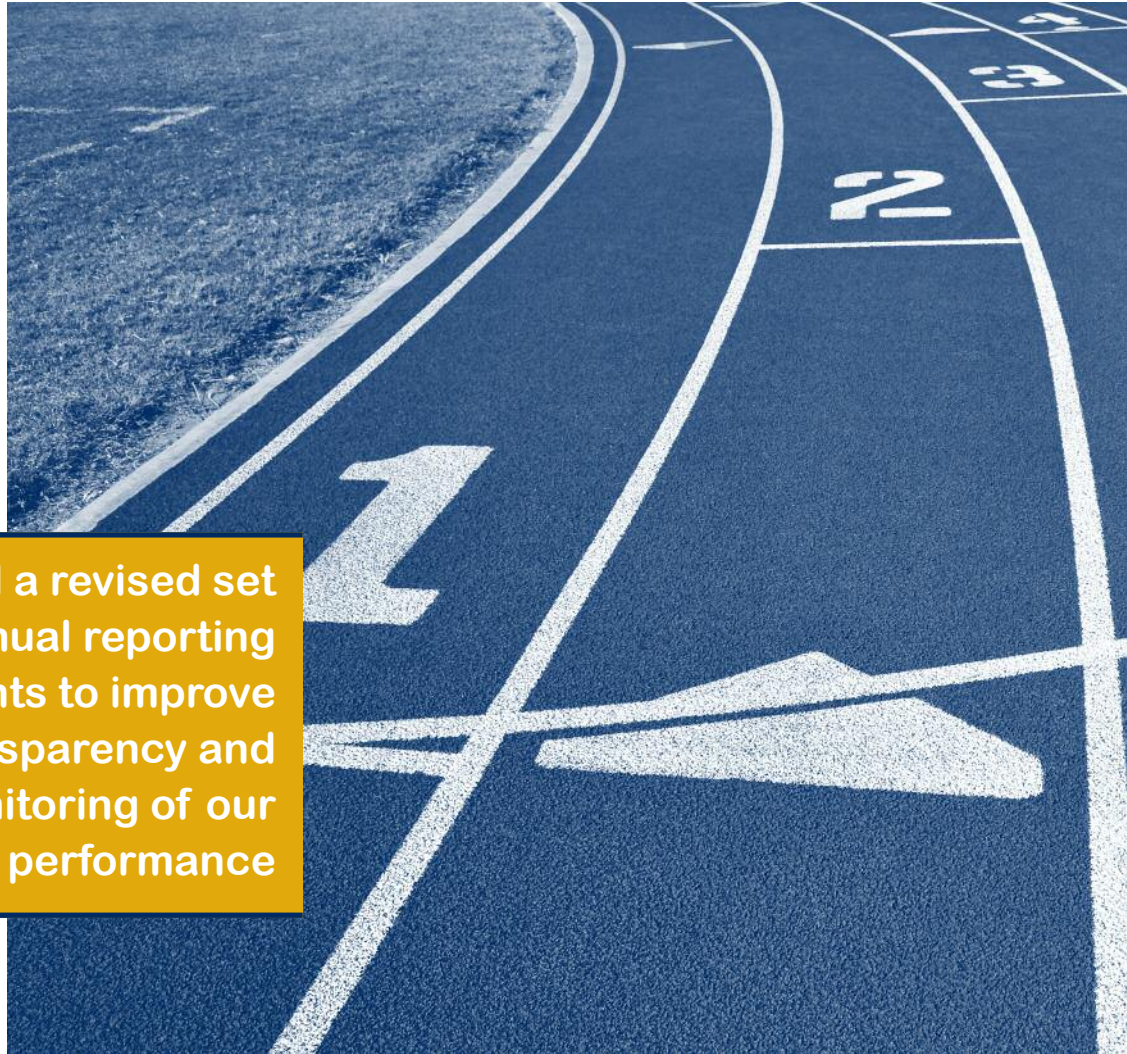
in our decisions to view, check and challenge any action we propose. This is an important part of a transparent decision-making process.

As a non-ministerial government department, our staff and Board abide by the principles of the Civil Service Code and its values of integrity, honesty, objectivity and impartiality. We have put in place policies that support and implement these values.

Ofwat takes any allegation of wrongdoing by any member of staff seriously and investigates thoroughly through a transparent and independent process. There have been two recent instances where anonymous allegations were made to people outside Ofwat. Once they were brought to our attention, we instigated an investigation in accordance with our whistleblowing policy. A full and independent review was carried out, which was scrutinised by our Audit Committee. This review found no wrongdoing or gain by any individual. But it did highlight a number of weaknesses in our processes and procedures and made a number of recommendations to improve them. So, during the year we updated and published a number of our recruitment and procurement procedures and policies, so that everyone understands how we do things and knows how to complain if they are not satisfied. This includes our:

- [policy and procedure for whistleblowing](#), to help employees who consider they have discovered malpractice or impropriety;
- [guidance on the handling of actual or potential conflicts of interest](#), to help our staff and so that our stakeholders can have confidence in our integrity and professionalism; and
- [policy on equality and dignity at work](#), which sets out our expectations of how our staff should be treated at work. Alongside this, we have also published how we are [complying with our public sector equality duty](#) as set out in the Equality Act 2010.





We developed a revised set of annual reporting arrangements to improve the transparency and monitoring of our performance

## Planning for the future

In August 2010, the UK and Welsh Governments announced a review of Ofwat and consumer representation in the water sector. The review was run within Defra, but led independently by an external reviewer, David Gray. The final report was published in July 2011. It contained a number of recommendations, some of which were for Ofwat.

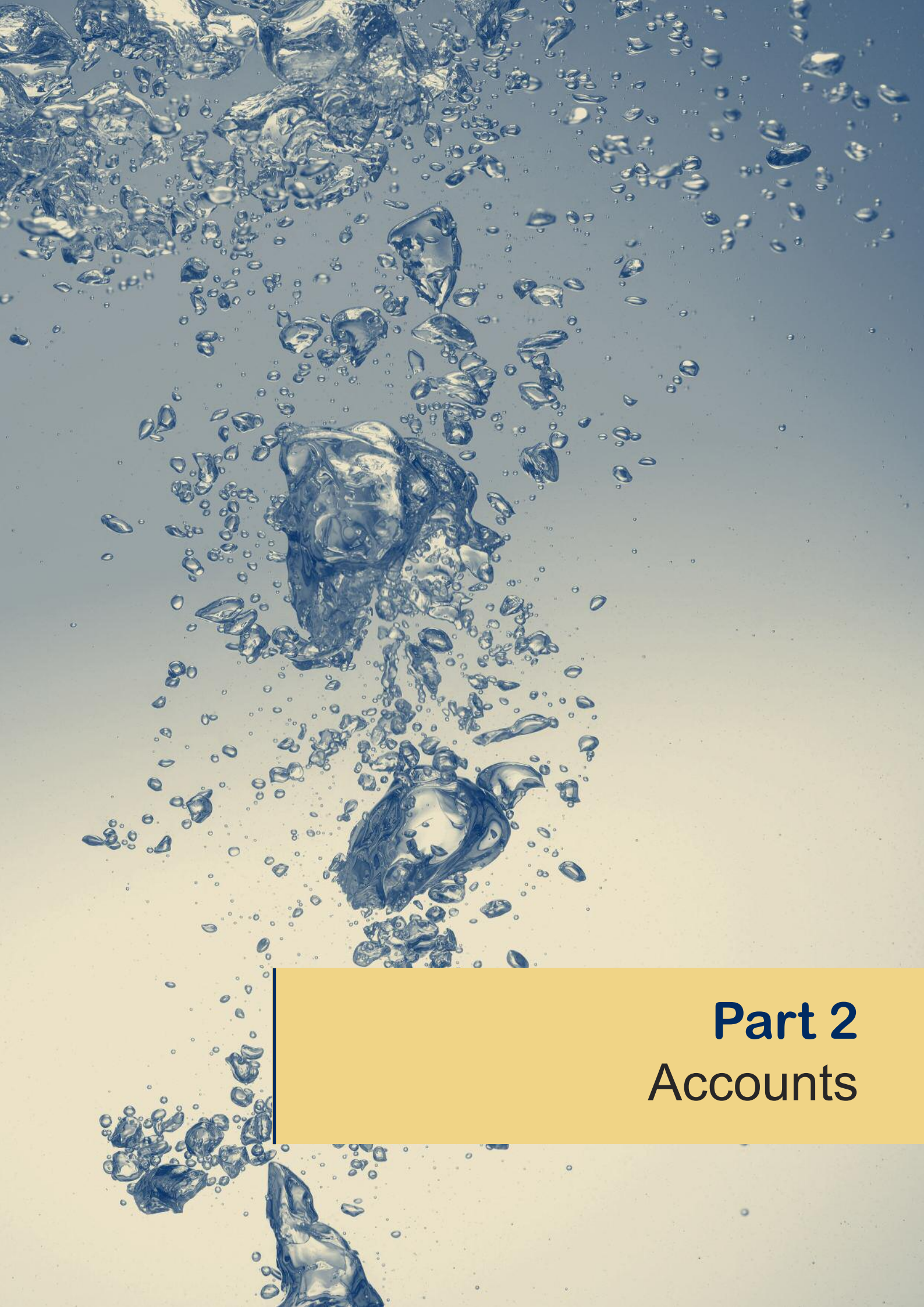
The review recognised the need for an independent economic regulator for the water and sewerage sectors. It concluded that the regulatory arrangements are effective and no changes to our existing duties are necessary. The review also helpfully highlighted some of the areas where we need to change and improve to the way we regulate. We were grateful for, and

accepted, the review's recommendations. We have already begun work to address these in a number of areas. In November 2011, we published '[IN 11/06: Review of Ofwat and consumer representation in the water sector](#)' to highlight how we are responding to the recommendations.

For example, in order to address recommendations relating to our governance and performance management, we developed a revised set of annual reporting arrangements (see appendix 1) to improve the transparency and monitoring of our performance. We will consult on these arrangements and test them during 2012-13. We will report our performance in next year's annual report and accounts.







# Part 2

## Accounts

## Management commentary

### Financial commentary

The financial highlights for Ofwat are summarised below.

#### Operating costs summary

	2011-12 £000	2010-11 £000
<b>Income</b>		
Deferred income from prior periods	5,361	4,999
Licence fees received	18,435	17,892
Other income	116	13
	<b>23,912</b>	<b>22,904</b>
<b>Expenditure</b>		
Administration costs	(19,104)	(17,423)
	<b>4,808</b>	<b>5,481</b>
Licence fee income deferred to the following period		(5,361)
Thames special fee refund in following period	(3)	
<b>Net operating cost</b>	<b>4,805</b>	<b>120</b>

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.

Following implementation of the HM Treasury alignment project, which attempts to bring estimates, budget and accounts into line, it was agreed that resource deferred income should no longer be carried forward in our accounts. As a result, deferred income was released at the 31 March 2012 to reduce the balance to nil.

At 31 March 2012 the cumulative unspent licence fees that have been surrendered to the Consolidated Fund total £5.7 million. Ofwat plans to offset this accumulated underspend against future licence fees by drawing from the reserve between 2012-13 to 2014-15. There is no reason to think that future reserve claims will not be approved.

The operating budget set at the start of the year was £18.7 million. At the beginning of the financial year, we

recovered £17.7 million in general licence fees with an additional £1 million cash being drawn from the reserve. In addition, a budget of £3 million, including a £1.5 million non-cash provision, was approved to cover the costs of the office reorganisation that took place between May 2011 and March 2012. £1.5 million cash was drawn from the reserve to cover compensation payments in the year. The £1.5 million provision was not required due to a change in Government policy during the year when the liability for early retirements transferred to the Principal Civil Service Pension Scheme (PCSPS).

The separate budget for regulating the Thames Tideway project was £0.9 million with a final outturn of £0.7 million, funded through two special fees recovered from Thames Water Utilities Ltd.

The overall underspend against budget was 15%. This was due to the Government's freeze on pay increases, cutting back non-business critical staff posts and consultancy, and reorganisation savings as a result of the future provision for early departure liabilities being transferred in full to the PCSPS from 2011-12.



We continued to draw on provisions made in 2009-10 to cover redundancy and early retirement costs. The 2011-12 reorganisation required a new provision of £190 thousand to be created to cover the costs of redundancy.

### 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. So, we are not exposed to significant liquidity risks. Further details are provided at note 12 to the accounts.

### Going concern

The statement of financial position at 31 March 2012 shows negative taxpayers' equity of £3.5 million. In common with other government departments, the future financing of Ofwat's liabilities are accordingly to be met by future grants of Supply and the application of future income, both to be approved annually by Parliament. There is no reason to think that future approvals will not be forthcoming. Accordingly, it has been considered appropriate to adopt a going concerns basis for the preparation of these financial statements.

