

Office of Water Services

Resource Accounts 2002–03

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(For the year ended 31 March 2003)

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OFWAT'S RESOURCE ACCOUNTS AND REVIEW OF ACTIVITIES 2002-03

ANNUAL REPORT

Introduction

These accounts cover the operation of the Office of Water Services (Ofwat) for the period 1 April 2002 to 31 March 2003. They have been prepared on an accrual basis in accordance with the HM Treasury Resource Accounting Manual. The accounts also cover the work of WaterVoice which is funded and supported by Ofwat.

Ofwat's aims and objectives

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

In the exercise of most of our key functions we are required, by section 2 of the Act, to act in a way that we judge will enable:

- water and sewerage companies properly to carry out their functions; and
- to finance their functions, in particular by securing a reasonable rate of return on their capital.

And, subject to the above, to:

- protect customers' interests as regards price and quality of service;
- promote economy and efficiency on the part of the companies; and
- facilitate effective competition.

We also take due account of our general environmental and recreational duties under the Act.

Our main objectives in 2002/03 were:-

Objective 1 – To assess and report on company progress towards improving water and environmental quality, security of supply and representing consumers;

Objective 2 – To monitor and report on company efficiency, regulatory accounts and taking action as required;

Objective 3 – To prepare for the forthcoming periodic review of price limits;

Objective 4 – To facilitate effective competition and to approve tariffs.

OPERATING AND FINANCIAL REVIEW

Review of activities by Ofwat

Our Annual Report was published on 22 May 2003 (HC 679). The annual report for Ofwat is available on our web site www.ofwat.gsi.gov.uk, or by contacting Ofwat on 0121 625 1373.

Our objectives for 2002-03 were set out in the Ofwat and WaterVoice forward programmes.

The key outputs achieved included:

- Receipt and analysis of the annual information submission from companies (the June return) and taking regulatory action as required;
- Publication of five annual performance reports covering levels of service, leakage and security of supply, tariffs, financial performance and relative efficiency;
- Consultations on our approach to the periodic review in 2004 (PR04);
- Work with other stakeholders on the Water Bill;
- Processing of merger proposals;

- Supporting the work of WaterVoice;
- Implementing the new financial model Aquarius 3;
- Implementing the new website for Ofwat and WaterVoice.

WaterVoice

The annual report for WaterVoice is available on our web site www.ofwat.gsi.gov.uk. The resource accounts include expenditure to support the functions of WaterVoice. To further strengthen their independence and identity, the statutory Ofwat Customer Service Committees (CSCs) were retitled WaterVoice in April 2002.

WaterVoice operates through nine regional committees in England and a committee for Wales. They represent the interests of all customers of the water and sewerage companies, allocated to each committee by the Director General. The Chairmen and members of the WaterVoice Committees are local people drawn from a wide range of backgrounds and experience, appointed on merit by the Director General. Both Chairmen and members are part-time. The Chairmen are paid, the members are not, but they can claim expenses and loss of earnings.

The non-statutory WaterVoice Council comprises the Chairmen of the ten WaterVoice Committees. The Chairman of the WaterVoice Council is appointed by the Director General in consultation with other Council members.

The WaterVoice Council and Committees are supported by small teams of permanent staff based in eight regional offices and a head office. Support services including technical and legal advice, human resources, IT and finance are provided by Ofwat.

The direct expenditure supporting the WaterVoice offices was £1.8m including Chairmen's remuneration. At the year-end there were 131 Committee members (non-remunerated).

Future developments

A Water Bill was introduced by Government to Parliament in February 2003. It proposes:

1. The formation of a Water Services Regulatory Authority which will take over the functions of the Director General of Water Services.
2. The creation of a new independent Consumer Council for Water to replace the statutory Ofwat Customer Services Committees.
3. New duties including promoting competition.

Financial commentary

The main financial highlights are summarised below:

Operating costs summary

	2002-03	2001-02
	£000	£000
Income		
Deferred income prior year	2,262	1,194
Licence fees received	11,900	11,900
Other income (e.g. publications; rental income)	63	731
	<u>14,225</u>	<u>13,825</u>
Expenditure		
Administration costs	(11,825)	(10,832)
	<u>2,400</u>	<u>2,993</u>
Income deferred to following year – i.e. increased £138k	(2,400)	(2,262)
Net operating surplus	<u>–</u>	<u>731</u>
Balance sheet summary		
Total assets	2,524	1,702
Total liabilities	(3,603)	(3,511)
Total net (liabilities)	<u>(1,079)</u>	<u>(1,809)</u>

Our fee income is subject to the constraints set out in Condition N of the companies' Licences and negotiation with HM Treasury. Fees are based on an estimate of costs at the start of the financial year. In anticipation of these costs, fees of £11.9m were recovered from the industry in 2002-03, the same level as in the previous year. In addition £1m was obtained from the Consolidated Fund under the end of year flexibility arrangements. This amount represents licence fees collected in previous years and not used, which was treated as deferred income and included within creditors at 31 March 2002 (see note 10). These funds were required to meet our cash requirements.