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

### Roles and responsibilities

Ofwat is a non-ministerial government department with its own resource estimate. The chairman of the Ofwat Board is Philip Fletcher, the former Director General of Water Services.

The Board has a non-executive chairman, four non-executive directors and three executive directors, including the Chief Executive, Regina Finn, who is the Accounting Officer.

#### Chief Executive

##### Regina Finn

Former Commissioner at the Commission for Energy Regulation (Dublin), 2005-06. Non-executive Director of Northern Ireland Energy Holdings from 1 November 2008.

#### Non-executive directors

##### Philip Fletcher CBE (Chairman)

2-3 days a week.

Director General of Water Services, 2000-06. Member of the Archbishops' Council for the Church of England and Chair of its Mission and Public Affairs Council; both posts unpaid. Board member of Ofqual, the statutory regulator of examinations and qualifications, for which a small salary is paid.

##### Penny Boys CB

(Member of the Audit Committee until 30 September 2011, Chair of the Audit Committee from 1 October 2011), 2-3 days a month.

Member of the Remuneration Committee from 1 October 2011. Member of the Membership Selection Panel, Network Rail Ltd, June 2011 to current. Deputy Chairman of the Horserace Betting Levy Board 2008-11. Former Executive Director of the Office of Fair Trading.

##### Michael Brooker

(Member of the Remuneration Committee until 30 September 2011), 2-3 days a month.

Non-executive Director of the Water Industry Commission for Scotland (to 30 June 2011) and the Executive Board of the Natural Environment Research Council. Member of the Audit and Risk Management Committee of Wales Audit Office. Former Chief Executive of Dŵr Cymru Cyfyngedig (Welsh Water Ltd).

##### Peter Bucks OBE

(Chairman of the Audit Committee until 30 September 2011), 2-3 days a month.

Non-executive Board member of the Office of Rail Regulation, Associate Oxera Consulting Limited and Trustee and Council Member of the Regulatory Policy Institute. Former Commissioner, Infrastructure Planning Commission. Senior Financial Adviser to Ofgem (1997-2008) and Corporate Finance Adviser to Ofwat (2000-05).

##### Jane May

(Chair of the Remuneration Committee until 30 September 2011), 2-3 days a month.

Non-executive Director with the Information Commissioner's Office and Government Actuary's Department. Previously Non-executive Director of the Office of Rail Regulation, the SITA Trust and the Public Guardianship Office. Former customer services director of Thames Water.

##### Gillian Owen

(Member of the Audit Committee from 1 October 2011, Chairman of the Remuneration Committee from

## Annual report and accounts 2011-12

1 October 2011), 2-3 days a month. Independent Consultant and Senior Research Associate at University College London. Deputy Chair of the Fuel Poverty Advisory Group and member of Consumer Challenge group, Ofgem. Previously Senior Research Fellow at the Centre for Management Under Regulation (Warwick University) and Adviser to the Renewable Energy and Energy Efficiency Partnership. Former member of the Competition Commission.

### **Robin Paynter Bryant**

Appointed January 2012, 2-3 days per month. Non-executive Director of Go Modern Ltd. and Director of The Trinity Column Ltd. Non-executive Director of Prime International Investments Group Ltd. until September 2011.

### **Wendy Barnes**

Appointed February 2012, 2-3 days per month. Director General at DECC from September 2011. Non-executive member of the Finance Committee of Chester Cathedral, Director of Practiq Consulting Limited and Practiq Ltd. and Non-executive Director at FCO Services. Non-executive Director on the Audit Committee and Approvals Committee at DECC until September 2011.

### **Non-executive Directors' terms of appointment**

Non-executive Director appointments are generally for five years. Philip Fletcher has agreed a contract extension up to 31 July 2012 pending the appointment of the new Chairman. Peter Bucks, Mike Brooker and Jane May did not seek reappointment and left the Board on 30 September 2011. Penny Boys' appointment is until 31 March 2014. Gillian Owen has had her appointment extended for three years to 31 March 2014. Robin Paynter Bryant's and Wendy Barnes' appointments are until January and February 2016 respectively.

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.

### **Executive directors' terms of appointment**

The executive directors, including the Chief Executive, are generally appointed to the Board for a period of three years at which point the appointment may be extended for a further three-year term. The Chief Executive Regina Finn was re-appointed for a further term from 9 October 2011 to 8 October 2014. The Senior Director of Finance and Networks Keith Mason was re-appointed for a further term from 1 April 2011 to

31 March 2014 and the Senior Director of Markets and Economics Sonia Brown was appointed on 1 March 2012 to 28 February 2015.

### **Audit Committee**

Our systems of internal control, risk management and governance are scrutinised by the Audit Committee. Members of the committee in 2011-12 were Peter Bucks (Chairman) up to 30 September 2011, Penny Boys (Chairman) from 1 October 2011, Gillian Owen from 1 October 2011 and Richard Kennett (independent member).

Richard Kennett is a chartered accountant with extensive experience in audit, business and risk management, and is an independent member of the Audit Committee of Hanover Housing Group, a Council Member of the Health Professions Council, where he is the Chairman of the Finance and Resources Committee and a Tribunal Panel member of the Accountancy and Actuarial Discipline Board.

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

### **Equal opportunities policy**

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

- race;
- colour;
- nationality, ethnic or national origin;
- sex;
- sexual orientation;
- age;
- marital status;
- disability;
- religion; or
- working pattern.

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

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

## Employee involvement

We attach great importance to managing, developing and training staff. During the year, we 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.

## Sickness absence

Our policy is to reduce employee absence and we rely on early intervention by line managers conducting a return to work interview after each period of absence. Human Resources advisors inform line managers when the following trigger points have been reached for an individual to allow them to consider whether further action or support is required:

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

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

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

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

## Exceptional item

In December 2010, the Administrative Court found in Ofwat's favour in a judicial review brought by Thames

Water Utilities Limited. The review concerned Ofwat's appointment of Independent Water Networks Ltd as the undertaker for Kings Cross in London. Thames Water took the Administrative Court's decision on appeal and the appeal was dismissed in January 2012. Ofwat was awarded costs for the Administrative and the Appeal Court hearings. A sum of £80,000 was agreed and invoiced in April 2012.

## Supplier payment performance

We achieved 96.5% against our target for paying 100% of agreed invoices within 30 days of receipt during 2011-12. The corresponding figure for 2010-11 was 96.2%.

## 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 have been no protected personal data related incidents in 2011-12.

## Internal audit

PricewaterhouseCoopers LLP (PwC) provided our internal audit services in 2011-12. The service provides an independent appraisal service for management by measuring and auditing the adequacy, reliability and effectiveness of management, risk management, and financial control systems. The internal auditors make recommendations based on the appraisal of each system reviewed.

## External audit

Our external auditor is the Comptroller and Auditor General (C&AG), who is required to audit the financial

	Short term	Long term	2011-12 total	Short term	Long term	2010-11 total
Days lost	679	545	1,224	737	728	1,465
Percentage lost			2%			3%

statements under the Government Resources and Accounts Act 2000, and report to Parliament on his 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 (2010-11: £41 thousand).

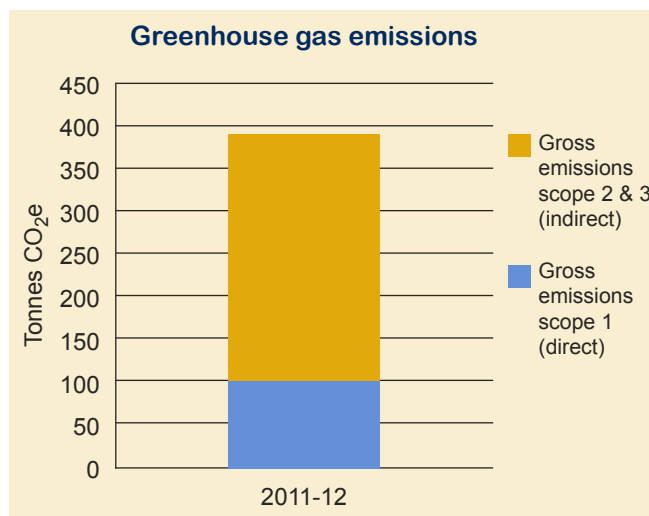
**Regina Finn, Accounting Officer**  
5 July 2012

## Sustainability report

### Summary of performance

In July 2011, HM Treasury issued guidance to government departments for sustainability reporting for the year 2011-12, as part of the Greening Government commitment. As a small department (<250 staff), Ofwat is not mandated to produce a sustainability report. But because of its role in a regulated sector with a major environmental impact, Ofwat has voluntarily undertaken to provide a report. The report below follows the guidance issued by HM Treasury.

Greenhouse gas emissions		2011-12
Non-financial indicators (1.000 tCO <sub>2</sub> e)	Total gross emissions	391.93
	Total net emissions	391.93
	Gross emissions scope 2 (direct)	99.88
	Gross emissions scope 2 & 3 (indirect)	292.05
Related energy consumption (million KWh)	Electricity: non-renewable	0.534
	Electricity: renewable	–
	Gas	–
	LPG	–
	Other	–
Financial indicators (£K)	Expenditure on energy	51
	CRC licence expenditure	1.3
	Expenditure on accredited offsets (for example, GCOF)	–
	Expenditure on official business travel	274



#### Performance commentary (including measures)

Scope 1 emissions are based on estimated readings for air conditioning and are not confirmed. Scope 2 emissions include general electricity supplies to our accommodation and server room (217.35 tCO<sub>2</sub>e) and scope 3 emissions relating to business travel (74.7 tCO<sub>2</sub>e).

#### Controllable impacts commentary

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



Waste		2011-12		
Non-financial indicators (tonnes)	Total waste		–	
	Hazardous waste	Total	–	
		Landfill	–	
	Non-hazardous waste	Reused/recycled		18.5
		Composted		–
		Incinerated with energy recovery		–
Financial indicators (£000)	Total disposal cost		8	
	Hazardous waste		–	
		Landfill		–
	Non-hazardous waste	Reused/recycled		8
		Composted		0
		Incinerated with energy recovery		0
		Incinerated without energy recovery		0

**Performance commentary (including measures)**

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

**Controllable impacts commentary**

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



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

**Performance commentary (including measures)**

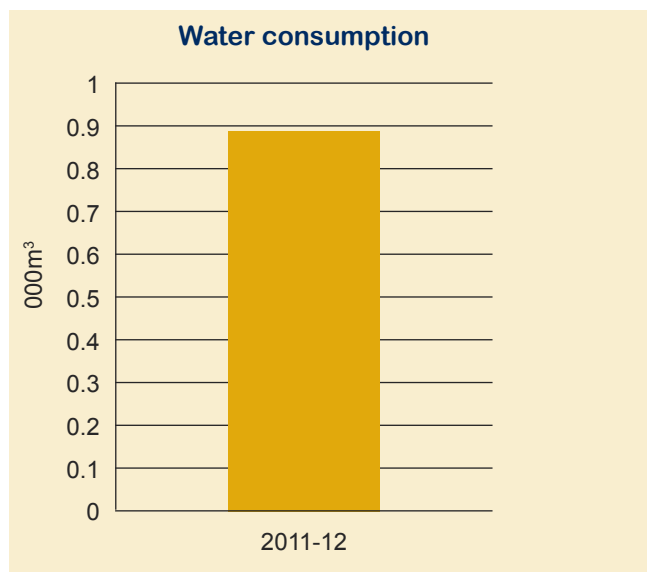
Previous water estimates have indicated volumes of 5.4m<sup>3</sup> per FTE. Metered usage for the 2011-12 period indicates an average consumption of 3.93m<sup>3</sup> per FTE.

**Controllable impacts commentary**

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

**Overview of influenced impacts**

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



**About our data**

2011-12 is the first year that Ofwat has captured this data. There are limitations to the accuracy of the non-financial sustainability information due to estimation techniques. But we are looking at systems that will improve the capturing of this data and increase accuracy in 2012-13.

**Future plans**

Ofwat will continue to take steps to improve its energy and water efficiency. Recycling is now integrated with the use of our office accommodation. The use of trains is already the principal means of business transport and we are investing in more video conferencing technology to reduce travel needs.

## Remuneration report

### Executive Team

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

Regina Finn\*  
Chief Executive

Keith Mason\*  
Senior Director of Finance and Networks

Cathryn Ross (until 7 August 2011)\*  
Senior Director of Markets and Economics

Sonia Brown (from 1 March 2012)\*  
Senior Director of Markets and Economics

Marian Spain  
Senior Director of Policy and Communications

Stuart Crawford  
Senior Director of Corporate Services and Programme Management

\* Denotes Board member.

### Service contracts

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

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

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

Each permanent member of the Executive Team participates in a bonus scheme which is in line with the Senior Salaries Review Body recommendations. The

bonus is paid on the individual's performance. Bonus payments are non-consolidated and non-pensionable.

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

### Interim directors

During the financial year, we employed Tim Keyworth (Keyworth Consultancy LLP) as the interim Chief Economist from 1 August to 31 March 2012. This was to cover the Senior Director of Market and Economics post until it was filled in March 2012.

### Staff remuneration

The Remuneration Committee approves annual pay awards.

Salaries are set on the basis of recruiting and retaining high-calibre staff within the framework of controlling public expenditure set by the Government. A non-consolidated bonus may be awarded to staff with exceptional performance. The Executive Team meets to review all line manager nominations and agree on bonus allocations. The annual bonus pot is agreed by the Remuneration Committee.

### Non-executive directors

The chairman and non-executive directors are remunerated in line with the recommendations made by Cabinet Office.

### Remuneration Committee members

During the year, committee members were:

- Jane May until 30 September 2011 (Chair);
- Gillian Owen (Chair) from 1 October 2011;
- Philip Fletcher CBE;
- Michael Brooker until 30 September 2011; and
- Penny Boys from 1 October 2011.

### 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

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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 45.

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

The roles of the chairman and non-executive directors are non-pensionable.

## Compensation for loss of office

The early departure cost of the 2011-12 reorganisation, including pay in lieu of notice, compensation payments and early retirements was £2.3 million. This included £190 thousand provision for compensation costs in future years. The use of the restructuring provision set up in 2009-10 is detailed in note 16.1.

The reorganisation meant that 48 employees left under voluntary redundancy terms in the year ending 31 March 2012. They received a compensation payment of between £4 thousand and £159 thousand. In some cases of early retirement, the compensation payment included a contribution from Ofwat to buy out part of the actuarially reduced pension.

Of the 48, eight elected to take early retirement. The cost to Ofwat of buying out the actuarial reduction on their pension was between £7 thousand and £50 thousand. They did not receive any additional compensation.

## Senior managers' remuneration

The following information was subject to audit.

	Salary £000	Bonus payments £000	2011-12 Benefits in kind (to nearest £100)	Salary £000	Bonus payments £000	2010-11 Benefits in kind (to nearest £100)
Regina Finn, Chief Executive	140-145	10-15	10,600	140-145	10-15	3,700
Keith Mason, Senior Director of Finance and Networks	105-110	5-10	–	100-105	10-15	100
Cathryn Ross, Senior Director of Markets and Economics (until 7 August 2011)	50-55 full year equivalent (130-135)	10-15	100	115-120	10-15	100
Sonia Brown, Senior Director of Markets and Economics (from 1 March 2012)	5-10 full year equivalent (115-120)	–	–	–	–	–
Stuart Crawford, Senior Director of Corporate Services and Programme Management	120-125	–	1,300	120-125	–	600
Marian Spain, Senior Director of Policy and Communications	110-115	–	7,700	100-105	–	100
Band of highest paid Director's total remuneration	165-170			160-165		
Median salary	£34,705			£32,813		
Ratio	4.8			5.0		



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 2011-12 was £165 thousand to £170 thousand (2010-11: £160 thousand to £165 thousand). This was 4.8 times (2010-11: 5.0 times) the median remuneration of the workforce, which was £34,705 (2010-11: £32,813).

In 2011-12, no employees received remuneration (2010-11: nil) in excess of the highest paid director. Remuneration excluding senior managers ranged from £3,246 to £107,973 (2010-11: £3,107 to £107,087).

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

## Third party payments\*

### Provision of interim manager services

The following information was subject to audit.

	2011-12 Payment £000	2010-11 Payment £000
Keyworth Consulting Ltd Tim Keyworth Interim Chief Economist (from 1 August 2011 to 31 March 2012)	125-130	–
Sands Resources Ltd Rob Ashley**, Interim Director of Policy and Communications (until 30 September 2010)	–	190-195

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

\*\*Between October and December 2010, there was a consultancy contract with Robert Ashley Ltd. This covered a range of consultancy services. The total value was £38,000.

## Non-executive members of the Authority remuneration

The following information was subject to audit.

	2011-12		2010-11	
	Salary £000	Benefits in kind (to nearest £100)	Salary £000	Benefits in kind (to nearest £100)
Philip Fletcher CBE, Chairman	105-110	1,200	105-110	1,500
Penny Boys CB, Non-executive Director	15-20	1,700	15-20	1,800
Michael Brooker, Non-executive Director (until 30 September 2011)	5-10 (full year equivalent 15-20)	500	15-20	1,200
Peter Bucks, Non-executive Director (until 30 September 2011)	5-10 (full year equivalent 15-20)	800	15-20	3,400
Jane May, Non-executive Director (until 30 September 2011)	5-10 (full year equivalent 15-20)	600	15-20	1,300
Gillian Owen, Non-executive Director	10-15	800	15-20	1,000
Robin Paynter Bryant (from 24 January 2012) Non-executive Director	0-5 (full year equivalent 10-15)	–	–	–
Wendy Barnes (from 7 February 2012) Non-executive Director	0-5 (full year equivalent 10-15)	–	–	–

## Independent member of the Audit Committee remuneration

The following information was subject to audit.

	2011-12		2010-11	
	Salary £000	Benefits in kind (to nearest £100)	Salary £000	Benefits in kind (to nearest £100)
Richard Kennett, Independent Member	0-5	800	0-5	800

### Salary

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

### Benefits in kind

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

Payments outlined below were net of tax and the tax amounts were paid over to HM Revenue and Customs. Items that fell into this category were subsistence and travel arrangements for the Authority.

### Bonuses

Bonuses are based on performance levels attained and are made as part of the appraisal process. Bonuses relate to the performance in the year in which they become payable to the individual. The bonuses reported in 2011-12 relate to performance in 2011-12 and the comparative bonuses reported for 2010-11 relate to performance in 2010-11.

## Senior managers' pension benefits

The following information was subject to audit.

	Real increase in pension and related lump sum at age 60 £000	Accrued pension at age 60 at 31 March 2012 and related lump sum £000	CETV at 31 March 2011* £000	CETV at 31 March 2012 £000	Real increase in CETV £000	Employer contribution to partnership pension account Nearest £100
Regina Finn, Chief Executive	0-2.5: lump sum –	10-15: lump sum –	132	171	23	–
Keith Mason, Senior Director of Finance and Networks	0-2.5: lump sum 0-2.5	20-25: lump sum 70-75	435	473	1	–
Cathryn Ross, Senior Director of Markets and Economics (until 7 August 2011)	0-2.5: lump sum 0-2.5	15-20: lump sum 50-55	204	220	6	–
Sonia Brown (1 March 2012) Senior Director of Markets and Economics	0-2.5: lump sum 0-2.5	15-20: lump sum 50-55	191	196	4	–
Stuart Crawford, Senior Director of Corporate Services and Programme Management	0-2.5: lump sum –	5-10: lump sum –	136	176	24	–
Marian Spain, Senior Director of Policy and Communications	42.5-45: lump sum –	42.5-45: lump sum –	8	472	184	–

\* The actuarial factors used to calculate CETVs were changed in 2011-12. The CETVs at 31 March 2011 and 31 March 2012 have both been calculated using the new factors for consistency. The CETV at 31 March 2011 therefore differs from the corresponding figure in last year's report which was calculated using the previous factors.

## Civil Service pensions

Pension benefits are provided through the Civil Service pension arrangements.

From 30 July 2007, civil servants may be in one of four defined benefit schemes: either a final salary scheme (classic, premium or classic plus); or a whole career scheme (nuvos). These statutory arrangements are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under classic, premium, classic plus and nuvos are increased annually in line with Pensions Increase legislation. Members joining from October 2002 may opt for either the appropriate defined benefit arrangement of a 'money purchase' stakeholder pension with an employer contribution (partnership pension account).

Employee contributions are set at the rate of 1.5% of pensionable earnings for classic and 3.5% for premium, classic plus and nuvos. Benefits in classic accrue at the rate of 1/80th of final pensionable earnings for each year of service. In addition, a lump sum equivalent to three years' initial pension payable on retirement. For premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike classic, there is no automatic lump sum. Classic plus is essentially a hybrid with benefits in respect of 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. In line with Government pensions policy, individual contributions will rise from 1 April 2012.

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

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

Further details about the Civil Service pension arrangements can be found at the website [www.civilservice.gov.uk/pensions](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.

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The figures include the value of any pension benefit in another scheme or arrangement that the individual has transferred to the Civil Service pension arrangements. They also include any additional pension benefit accrued to the member as a result of their buying additional pension benefits at their own cost. CETVs are worked out within the guidelines and framework prescribed by the Institute and Faculty of Actuaries and do not take account of any actual or potential reduction to benefits resulting from Lifetime Allowance Tax which may be due when pension benefits are taken.

### **Real increase in CETV**

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

**Regina Finn, Accounting Officer**  
**5 July 2012**



## Statement of Accounting Officer's responsibilities

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

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

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

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

HM Treasury has appointed Regina Finn, Chief Executive, Accounting Officer of the department.

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

## The Governance statement

### Scope of responsibility

The Accounting Officer and Ofwat Board have responsibility for maintaining corporate governance that supports the achievement of Ofwat's policies, aims and objectives, while safeguarding the public funds and departmental assets. This is in accordance with the responsibilities set out in 'Managing Public Money'. The Accounting Officer is accountable to the Chairman and Board for all aspects of Ofwat's work. This includes the management of risk. Ofwat's duties are laid down by legislation, in particular the Water Industry Act 1991 and the Water Act 2003. Ofwat is a non-ministerial government department.

### The purpose of the governance framework

The governance framework is designed to give assurance that Ofwat carries out its duties in a manner that meets the highest standards of internal control and risk management. This is based on processes designed to:

- identify and prioritise the opportunities and risks to the achievement of Ofwat's strategy, policies, aims and objectives;
- evaluate the likelihood of those opportunities and risks being realised (and the impact should they be realised); and
- manage them efficiently, effectively and economically.

The governance framework has been in place in Ofwat for the year ended 31 March 2012 and up to the date of approval of the annual report and accounts, and accords with HM Treasury guidance. Assurance is provided to the Accounting Officer by each budget holder (directors and team leaders) who have signed a governance statement covering the period from 1 April 2011 to 31 March 2012.

### 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. The Board has a majority of non-executives with a non-executive chairman, four non-executive directors and three executive directors, including the chief executive. The Board membership provides the necessary balance of experience and expertise covering Ofwat's duties and strategy. The Director of Legal Services is the Board secretary and legal adviser.

The non-executive members are independent of management and comprise a majority of the Board.

Apart from one small contract (see note 20: Related party transactions), there were no other 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 which were not addressed appropriately.

During the year, the Board reviewed the membership of its committees.

The Board's rules of procedure are updated periodically and published on the Ofwat website. This includes:

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

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

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

From April 2011 to March 2012

	10 Board meetings	2 Remuneration Committee meetings	3 Audit Committee meetings**	NAV Committee meetings***
Board members				
Philip Fletcher	10/10	2/2	NA	2/2
Penny Boys	10/10	1/1	3/3	NA
Gillian Owen	9/10	1/1	2/2	NA
The following new NEDs joined Ofwat in January and February 2012				
Robin Paynter Bryant	2/2*	NA	NA	NA
Wendy Barnes	1/2	NA	NA	NA
The following NEDs left Ofwat in September 2011				
Peter Bucks	5/5	NA	1/1	NA
Mike Brooker	4/5	1/1	NA	NA
Jane May	5/5	1/1	NA	NA
Executive members				
Regina Finn	10/10			
Keith Mason	10/10			
Cathryn Ross	5/5			
Sonia Brown	2/2			

\* Attended the February Board meeting as an observer.

\*\* Richard Kennett, independent member of the Audit Committee, 3/3.

\*\*\* Apart from meetings, the Committee has considered numerous papers through correspondence.

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

The Board met in Wales in July 2011, using the occasion to meet informally with a Minister and officials of the Welsh Government.

As well as 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 future water charging, retail mergers and customer engagement and challenge sessions on non-discrimination, retail separation and water trading. Board members also attended the sustainable water events in May and

November 2011 at which Ofwat gave briefings on its strategy and listened to the views of stakeholders.

The Board has three standing committees: the New Company Appointments Committee, the Audit Committee and the Remuneration Committee. Each 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.

The Board reviews its performance regularly. In 2011, it carried out an informal self-assessment which reported no concerns. The Board had an independent assessment by David Gray, who was commissioned by Defra to carry out an independent review of Ofwat. The review findings published in July 2011 made the following comments on the Board's governance and adherence to the Combined Code.

- "The review team considers that Ofwat's approach, as set out in the rules of procedure, complies well with the main requirements of the Code where these

are relevant. The responsibilities of the Board and the respective roles of the Chair, the NEDs and the executive seem well defined. The Terms of Reference of the Audit and Remuneration Committees are clearly set out and procedures are in place for assessment of risk and internal controls.”

- “It also came across strongly that the NEDs felt well informed and fully engaged in decision making on Ofwat’s strategic direction. It was clear that the NEDs were fully aware of, and in many cases driving forward, the major work programmes currently being undertaken by Ofwat, including reducing the regulatory burden and introducing more competition in the sector.”

The three committees of the Board carried out self-assessment performance reviews. These confirmed the value of the committees and provided valuable lessons to improve committee effectiveness.

### Committees of the Board

#### Audit Committee

The Audit Committee is chaired by Penny Boys (from September 2011). The non-executive members who served during the year are Gillian Owen (from September 2011), Peter Bucks (Chairman until September 2011) and Richard Kennett (independent member). The Chief Executive, directors, other staff, the external auditors (National Audit Office), the internal auditors (PwC), and the Assistant Board Secretary attend by invitation.

The Committee’s role is to support the Board in its responsibilities for issues of risk, control and governance and associated assurance by reviewing the comprehensiveness of assurances in meeting the Board and Accounting Officer’s assurance needs, reviewing the reliability and integrity of these assurances, and providing an opinion on how well the Board and Accounting Officer are supported in decision taking and discharging their accountability obligations. The Committee met three times during 2011-12. In June 2011, the Committee submitted its annual report to the Board along with its recommendations to approve the annual accounts.

Matters discussed by the Committee included:

- the future price limits project risk assurance;
- the office reorganisation project risk assessment; and
- risk management in the Finance and Networks Division.

An independent investigation was commissioned by the Accounting Officer in October 2011 into allegations set out in letters sent anonymously to a number of stakeholders, including the NAO. The letters alleged failures by named Ofwat staff to follow internal due process and the Civil Service Code. The allegations were examined fully by the Director of Legal Services and Board Secretary supported by independent forensic specialists. The review was completed in January 2012 with the Director of Legal Services and Board Secretary reporting to the Audit Committee (which in turn reported to the Board). The Accounting Officer, Audit Committee and NAO stated that although no conflict of interest arose some procedures were to be tightened.

#### Remuneration Committee

The Remuneration Committee is chaired by Gillian Owen (from September 2011). The non-executive members who served during the year are Jane May (Chair until September 2011), Mike Brooker (up to September 2011), Penny Boys and Philip Fletcher. The Committee’s role is considering matters relating to the pay and conditions of employment of Ofwat’s staff and succession planning. Issues discussed in 2011 included:

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

#### New Company Appointments Committee

The New Company Appointments Committee is chaired by Philip Fletcher (although the Committee can elect a different chair for any particular meeting). The Committee met twice during the year and discussed:

- the Hills Farm Lane application; and
- new appointments and variations policy and the Brewery Square site.



## Executive Team and audit arrangements

### Executive Team

The Executive Team comprises all 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 2011-12, the office implemented a new approach to delivering its strategy through programme and project management. This has been applied using the governance procedures set out in Managing Successful Programmes (MSP) and PRINCE 2.

### Auditors

The Comptroller and Auditor General, who has been appointed under statute and reports to Parliament, has audited the 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 Audit Committee. We have chosen to outsource the provision of the internal audit service to ensure wholly independent and fully professional analysis and recommendations. For 2011-12, our provider is PwC, who were appointed on 1 April 2010, following a competitive tender.

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

The Board, Audit Committee and Executive Team review regularly the strategic risk register and current priority risks from the operational risk register. The Audit Committee also receives presentations on a rolling basis from each director on their management of risk in their division. Risk assessment is embedded

into the work of the office. Senior managers, and their staff, are committed to managing risk. To strengthen its oversight we have an independent member to our Audit Committee, who is not a Board member.

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

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

Our risk strategy is reviewed annually and updated as required.

### Risk environment

The overall risk environment increased during the year due to the office reorganisation and the launch of extensive consultations key to the delivery of the Ofwat strategy – notably on future price limits and regulatory compliance. Defra published its Water White Paper in December 2011, which mitigated risk increase as it provides greater clarity on the policy environment and is well aligned with Ofwat's strategy. Ofwat continues to seek broad stakeholder support for its proposals to secure the long-term financial, social and environmentally sustainable future for the sectors.

The key risks managed during the year are as follows.

- The independent review of Ofwat, commissioned by Defra and carried out by David Gray, was broadly supportive of Ofwat's strategy and approach. Ofwat's Board and staff engaged fully with the review team at all levels within the organisation and the final report and recommendations were welcomed by the Board and Executive Team. A project has been established to take forward the implementation of the report's recommendations as agreed by the Ofwat Board.
- The office reorganisation was completed by March 2012. It involved a restructure with 48 posts becoming redundant. Thirty new posts were created designed to strengthen performance in key parts of the strategy. Risks to delivery of key outputs were managed effectively during the transition to the new organisation and no major outputs were delayed or compromised.
- The reorganisation of the office to apply programme/project management for the delivery of the strategy goals has included embedding risk management into all projects. This has been strengthened by further programme and project management training. Regular risk assessments are completed across the programme interdependent projects.
- The recruitment of a new chairman and three non-executives by Defra was a key risk during the year. The outcome was the appointment of two non-executive directors by 31 March 2012. The chairman recruitment was unsuccessful and was restarted in January 2012. Risks posed by this were mitigated by the agreement of the current chairman to continue in post for a short extension. The aim is to recruit the new chairman by 31 July 2012.

The internal audit plan 2011-12 covered the:

- financial and human resources systems;
- office reorganisation;
- case management system project; and
- information security.

The internal audit findings were satisfactory. Apart from one moderate risk rating all the other findings were low risk.

The risk assessment for the next financial year 2012-13 remains high. The main areas of risk are:

- the draft Water Bill and the timing and content of related future legislation;
- the outcome of a potential reference to the Competition Commission to reform company licences; and
- the launch of the next periodic review of price limits project.

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

### Information security statement

Ofwat holds a range of information covering commercial and personal data. We have an Information Risk Policy (IRP) and related procedures in place. In June 2011, we reported to the Cabinet Office our Annual Security Report. No areas of concern were identified.

### Ofwat's effectiveness

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

We consult on and publish our 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 divisional plans, programme projects and ultimately each member of staff's objectives. Directors, project managers and team leaders review progress on divisional, project and team plans regularly. The Executive Team reviews the progress of key projects on a monthly basis. The Executive Team and the Board review progress on the strategy each quarter. We have a process of individual performance review for staff in place. The resource requirements for Ofwat

are assessed regularly against the forward programme and developing priorities. The non-executive directors also provide the Accounting Officer with an independent view of our performance.

The Board, Audit Committee and Executive Team regularly assess and monitor our performance and related systems of internal control. Our internal auditors in 2011-12, PwC, review and advise on our risk management processes and internal controls and during the year reviewed systems and procedures in respect of finance and information security.

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

**Regina Finn, Accounting Officer**  
**5 July 2012**

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

I certify that I have audited the financial statements of the Water Services Regulation Authority for the year ended 31 March 2012 under the Government Resources and Accounts Act 2000. The financial statements comprise: the Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity; and the related notes. I have also audited the Statement of Parliamentary Supply and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

### Respective responsibilities of the Accounting Officer and auditor

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

### Scope of the audit of the financial statements

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

financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

I am required to obtain evidence sufficient to give reasonable assurance that the Statement of Parliamentary Supply properly presents the outturn against voted Parliamentary control totals and that those totals have not been exceeded. The voted Parliamentary control totals are Departmental Expenditure Limits (Resource and Capital), Annually Managed Expenditure (Resource and Capital), Non-Budget (Resource) and Net Cash Requirement. I am also required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

### Opinion on regularity

In my opinion, in all material respects:

- the Statement of Parliamentary Supply properly presents the outturn against voted Parliamentary control totals for the year ended 31 March 2012 and shows that those totals have not been exceeded; and
- the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

### Opinion on financial statements

In my opinion:

- the financial statements give a true and fair view of the state of the Department's affairs as at 31 March 2012 and of its net operating cost for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions issued thereunder.



## Opinion on other matters

In my opinion:

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

## 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

I have no observations to make on these financial statements.

**Amyas C E Morse**  
**Comptroller and Auditor General**  
**National Audit Office**  
**157-197 Buckingham Palace Road**  
**Victoria**  
**London**  
**SW1W 9SP**  
**5 July 2012**



**Administration costs 2011-12**

		2011-12 £000	2010-11 £000
Note	Estimate	Outturn	Outturn
3.2	103	(4,805)	120

The saving in administration costs of £103 thousand relates to the HM Treasury instructed changes to the scoring of interest on pension liabilities. A derogation letter was issued to Ofwat in November 2011 and transferred provisions expense from Annually Managed Expenditure (AME) to Departmental Expenditure Limits (DEL). Under DEL arrangements the interest charge is now offset against licence fee income generated.

As disclosed in note 9, following implementation of the HM Treasury Alignment Project, HM Treasury have instructed that unspent licence fees previously held as deferred income could no longer be accounted for in this manner. This has released £4,805 thousand against our administration costs for 2011-12.

## Statement of Comprehensive Net Expenditure

for the year ended 31 March 2012

		2011-12 £000	Restated 2010-11 £000
<b>Administration costs</b>			
Staff costs	7	12,351	11,270
Other costs	8	6,753	6,153
Income	9	(23,909)	(17,543)
<b>Net operating costs for the year ended 31 March 2012</b>		<b>(4,805)</b>	<b>(120)</b>
<b>Total expenditure</b>		<b>19,104</b>	<b>17,423</b>
<b>Total income</b>		<b>(19,104)</b>	<b>(17,543)</b>
Income deferred from prior years		(4,805)	–
<b>Net operating costs for the year ended 31 March 2012</b>		<b>(4,805)</b>	<b>(120)</b>
Net gain on revaluation of property, plant and equipment		–	(36)
Non-cash charges – actuarial (gain)/loss		110	(103)
<b>Other comprehensive income/expenditure for the year ended 31 March 2012</b>		<b>110</b>	<b>(139)</b>
<b>Total comprehensive expenditure for the year ended 31 March 2012</b>		<b>(4,695)</b>	<b>(259)</b>

The notes on pages 62 to 83 form part of these accounts.



# Statement of Financial Position

as at 31 March 2012

	Note	31 March 2012 £000	31 March 2011 £000
<b>Non-current assets:</b>			
Property, plant and equipment	10	617	646
Intangible assets	11	259	137
<b>Total non-current assets</b>		<b>876</b>	<b>783</b>
<b>Current assets:</b>			
Trade and other receivables	13	555	726
Cash and cash equivalents	14	1,679	965
<b>Total current assets</b>		<b>2,234</b>	<b>1,691</b>
<b>Total assets</b>		<b>3,110</b>	<b>2,474</b>
<b>Current liabilities:</b>			
Trade and other payables	15	(3,672)	(8,863)
<b>Total current liabilities</b>		<b>(3,672)</b>	<b>(8,863)</b>
<b>Non-current assets less net current liabilities</b>		<b>(562)</b>	<b>(6,389)</b>
<b>Non-current liabilities:</b>			
Provisions	16	(354)	(167)
Pension liabilities	16	(2,600)	(2,516)
<b>Total non-current liabilities</b>		<b>(2,954)</b>	<b>(2,683)</b>
<b>Assets less liabilities</b>		<b>(3,516)</b>	<b>(9,072)</b>
<b>Taxpayers' equity:</b>			
General Fund		(3,554)	(9,112)
Revaluation Reserve		38	40
<b>Total equity</b>		<b>(3,516)</b>	<b>(9,072)</b>

Regina Finn, Accounting Officer  
5 July 2012

The notes on pages 62 to 83 form part of these accounts.

## Statement of Cash Flows

for the year ended 31 March 2012

	Note	2011-12 £000	2010-11 £000
<b>Cash flows from operating activities</b>			
Net operating cost	3	(4,805)	(120)
Adjustments for non-cash transactions	8	(675)	(434)
Increase/(decrease) in trade and other receivables		(171)	(453)
Less movements in receivables relating to items not passing through the OCS		–	(429)
(Increase)/decrease in trade payables		5,191	(762)
Less movements in payables relating to items not passing through the OCS		653	(471)
Use of provisions	16	204	700
<b>Net cash (inflow)/outflow from operating activities</b>		<b>397</b>	<b>(1,112)</b>
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment		178	225
Purchase of intangible assets		187	93
Proceeds of disposal of property, plant and equipment		(3)	–
Net movement in capital receivables (payables)		62	(55)
<b>Net cash outflow/(inflow) from investing activities</b>		<b>424</b>	<b>263</b>
<b>Cash flows from financing activities</b>			
From the Consolidated Fund (Supply) – current year		(2,500)	(116)
Advance from the Contingencies Fund		3,000	3,000
Repayment to the Contingencies Fund		(3,000)	(3,000)
Capital element of payments in respect of finance leases		–	–
<b>Net financing</b>		<b>(2,500)</b>	<b>(116)</b>
<b>Net increase/(decrease) in cash and cash equivalents in the period before adjustment for receipts and payments to the Consolidated Fund</b>			
		<b>1,679</b>	<b>965</b>
Receipts due to the Consolidated Fund which are outside the scope of the department's activities		–	429
Payment of amounts due to the Consolidated Fund		(965)	(1,492)
<b>Net increase/(decrease) in cash and cash equivalents in the period after adjustment for receipts and payments to the Consolidated Fund</b>		<b>714</b>	<b>(98)</b>
<b>Cash and cash equivalents at the beginning of the period</b>			
	<b>14</b>	<b>965</b>	<b>1,063</b>
<b>Cash and cash equivalents at the end of the period</b>			
	<b>14</b>	<b>1,679</b>	<b>965</b>

The notes on pages 62 to 83 form part of these accounts.

## Statement of Changes in Taxpayers' Equity

for the year ended 31 March 2012

		General Fund	Revaluation Reserve	Total reserves
	Note	£000	£000	£000
<b>Balance at 1 April 2010</b>		(8,545)	22	(8,523)
<b>Changes in taxpayers' equity for 2010-11</b>				
Total comprehensive net expenditure for the year		241	18	259
Non-cash charges – auditor's remuneration	8	41	–	41
Net Parliamentary funding drawn down		116	–	116
Licence fee income not spent at year end	14	(965)	–	(965)
<b>Balance at 31 March 2011</b>		<b>(9,112)</b>	<b>40</b>	<b>(9,072)</b>
<b>Changes in taxpayers' equity for 2011-12</b>				
Total comprehensive net expenditure for the year		4,697	(2)	4,695
Non-cash charges – auditor's remuneration	8	41	–	41
Net Parliamentary funding drawn down		2,500	–	2,500
Amounts issued from consolidated fund but not spent at year end	14	(1,679)	–	(1,679)
<b>Balance at 31 March 2012</b>		<b>(3,554)</b>	<b>38</b>	<b>(3,516)</b>

The notes on pages 62 to 83 form part of these accounts.

## Notes to the departmental accounts

### 1. Statement of accounting policies

These financial statements have been prepared in accordance with the 2011-12 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 to reflect the changes required by HM Treasury's Clear Line of Sight (CLOS) alignment in dealing with items that are considered material to the accounts, notably the surrendering of deferred income.

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

#### 1.1 Accounting convention

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

#### 1.2 Property, plant and equipment

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

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

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

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

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

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

#### 1.3 Intangible assets

Intangible assets include separable software licences, such as those for the finance system. They are separable in that the IT equipment will operate without them. Operating software is included with the cost of the tangible asset it supports.



## 1.4 Amortisation

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

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

## 1.5 Financial instruments

Ofwat does not hold any complex financial instruments. Financial instruments included within these accounts are receivables and payables (notes 13 and 15). Trade receivables are recognised initially at fair value less provision for impairment. A provision for impairment is made when Ofwat is unable to collect an amount due in accordance with the agreed terms.

## 1.6 Financing

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

## 1.7 Operating income

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

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

## 1.8 Cash

Cash is primarily generated through licence fees and the activities outlined in 1.6. At the end of a financial year any cash remaining in Ofwat's bank accounts (Citibank and Royal Bank of Scotland) is paid over to the Consolidated Fund (note 5). As Ofwat does not receive the income from companies at the start of the

financial year a sum is borrowed from the Consolidated Fund and repaid later.

## 1.9 Trade receivables

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

## 1.10 Fines and penalty income

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

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

## 1.11 Administration and programme expenditure

Administration costs are recorded in the Statement of Comprehensive Net Expenditure. They include the costs of running Ofwat, as determined under the administration cost-control regime. There was no programme expenditure between 1 April 2011 and 31 March 2012 (2010-11: nil).

## 1.12 Leases

Rentals due on operating leases are charged over the lease term on a straight line basis or on the basis of actual rental payable where this fairly reflects usage. Equipment purchased under a finance lease is charged to the Statement of Comprehensive Net Expenditure through depreciation on a straight line basis over the minimum term of the lease. An annual interest charge is calculated at either the rate explicit in the lease or the Bank of England base rate as at the contractual date if no rate is explicit in the lease.

## 1.13 Pensions

The majority of past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS). The defined benefit schemes are unfunded and are non-contributory except in respect of dependant's benefits. Individual contributions will increase from 1 April 2012. Ofwat recognises the expected cost of these elements on a

systematic and rational basis over the period during which it benefits from the employees' services by payment to the PCSPS of amounts calculated on an accruing basis. Liability for payment of future benefits is a charge on the PCSPS. In respect of the defined contribution schemes, Ofwat recognises the contribution payable for the year.

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

### 1.14 Value added tax

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

### 1.15 Provisions

Ofwat provides for legal or constructive obligations which are of uncertain timing or amount at the date of the Statement of Financial Position on the basis of the best estimate of the expenditure required to settle the obligation. Where the effect of the time value of money is significant, the estimated risk-adjusted cash flows are discounted using the HM Treasury discount rate. Discount rates of 2.8% per annum apply for pension liabilities.

### 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 2012 shows negative taxpayers' equity of £3.5 million. In common with other government departments, the future financing of Ofwat's liabilities are accordingly to be met by future grants of Supply and the application of future income, both to be approved annually by Parliament. There is no reason to think that future approvals will not be forthcoming. Accordingly, it has been considered appropriate to adopt a going concern basis for the preparation of these financial statements. Under the Government Resource and Accounts Act 2000, no money may be drawn from the Fund other than required for the service of the specified year or retained excess of the need. All unspent monies, including those derived from our income, are surrenderable to the Fund.

We confirm our funding for 2012-13 has been approved.

### 1.18 Staff costs

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

### 1.19 Accounting estimates

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

## 2. Net resource outturn

### 2.1 Analysis of net resource outturn by section

£000	2011-12 Outturn						2011-12 Estimate	2010-11		
	Administration			Programme			Net total compared to Estimate	Outturn		
	Gross	Income	Net	Gross	Income	Net			Total	
Spending in Departmental Expenditure Limit										
Voted: A	19,104	(23,909)	(4,805)	–	–	–	(4,805)	103	4,908	(120)
<b>Total</b>	<b>19,104</b>	<b>(23,909)</b>	<b>(4,805)</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>(4,805)</b>	<b>103</b>	<b>4,908</b>	<b>(120)</b>

Section A: Water Services Regulation Authority

### 2.2 Analysis of net capital outturn by section

£000	2011-12 Outturn			2011-12 Estimate	2010-11	
	Administration			Net total compared to Estimate	Total	
	Gross	Income	Net			Net total
Spending in Departmental Expenditure Limit						
Voted: A	365	(3)	362	470	108	318
<b>Total</b>	<b>365</b>	<b>(3)</b>	<b>362</b>	<b>470</b>	<b>108</b>	<b>318</b>

Section A: Water Services Regulation Authority

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

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

				2011-12 £000	2010-11 £000
	Note	Outturn	Supply Estimate	Outturn compared with Estimate	Outturn
Total resource outturn in Statement of Parliamentary Supply	2	(4,805)	103	4,908	(120)
<b>Net operating cost in Consolidated Statement of Comprehensive Net Expenditure</b>		<b>(4,805)</b>	<b>103</b>	<b>4,908</b>	<b>(120)</b>

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

	2011-12 £000	2010-11 £000
	Outturn	Outturn
Estimate – Administration costs limit	103	105
Outturn – Gross Administration costs	19,104	17,423
Outturn – Gross income relating to administration costs	(23,909)	(17,543)
<b>Outturn – Net administration costs</b>	<b>(4,805)</b>	<b>(120)</b>

### 4. Reconciliation of Net Cash Requirement to increase/(decrease) in cash

	2011-12 £000	2010-11 £000
	Outturn	Outturn
Net cash requirement	(821)	849
From the Consolidated Fund (Supply) – current year	2,500	116
Amounts due to the consolidated fund received in prior year and paid over	(965)	(1,063)
<b>Increase/(decrease) in cash held</b>	<b>714</b>	<b>(98)</b>



## 5. Income payable to the Consolidated Fund

### 5.1 Analysis of income payable to the Consolidated Fund

In addition to income retained by the department, the following income relates to Ofwat and is payable to the Consolidated Fund (cash receipts being shown in italics).

	2011-12 £000				
	Note	Income	Forecast		Outturn
			Receipts	Income	Receipts
Excess cash surrenderable to the Consolidated Fund	14	–	–	1,679	1,679
Other amounts collectable on behalf of the Consolidated Fund		–	–	1,679	1,679
<b>Total income payable to the Consolidated Fund</b>		–	–	<b>1,679</b>	<b>1,679</b>

### 5.2 Consolidated Fund income

Consolidated Fund income shown in note 5.1 above does not include any amounts collected by Ofwat where it was acting as agent of the Consolidated Fund rather than as principal. The amounts collected as agent for the Consolidated Fund (which are otherwise excluded from these financial statements) were as follows.

	2011-12 £000	2010-11 £000
Competition Commission costs recovery	–	–
<b>Amount payable to the Consolidated Fund</b>	–	–
Balance held at the start of the year	–	429
Payments to the Consolidated Fund	–	(429)
<b>Balance held at the year end</b>	–	–

## 6. Operating costs

### 6.1 Statement of operating costs by strategy strand

Ofwat operates a time recording system capturing staff hours against each 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.

	2011-12 £000	2010-11 £000
<b>Description of strands:</b>		
Ensuring a fair deal for customers	2,923	2,634
Keeping companies accountable	2,713	3,300
Making monopolies improve	2,150	2,629
Harnessing market forces	3,368	3,359
Contributing to sustainable development	2,109	2,705
Delivering better regulation	5,110	2,590
Thames Tideway project regulation	731	206
Total expenditure	19,104	17,423
Total income	(23,909)	(17,543)
<b>Net expenditure</b>	<b>(4,805)</b>	<b>(120)</b>

### 6.2 Reconciliation between strategy strand and note 2

Total net expenditure per strategy strand	(4,805)	(120)
Past service costs	–	(240)
Interest costs	–	120
<b>Net outturn per Statement of Parliamentary Supply</b>	<b>(4,805)</b>	<b>(120)</b>

## 7. Staff costs

### 7.1 Staff numbers and related costs

Staff costs comprise:

					2011-12 £000	2010-11 £000
	Total	Perma- nently employed staff	Others	Non- executive directors	Total	
Wages and salaries	8,052	7,707	182	163	8,924	
Social Security costs	656	621	18	17	690	
Other pension costs	1,505	1,505	–	–	1,656	
Other staff costs	2,138	2,138	–	–	–	
<b>Sub-total</b>	<b>12,351</b>	<b>11,971</b>	<b>200</b>	<b>180</b>	<b>11,270</b>	
Less recoveries in respect of outward secondments	–	–	–	–	–	
<b>Total net costs*</b>	<b>12,351</b>	<b>11,971</b>	<b>200</b>	<b>180</b>	<b>11,270</b>	

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

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

For 2011-12, employer's contributions of £1,567,832 were payable to the PCSPS (2010-11: £1,612,731) at one of four rates in the range 16.7% to 24.3% (2010-11: 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 2011-12 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 £36,812 (2010-11: £31,371) were paid to one or more of the panel of three appointed stakeholder pension providers. Employer contributions are age-related and range from 3% to 12.5% of pensionable pay. Employers also match employee contributions up to 3% of pensionable pay. In addition, employer contributions of £2,497, 0.8% (2010-11: £2,267; 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 £3,010 (2010-11: £862). Contributions prepaid at that date were nil (2010-11: nil).

## 7.2 Average number of persons employed

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

				2011-12 £000	2010-11 £000
	Total	Perma- nently employed staff	Others	Non- executive directors	Total
Ensuring a fair deal for customers	33.90	33.74	0.02	0.14	33.64
Keeping companies accountable	38.72	38.56	0.02	0.14	42.10
Making monopolies improve	27.15	26.99	0.02	0.14	33.58
Harnessing market forces	37.29	36.63	0.52	0.14	43.85
Contributing to sustainable development	29.08	28.92	0.02	0.14	34.55
Delivering better regulation	31.34	29.88	1.32	0.14	33.28
Thames Tideway project regulation	2.00	1.00	1.00	0.14	1.00
<b>Total</b>	<b>199.48</b>	<b>195.72</b>	<b>2.92</b>	<b>0.84</b>	<b>222.00</b>

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

Redundancy and other departure costs have been paid in accordance with the provisions of the Civil Service Compensation Scheme, a statutory scheme made under the Superannuation Act 1972. Exit costs are accounted for in the year that obligation has arisen. Where the department has agreed early retirements, the additional costs are met by the department and not by the Civil Service pension scheme. Ill-health retirement costs are met by the pension scheme and are not included in the table.

	2011-12	2011-12	2011-12	2010-12
Cost band	Number of compulsory redundancies	Number of other departures agreed	Total number of exit packages by cost band (total cost)	Total number of exit packages by cost band (total cost)
<£10,000	–	6	6	–
£10,000 – £25,000	–	15	15	–
£25,001 – £50,000	–	16	16	–
£50,001 – £100,000	–	7	7	–
£100,001 – £150,000	–	3	3	–
£150,001 – £200,000	–	1	1	–
<b>Total resource cost (£000)</b>	<b>–</b>	<b>1,739</b>	<b>1,739</b>	<b>–</b>

## 8. Other administration costs

	2011-12 £000	2010-11 £000
	Outturn	Outturn
<b>Rentals under operating leases:</b>		
Accommodation	924	912
Office equipment	41	–
	965	912
<b>Non-cash items:</b>		
Depreciation	204	138
Amortisation	53	55
Loss on disposal of assets	12	356
Addition/(release) of provision	–	(38)
Restructuring provisions	229	–
Other finance costs	136	122
Past service costs	–	(240)
External auditors' remuneration	41	41
	<b>675</b>	<b>434</b>
<b>Other expenditure:</b>		
Consultancy services	3,038	2,359
Training	135	301
Travel and subsistence	375	289
Taxation charges	9	23
Rates	201	195
Computer hire and maintenance	455	648
Other hire and maintenance	29	77
Seminars, meetings and conferences	125	100
Minor items and stationery	24	30
Publications	42	49
Books and periodicals	37	81
Postal services and couriers	7	11
Telecommunications	104	85
Recruitment costs	91	39
Office consumables	46	114
Accommodation expenses	157	194
Internal audit fees	37	46
Professional subscriptions	54	26



	2011-12 £000	2010-11 £000
	Outturn	Outturn
<b>Other expenditure:</b>		
Transfer allowance – relocation	8	–
Payroll and pension services	32	29
Business continuity	21	26
Record management	22	27
Other	64	58
	<b>5,113</b>	<b>4,807</b>
<b>Total</b>	<b>6,753</b>	<b>6,153</b>

## 9. Income

	2011-12 £000	2010-11 £000
	Outturn	Outturn
<b>RfR1</b>		
Licence fees	18,435	17,892
Licence fees received in advance – prior year	5,361	4,999
Licence fees received in advance – current year	(3)	(5,361)
CCWater administration support fees	–	–
Miscellaneous	116	13
<b>Total</b>	<b>23,909</b>	<b>17,543</b>

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

Following implementation of the HM Treasury alignment project which attempts to bring estimates, budgets and accounts into line, it was instructed by HM Treasury that unspent licence fees, previously carried forward in our accounts as deferred income should no longer be accounted for in the Statement of Financial Position. The balance of £4.8 million was released at 31 March 2012.

At 31 March 2012, the cumulative unspent licence fees that have been surrendered to the Consolidated Fund total £5.7 million. Ofwat plans to offset this accumulated underspend against future licence fees by drawing from the reserve between 2012-13 to 2014-15 using the supplementary estimate process. There is no reason to think that future reserve claims will not be approved.

We are budgeting to draw £1.5 million of previously unspent licence fees that have been surrendered to the Consolidated Fund from the reserve in 2012-13. This will allow us to set licence fees at a lower rate than would otherwise be the case.

Ofwat is mandated to collect licence fees from the appointed companies and licensed suppliers in respect of CCWater's operating costs. In 2011-12, we collected £5.1 million; £4.5 million was transferred to the Department for Environment, Food and Rural Affairs and £0.6 million to the Welsh Assembly Government. In accordance with HM Treasury guidance, we do not record these transactions in our financial statements.

## 10. Property, plant and equipment

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

Opening balances for furniture and fittings and information technology have been restated to correct a discrepancy between opening cost and opening depreciation brought to light following the transfer of assets to new asset register software. The overall impact on the carrying amount in the financial statements is nil.

	£000	£000	£000	£000	£000	£000	£000	£000
	Furniture and fittings payments on account	Furniture and fittings	Office machinery and telecoms	Leasehold improvements payments on account	Leasehold Improvements	Information technology payments on account	Information technology	Total
<b>Cost or valuation</b>								
At 1 April 2011	12	47	340	21	343	113	1,413	2,288
Additions	–	6	26	–	17	87	42	178
Reclassifications	(12)	12	–	(21)	21	(98)	98	–
Disposals	–	(7)	(16)	–	–	–	(35)	(58)
Revaluation	–	–	–	–	–	–	–	–
<b>At 31 March 2012</b>	<b>–</b>	<b>58</b>	<b>350</b>	<b>–</b>	<b>381</b>	<b>102</b>	<b>1,518</b>	<b>2,408</b>
<b>Depreciation</b>								
At 1 April 2011	–	15	219	–	111	–	1,297	1,642
Charged in year	–	6	61	–	42	–	95	204
Disposals	–	(7)	(13)	–	–	–	(35)	(55)
Revaluation	–	–	–	–	–	–	–	–
<b>At 31 March 2012</b>	<b>–</b>	<b>14</b>	<b>267</b>	<b>–</b>	<b>153</b>	<b>–</b>	<b>1,357</b>	<b>1,791</b>
<b>Carrying amount at 31 March 2012</b>	<b>–</b>	<b>44</b>	<b>83</b>	<b>–</b>	<b>228</b>	<b>102</b>	<b>161</b>	<b>617</b>
<b>Carrying amount at 31 March 2011</b>	<b>12</b>	<b>32</b>	<b>121</b>	<b>21</b>	<b>232</b>	<b>113</b>	<b>116</b>	<b>646</b>
<b>Asset financing:</b>								
Owned	–	44	30	–	228	102	161	564
Finance leased	–	–	53	–	–	–	–	53
<b>Carrying amount at 31 March 2012</b>	<b>–</b>	<b>44</b>	<b>83</b>	<b>–</b>	<b>228</b>	<b>102</b>	<b>161</b>	<b>617</b>

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	£000	Restated £000	£000	£000	£000	Restated £000	Restated £000	Restated £000
	Furniture and fittings payments on account	Furniture and fittings	Office machinery and telecoms	Leasehold improve- ments payments on account	Leasehold Improve- ments	Information technology payments on account	Information technology	Total
<b>Cost or valuation</b>								
At 1 April 2010	–	392	329	–	307	–	1,723	2,751
Additions	12	16	33	21	37	98	8	225
Reclassifications	–	–	–	–	–	–	6	6
Disposals	–	(357)	(18)	–	–	–	(292)	(667)
Revaluation	–	–	(4)	–	–	–	–	(4)
<b>At 31 March 2011</b>	<b>12</b>	<b>51</b>	<b>340</b>	<b>21</b>	<b>344</b>	<b>98</b>	<b>1,445</b>	<b>2,311</b>
<b>Depreciation</b>								
At 1 April 2010	–	189	226	–	78	–	1,398	1,891
Charged in year	–	–	49	–	33	–	57	139
Disposals	–	(169)	(16)	–	–	–	(140)	(325)
Revaluation	–	–	(40)	–	–	–	–	(40)
<b>At 31 March 2011</b>	<b>–</b>	<b>20</b>	<b>219</b>	<b>–</b>	<b>111</b>	<b>–</b>	<b>1,315</b>	<b>1,665</b>
<b>Carrying amount at 31 March 2011</b>	<b>12</b>	<b>31</b>	<b>121</b>	<b>21</b>	<b>233</b>	<b>98</b>	<b>130</b>	<b>646</b>
<b>Carrying amount at 31 March 2010</b>	<b>–</b>	<b>203</b>	<b>103</b>	<b>–</b>	<b>229</b>	<b>–</b>	<b>325</b>	<b>860</b>
<b>Asset financing:</b>								
Owned	12	31	14	21	233	98	130	539
Finance leased	–	–	107	–	–	–	–	107
<b>Carrying amount at 31 March 2011</b>	<b>12</b>	<b>31</b>	<b>121</b>	<b>21</b>	<b>233</b>	<b>98</b>	<b>130</b>	<b>646</b>

## 11. Intangible assets

Purchased software licences.

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

		£000	£000
	Purchased software licences	Assets under development	Total
<b>Cost or valuation</b>			
At 1 April 2010	238	32	270
Additions	93	–	93
Reclassifications	13	(19)	(6)
Disposals	(39)	–	(39)
Revaluation	–	–	–
<b>At 31 March 2011</b>	<b>305</b>	<b>13</b>	<b>318</b>
<b>Amortisation</b>			
At 1 April 2010	150	–	150
Charged in year	55	–	55
Disposals	(24)	–	(24)
Revaluation	–	–	–
<b>At 31 March 2011</b>	<b>181</b>	<b>–</b>	<b>181</b>
<b>Carrying amount at 31 March 2011</b>	<b>124</b>	<b>13</b>	<b>137</b>
<b>Carrying amount at 31 March 2010</b>	<b>88</b>	<b>32</b>	<b>120</b>

## 12. Financial Instruments

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

### 12.1 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.

### 12.2 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.

### 12.3 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 2011.



### 13. Trade receivables and other current assets

Analysis by type.

	2011-12 £000	2010-11 £000
<b>Amounts falling due within one year</b>		
Trade receivables	20	241
Deposits and advances	57	45
Other receivables	–	–
HM Revenue and Customs (VAT)	48	88
Prepayments and accrued income	430	350
	<b>555</b>	<b>724</b>
<b>Amounts falling due after more than one year</b>		
Prepayments and accrued income	–	2
	–	2

### 14. Cash and cash equivalents

	2011-12 £000	2010-11 £000
Balance at 1 April 2011	965	1,063
Net change in cash and cash equivalent balances	714	(98)
<b>Balance at 31 March 2012</b>	<b>1,679</b>	<b>965</b>
The following balances are held at:		
Government Banking Services (GBS)	1,679	965
<b>Balance at 31 March 2012</b>	<b>1,679</b>	<b>965</b>

## 15. Trade payables and other current liabilities

Analysis by type.

	2011-12 £000	2010-11 £000
<b>Amounts falling due within one year</b>		
Trade payables	229	518
Other payables	145	169
Accruals	1,361	1,518
Licence fee deferred income	3	5,360
Deferred income	19	36
Current part of finance leases	2	35
Other taxation and social security	234	262
Consolidated Fund extra receipts due to be paid to the Consolidated Fund	–	–
– receivable		
Excess cash due to be paid to the Consolidated Fund	1,679	965
	<b>3,672</b>	<b>8,863</b>

## 16. Provisions for liabilities and charges

### 16.1 Provisions

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

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

### 16.2 Pension liabilities

	2011-12 £000	2010-11 £000
Balance at 1 April 2011	2,516	2,897
<b>Analysis of the amount charged to the Statement of Comprehensive Net Expenditure</b>		
Past service costs	–	(240)
Interest costs	136	120
<b>Benefits paid</b>		
Benefits paid	(162)	(158)
<b>Analysis of the amount recognised in the Statement of Changes in Taxpayers' Equity</b>		
Experience (gain)/loss	71	15
Actuarial (gain)/loss	39	(118)
<b>Balance at 31 March 2012</b>	<b>2,600</b>	<b>2,516</b>

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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 2012. 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 for pensioners are assumed to follow standard mortality tables (PA92-10).
- 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 2012) are as follows.

- The net discount rate is assumed to be 2.8%.
- The gross discount rate is assumed to be 4.85% a year (31 March 2011:5.6%).
- Consumer price inflation 2.0%.

A cumulative actuarial loss of £1.6 million has been incurred by the scheme since 1 April 2004.

### Analysis of actuarial loss

	2011-12 £000	2010-11 £000	2009-10 £000
<b>Analysis of actuarial (gain)/loss</b>			
Experience (gains)/losses arising on the scheme liabilities	71	15	63
Changes in assumptions underlying the present value of scheme liabilities	39	(118)	483
<b>Per Statement of Changes in Taxpayers' Equity</b>	<b>110</b>	<b>(103)</b>	<b>546</b>

### History of experience losses

	2011-12	2010-11	2009-10	2008-09	2007-08
Experience (gains)/losses arising on the scheme liabilities					
Amount (£000)	71	15	63	69	29
Percentage of the present value of the scheme liabilities	2.7%	0.6%	2.2%	2.9%	1.2%
Total amount recognised in Statement of Taxpayers' Equity					
Amount (£000)	110	(103)	546	(136)	(16)
Percentage of the present value of the scheme liabilities	4.2%	(4.1)%	18.8%	(5.7)%	(0.6)%

## 17. Capital commitments

Contracted capital commitments at 31 March 2012 not otherwise included in these financial statements.

	2011-12 £000	2010-11 £000
Contracted capital commitments at 31 March not otherwise included in these financial statements		
Property, plant and equipment	49	44
Intangible assets	1	–
	<b>50</b>	<b>44</b>

## 18. Commitments under leases

### 18.1 Operating leases

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

	2011-12 £000	2010-11 £000
<b>Obligations under operating leases comprise:</b>		
<b>Buildings</b>		
Not later than one year	818	841
Later than one year and not later than five years	3,274	4,060
Later than five years	273	359
	<b>4,365</b>	<b>5,260</b>
<b>Other</b>		
Not later than one year	–	25
Later than one year and not later than five years	–	54
Later than five years	–	–
	<b>–</b>	<b>79</b>



## 18.2 Finance leases

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

	2011-12 £000	2010-11 £000
<b>Obligations under finance leases comprise:</b>		
Other		
Not later than one year	2	33
Later than one year and not later than five years	–	–
Later than five years	–	–
	<b>2</b>	<b>33</b>
Less interest element	–	–
	<b>2</b>	<b>33</b>

## 19. Contingent liabilities disclosed under IAS37

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

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.

## 20. Related party transactions

Ofwat transferred £4.5 million to the Department for Environment, Food and Rural Affairs and £0.6 million to the Welsh Government in respect of CCWater's operating costs for 2011-12.

In September 2011, a small contract for £10,800 was placed with Oxford Economic Consulting Ltd. The consultant concerned is the husband of the former senior Director of Markets and Economics who had left Ofwat on 7 August 2011 and was not involved in the placing of the contract.

During 2011-12, Ofwat had transactions amounting to £1,416 with the Regulatory Policy Institute, of which our former non-executive director Peter Bucks is a Trustee. These payments were in respect of attendance of Ofwat staff at regulation seminars.

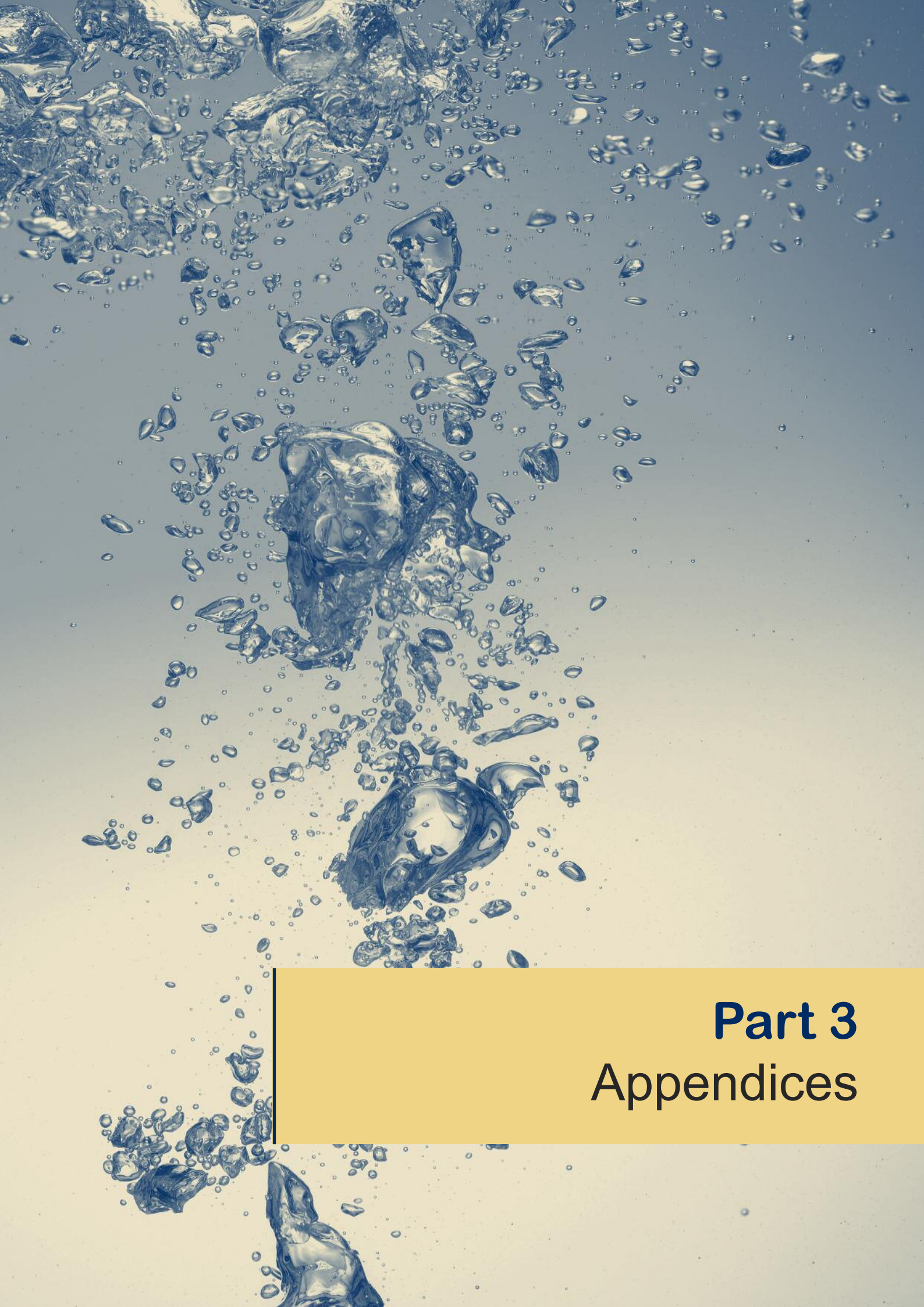
Ofwat also has a small number of immaterial transactions with other government departments. There are no related party transactions between Ofwat and any of its directors.

## 21. Events after the reporting period

The financial statements do not reflect events after the 5 July 2012.







**Part 3**  
Appendices

## Appendix 1: Measuring our performance

**W**e have been developing our annual reporting processes to better understand how well we are doing at delivering our strategy, and to identify areas where we need to improve. We also wanted to make this more transparent for our stakeholders and address recommendations from the Gray review that related to our governance and performance management.

During 2012-13, we will be consulting on introducing a framework of indicators that will help us measure the progress we are making towards delivering our strategy. This will include outcomes for the water and sewerage sectors, to which we contribute, as well as indicators of our own performance. By bringing these two aspects together we hope to show our work in context.

We have also been considering how to improve our cost allocation and financial reporting processes. This will enable us to report more transparently the resources we are spending on particular work.

We intend to operate a shadow system of the model on which we are consulting during 2012-13. This is so we can learn from the experience of operating an interim system of reporting, and how we report on our performance.

Our final performance framework, which will reflect the responses we receive to our consultation, will be in place for 2013-14. We will report on our performance against that framework in our 2013-14 annual report and accounts.



## Appendix 2: Having regard to the social and environmental guidance from Government

Under the Water Industry Act 1991, 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.

The Secretary of State published final, statutory (legal) social and environmental guidance to us in 2008. The Welsh Government published its guidance to us in 2009. We took account of the guidance when we set price limits in November 2009 for the period 2010-15.

Both the Secretary of State and the Welsh Government have made it a requirement that we demonstrate in our annual report and accounts each year how we have contributed to the delivery of the policies set out in their respective sets of guidance.

As part of its final report, in July 2011 the Gray review recommended that:

“Ofwat should be more explicit in its annual report about how its decisions have followed the guidance issued by the UK and Welsh governments, highlighting where it has departed from the guidance and the rationale for that decision.”

In line with this recommendation, we highlight below how we had regard to the Governments’ guidance in our key decisions in 2011-12.

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

<b>Description</b>	<p>In ‘<a href="#">Delivering proportionate and targeted regulation – a risk-based approach</a>’ we confirmed, following consultation, that we are adopting a risk-based approach to regulation (see pages 19 and 29 for more information).</p> <p>Our approach will help us decide whether or not we start new work, and prioritise our regulatory action. We:</p> <ul style="list-style-type: none"> <li>• assess whether we are best placed to act;</li> <li>• weigh up the likely costs and potential benefits of the work; and</li> <li>• decide whether the proposal intends to go about the work in the right way.</li> </ul> <p>This should help us make sure the work we carry out is proportionate to the risks posed, and targeted on the areas that matter most to consumers.</p> <p>To support our risk-based approach, we made a number of changes to our regulatory reporting tools, which we are now implementing.</p> <ul style="list-style-type: none"> <li>• We will no longer collect the June return.</li> <li>• Instead, companies will submit a risk and compliance statement and publish a suite of key indicators.</li> <li>• Companies will take responsibility for assurance of their data and systems.</li> </ul>
<b>How we have had regard to the guidance in England</b>	<p>Our approach:</p> <ul style="list-style-type: none"> <li>• encourages companies to look at their own operations and performance (sustainable development, page 5);</li> <li>• is modern, effective and risk based (better regulation, page 8);</li> <li>• is a proportionate, innovative regulatory solution informed by best practice (better regulation, page 8);</li> <li>• reflects the principles of good regulation – proportionality, accountability, consistency, transparency and targeting (better regulation, page 8);</li> <li>• streamlines the information requirements placed on companies (better regulation, page 8); and</li> <li>• requires us to justify new burdens on compelling cost-benefit grounds (better regulation, page 8).</li> </ul>
<b>How we have had regard to the guidance in Wales</b>	<p>Our approach:</p> <ul style="list-style-type: none"> <li>• frees companies to develop their own indicators of performance based on local priorities (sustainable development, page 6);</li> <li>• means our decisions will take into account the long- and short-term effects on society and the costs and benefits of action and inaction (sustainable development, page 6);</li> <li>• encourages companies to look at their own operations and performance (corporate social responsibility, page 7);</li> <li>• streamlines information requirements on the sectors and requires us to justify any new burdens on compelling cost-benefit grounds (company reporting – better regulation, page 8); and</li> <li>• means our decisions will take account of costs as well as benefits (community engagement and consultation, page 10).</li> </ul>
<b>Any departures from the guidance</b>	<p>None.</p>

## Moving to a more outcomes-focused approach to price setting, part of our future price limits decisions, May 2012

<p><b>Description</b></p>	<p>In 'Future price limits – statement of principles' we confirmed, following our consultation between November 2011 and February 2012, that as part of our future approach to price setting we will require the companies to develop outcome-based business plans.</p> <p>Outcomes are high-level objectives that company actions, activities and achievements are intended to help deliver. They represent what customers and society value – such as reliability, availability and safety of water supplies. Outcomes are generally continuous, long-term requirements that do not necessarily fit into one price control period.</p> <p>The move to outcomes would have a number of impacts.</p> <p>First, because they are longer term and related to the service customers want and receive, they will allow the companies to focus on what they really need to achieve. It also allows them to determine the most efficient and effective way to deliver those outcomes.</p> <p>Second, the companies will be able to develop outcomes relevant to their own circumstances and in line with their customers' and stakeholders' priorities, identified through their customer engagement. By involving customers more, this will improve customer engagement with the service they receive and legitimacy in their eyes about what their bills pay for.</p> <p>Third, because we intend to hold the companies to account for delivering outcomes, and not the means of delivery, there should be greater scope for them to innovate in how they achieve the agreed outcomes.</p> <p>Finally, we will continue to protect customers by ensuring that, where outcomes are not delivered, they do not pay for them. At all times, we will expect the companies' plans to continue to align with Government policy and meet all statutory requirements.</p> <p>Making this happen will require both the companies and Ofwat to work with other stakeholders, including:</p> <ul style="list-style-type: none"> <li>• the UK and Welsh Governments;</li> <li>• the Environment Agency;</li> <li>• the Drinking Water Inspectorate;</li> <li>• Natural England;</li> <li>• the Countryside Council for Wales; and</li> <li>• consumers.</li> </ul>
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<p><b>Description</b></p>	<p>The benefits of this approach are:</p> <ul style="list-style-type: none"> <li>• a focus on what matters to customers (such as the quality of service), not outputs (such as installing additional capacity at a particular treatment works);</li> <li>• a more proportionate, risk-based approach to regulation;</li> <li>• companies that can focus on longer-term outcomes that are relevant to their specific – and sometimes unique – circumstances and customers; and</li> <li>• companies that are incentivised to find the best and most cost-beneficial ways of delivering their agreed outcomes, and to adapt their programmes in light of circumstances and experience.</li> </ul>
<p><b>How we have had regard to the guidance in England</b></p>	<p>Our approach:</p> <ul style="list-style-type: none"> <li>• encourages companies to deliver integrated solutions which generate effective economic outcomes that minimise costs, while maximising multiple social and environmental benefits and minimising negative social and environmental impacts (sustainable development, pages 4-5);</li> <li>• encourages greater innovation in the water and sewerage sectors (sustainable development, pages 4-5);</li> <li>• takes steps to ensure each company delivers high standards of service at a reasonable cost for all its customers (social policies, page 6);</li> <li>• allows companies to take a long-term perspective in the stewardship of assets (fairness and affordability, page 7);</li> <li>• helps companies to find new ways of minimising the impact that future demand and regulations could have on energy usage ([climate change] mitigation, page 9); and</li> <li>• enables companies to take a long-term view for climate change adaptation, balancing supply and demand for services, surface water flooding, resilience and water quality (environmental policies pages 8-15).</li> </ul>
<p><b>How we have had regard to the guidance in Wales</b></p>	<p>Our approach:</p> <ul style="list-style-type: none"> <li>• will require us to draw on a wide range of expertise in our decision making and to work in partnership with all stakeholders (sustainable development, page 6);</li> <li>• supports approaches to longer-term planning and water company programmes that are designed in an integrated way (sustainable development, page 7);</li> <li>• ensures that the wishes of water bill payers should be given a high priority within the price review process (community engagement and consultation, page 9-10);</li> <li>• encourages water companies to respect environmental limits so that resources are not irrecoverably depleted or the environment irreversibly damaged (environmental policies, page 14); and</li> <li>• supports water companies in developing long-term, sustainable solutions to new challenges – including innovative approaches and new ways of tackling issues (climate change, page 15).</li> </ul>
<p><b>Any departures from the guidance</b></p>	<p>None.</p>

## Giving customers more say in price-setting, part of our future price limits decisions, August 2011

<p><b>Description</b></p>	<p>In <a href="#">‘Involving customers in price setting – Ofwat’s customer engagement policy statement’</a>, which we published in August 2011, we confirmed that we were increasing significantly the say that customers have over the prices and services they receive at our next price review in 2014.</p> <p>Our policy:</p> <ul style="list-style-type: none"> <li>• puts water customers at the heart of the price setting process;</li> <li>• ensures they have a say in the services they get from their company; and</li> <li>• (most of all) they get the service they want and pay a fair price for it.</li> </ul> <p>Our three-tiered approach will allow customers to influence the price and service package they receive through:</p> <ul style="list-style-type: none"> <li>• direct engagement with their water company on issues including local services and tariffs;</li> <li>• challenging the shape of their company’s overall business plan through customer challenge groups; and</li> <li>• informing our decisions through our sector-wide customer advisory panel.</li> </ul> <p>Customer acceptability will be a key factor in our decisions on the price limits that each company will be set for 2015-20. Evidence of effective customer engagement on, and support for, a company’s business plan will inform our scrutiny of each company’s plan. We will follow a risk-based approach that focuses on the material issues. We should be able to accept the plan with less scrutiny if:</p> <ul style="list-style-type: none"> <li>• the company demonstrates that its customers support their plan;</li> <li>• the company can comply with its obligations and meet cost assumptions; and</li> <li>• we are confident of their track record of effective planning and delivery.</li> </ul>
<p><b>How we have had regard to the guidance in England</b></p>	<p>Our policy:</p> <ul style="list-style-type: none"> <li>• help raises customer awareness of the water and sewerage sectors (social policies, page 6);</li> <li>• frees companies to consider with their customers the balance between the need to limit price increases and the need to generate improvements in services that are financed through higher bills (fairness and affordability, page 6); and</li> <li>• allows customers to challenge the priorities and all aspects of their company’s plan, including balancing supply and demand for services, tackling climate change, flooding, resilience and water quality (social policies, pages 6-8; and environmental policies, page 8-15).</li> </ul>



<p><b>How we have had regard to the guidance in Wales</b></p>	<p>Our policy:</p> <ul style="list-style-type: none"> <li>• encourages companies' decisions to reflect the needs and priorities of local communities (community engagement and consultation, page 9-10);</li> <li>• ensures that the wishes of water bill payers are given a high priority within the price review process (community engagement and consultation, page 9-10);</li> <li>• helps us find out customers' views and priorities (community engagement and consultation, page 9-10);</li> <li>• involves positive and purposeful engagement with the Consumer Council for Water and others (community engagement and consultation, page 9-10); and</li> <li>• allows customers to challenge the priorities and all aspects of their company's plan, including balancing supply and demand for services, tackling climate change, flooding, resilience and water quality (environmental policies, page 14-23).</li> </ul>
<p><b>Any departures from the guidance</b></p>	<p>None.</p>

## Appendix 3: List of impact assessments carried out during 2011-12

We published our revised policy on preparing impact assessments in April 2011.

During 2011-12, we also published the following impact assessments.

- 'Future price limits – a consultation on the framework', Draft impact assessment, November 2011.
- 'Regulatory compliance – a proportionate and targeted approach: A consultation', Draft impact assessment, October 2011.

## Appendix 4: Review of Board effectiveness

**D**uring 2010-11, the Gray review consulted with our stakeholders on our governance. As a result of the work done by the review, and our expectation that we will have a new Chair, the Board considered that it was not appropriate to carry out further consultation during 2011-12.

In its final report, which was published in July 2011, the Gray review concluded the following about our governance arrangements.

**“Taken as a whole, our review of Ofwat’s governance and Board arrangements suggests that the current arrangements are working well. There are no obvious issues with the way the Board operates, either in terms of relationships within the Board or with Ofwat as a whole, or in terms of its processes for making decisions in the context of its statutory powers and duties. The Board is well informed on the major issues to be addressed and is in a position to exercise effective scrutiny of Ofwat’s activities.**

**Nonetheless, it was clear from the evidence that a perception exists among stakeholders of a lack of transparency in the way that Ofwat and the Board make decisions.”**

The review set out the following recommendations, specifically related to our Board.

- **“Recommendation 15: The Ofwat Board should recognise active stakeholder engagement as a key part of the non-executive director role, particularly during price reviews, and it should agree how to achieve greater exposure to stakeholders.”**
- **“Recommendation 16: The new Chair of Ofwat once appointed, should undertake to carry out and publish a full review of the Board’s effectiveness.”**
- **“Recommendation 24: Ofwat’s new Chair should publish a report on Ofwat’s progress in responding to the issues and recommendations [set out in the review] in line with its annual reporting processes.”**

The Board has decided to consider these recommendations, and the appropriate actions to take, once our new Chair is in place. Once a new Chair is appointed, the Board will also consider the value of a stakeholder survey, which may help to inform the review of its effectiveness.

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

## Appendix 5: Progress in reducing regulatory burdens

The UK Government introduced the Regulatory Enforcement and Sanctions Act 2008 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

Over the past year, we have changed our approach to regulation (see pages 19 and 29). This has helped us begin to make the way we regulate more targeted and proportionate – and deliver better regulation in practice.

In March 2012, we confirmed we will no longer collect the main annual regulatory submission (the ‘June return’) from each company. Instead, each company will report on its performance against a range of key performance indicators, and submit an annual risk and compliance statement that highlights any risks to it fulfilling its obligations. The companies will continue to send us their annual regulatory accounts, but we plan to consult on the contents of these over the next year.

Since privatisation, the June return had grown from 16 to more than 80 tables of data. Our instructions, which we gave companies on things we required them to report on, also grew from 64 pages to more than 800. While this information served a useful purpose – in helping us drive up the standards and efficiency of services that companies deliver to customers and the environment – we did not think it was sustainable. This is one of the reasons we decided to change our approach to regulation.

In September 2011, we published revised guidance to make it easier for new companies to apply for a water supply licence. We also published guidance on the circumstances under which customers can switch their supplier – and a standardised

process to help ensure eligible customers are transferred in a timely and efficient manner when they choose to change their supplier.

Each year, we must approve a charges scheme for each water company so that they can charge their customers for water and sewerage services.

Historically, the way we have approved customer charges was detailed. Given the growth in their complexity, it was also increasingly burdensome. We were concerned that this may have led the companies to focus their effort on our process for approval rather than their customers' needs. There is also a concern that the process inhibits innovation in tariffs.

During the year, we consulted on and implemented changes to our charges approval process for 2012-13 that will:

- simplify our process;
- reduce the burden; and
- target our effort carefully on those areas of most importance to customers.

From 2012-13 onwards, we will stop the process of individual checks of each company's individual charges before we approve them. Instead, we will seek assurance from each company that it has complied with its legal obligations and with our principles and guidelines on charges. The principles set out our requirements for the companies' charges schemes. They are accompanied by guidelines, which set out how we think they should meet the principles, and our view of good practice.

We will approve the companies' charges schemes if we receive company assurance, and if CCWater is content. CCWater should have had meaningful involvement during the development of any new charges.

We will target our checks on the companies' charges following approval by focusing on charging issues with significant risks and impacts for customers. This is to make better use of resources, reduce the regulatory burden and maintain protection for customers.

We consider that these changes will result in faster approval for the companies, as well as a reduced data burden and more transparency about the principles on which the charges have been based.

## 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 2011-12 against our standards of service below.

### General enquiries

In 2011-12, we replied to more than 1,100 written enquiries, including emails. This compares with 630 in 2010-11. During the year, we worked with CCWater to put in place revised arrangements to ensure that consumer complaints are handled effectively, efficiently and by the organisation best placed to deal with specific matters that consumers raised.

Performance standard for general enquiries		
Standard	2011-12	2010-11
95% of written enquiries to be dealt with within ten working days	100%	99%

Between 1 April 2011 and 31 March 2012, pages in the 'Household consumers' and 'Non-household consumers' sections of our website were viewed a total of 336,620 times. These pages provide help and information to consumers about the services they receive. Last year, the same sections of our website were viewed a total of 321,124 times. We continue to keep the content of the pages under review so they are useful for consumers.

### Freedom of information requests

The Freedom of Information Act 2000 (FOIA) provides a general right of access to all types of recorded information held by public authorities. It places a number of obligations on public authorities and sets out exemptions from that right. The FOIA applies to Ofwat as we are a public authority. We have a responsibility under the FOIA to provide information in response to any written request, normally within 20 working days. The FOIA is retrospective and applies to records both recent and old.

We plan to respond positively to most requests for information. The exemptions provided by the FOIA protect the public interest. We apply these as appropriate.

Over the past year, we received 96 requests. We responded to 94% within the 20-day deadline. Detailed information on the FOIA 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 under the Freedom of Information Act by more than 40 central government bodies, including Ofwat. You can view the performance of participating bodies on the MoJ website.



## Disputes and complaints

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

We are responsible for 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 appeals.
- Refusals by the companies to install an optional meter.
- Guaranteed standards scheme payments (GSS).
- Trade effluent appeals.
- Pipe-laying in streets and across private land.

The time taken to resolve complaints depends on the nature and complexity of individual cases, but we aim to deliver our performance standards. Performance against these standards is shown in the table below.

<b>Performance standards for non-investigated disputes and complaints</b>		
<b>Standard</b>	<b>2011-12</b>	<b>2010-11</b>
80% of non-investigated complaints to be dealt with within ten working days	91%	95%
95% of non-investigated complaints to be acknowledged within ten working days	94%	95%

For those disputes and complaints we investigated, we resolved:

- 63% within three months (compared with 62% in 2010-11); and
- 78% within six months (compared with 74% in 2010-11).

We continue to keep our performance under review.

## Appendix 7: Resource management 2011-12

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

Level	2011-12			2010-11		
	Number appointed	Proportion of women (%)	Proportion from ethnic minorities (%)	Number appointed	Proportion of women (%)	Proportion from ethnic minorities (%)
Head of team/function	4	50	25	5	20	20
Middle management	7	57	29	10	50	10
Clerical and secretarial	0	0	0	1	100	0
Total	11	55	27	16	44	13

### Employed staff information

Area	As at 31 March 2012	As at 31 March 2011
Full-time equivalent staff	174	222
Proportion of women (%)	49	51
Proportion from ethnic minorities (%)	17.5	18
Proportion disabled (%)	1.7	1.3
Members of the Senior Civil Service	9	10
Number of fixed-term and casual contracts	7	14
Number of staff working part-time	26	46
Staff turnover (%)	24	9.1

### Staff training attendance (by ethnic group)

Ethnic group	2011-12		2010-11	
	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	166	86	939	81
Other ethnic groups	27	14	213	19
Total number of training days	193	100	1,152	100

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



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