We underspent against the Resource Estimate (schedule 1) by £700k. We anticipated in February 2002 that we would require £1.7m of deferred income to fund our operations. Under HM Treasury's accounting requirements a supplementary estimate was submitted and agreed for this amount, however by 31 March 2003 only £1m of this figure was required and called down from the Consolidated Fund. This underspend was due to delays in some consultancy projects; including our new financial model Aquarius 3 (price review financial model), a higher level of staff vacancies than expected and the fact that some budget for the investigation into leakage and Competition Act 1998 cases was not in the end required. We have also achieved savings in a number of areas including publications, telecommunications, and postal services.

We have a relatively low asset base but recognise the importance of investing for the future. Our fixed assets at 31 March 2003 were £1.7m, an increase of £0.9m on the previous year. Our investment in Aquarius 3, Website and IT equipment accounts for this increase.

£63k of other income was recovered during the year of which £47k relates to subletting part of our estate.

We are required to make full provision for the previous Director's pension, although sixty percent of the pension relates to employment prior to Ofwat and will be funded from the Exchequer.

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

Our financial statements on pages 12 to 17 and the notes to the accounts (pages 18 to 29) provide further information.

As a government department we do not have shareholders. However, we are required by HM Treasury to achieve a cost of capital return of 6%. This is assessed on the average value of the assets over the financial year. We have to observe parliamentary control totals in relation to administration costs (schedule 1). Our costs analysed by objectives are also included in schedule 5.

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

Financial instruments

We do not have borrowings and rely primarily on Licence fee income and Contingency Fund loans for our cash requirements. We are not, therefore, exposed to liquidity risks. Further details are provided at note 20 to these accounts.

Going concern

Our balance sheet at 31 March 2003 shows negative taxpayers' equity of £1.191m. This reflects the inclusion of liabilities falling due in future years, which are to be financed mainly by drawings from the Consolidated Fund. Such drawings will be from grants of supply approved annually by Parliament, to meet our net cash requirement. Under the Government Resources and Accounts Act 2000, no money may be drawn from the Fund other than that required for the specified year or retained in excess of that need. All unspent monies, including those derived from the department's income, are surrenderable to the Fund.

In common with other government departments, the future financing of our liabilities is met by future grants of Supply and the application of future income, both to be approved annually by Parliament. There is no reason to believe that future approvals will not be forthcoming. We have adopted a going concern basis for the preparation of these financial statements.

Roles and responsibilities

We are a non-ministerial government department with our own resource estimate. We are led by the Director General who carries the responsibilities of the Accounting Officer; supported by the Director of Operations who is the Principal Finance Officer. The Director General presented his annual report on the performance of the office to the Rt. Hon Margaret Beckett, MP, Secretary of State for Environment, Food and Rural Affairs and the Rt. Hon Rhodri Morgan AM First Minister of the Welsh Assembly Government on 22 May 2003 (HC 679).

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

John Baker CBE

Non-Executive Director Royal & Sun Alliance plc and chairman of the Maersk company. Chief Executive (1989-95) and Chairman (1995-97) of National Power plc; Chairman of English National Opera (1995-2001) and Groundwork Foundation (1996-2000).

Jane May

Formerly Customer Service Director, Thames Water (1994-2000) and Freeman's Customer Relations Director (1992-94).

Roger Munson (appointed on 7/7/02)

Member of the Competition Commission (1996-2003); formerly partner, Coopers & Lybrand.

Martin Cave

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

The composition of the senior management team in the reporting period was as follows:

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

*denotes Board member.

Mike Saunders retired on 19 May 2003. Tony Smith was appointed as Director of Competition and Consumer Affairs and took up his appointment on 6 May 2003. Huw Brooker was appointed as Head of Legal Services on 1 April 2003 on the retirement of Allan Merry.

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

Members of the senior management team are members of the Senior Civil Service and are appraised and remunerated, (including performance pay) in line with Senior Civil Service requirements. The details of remuneration are included at note 2 to the accounts.

Staff remuneration

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

Pension liabilities

The main pension scheme for Ofwat staff is the Principal Civil Service Pension Scheme (PCSPS). This is a defined benefit, unfunded scheme. During the year we completed the implementation of the Pensions 2000 project. The payment of benefits from the scheme are borne by the Civil Service Superannuation Vote. The pension liabilities arising from Ofwat's employees' membership of the PCSPS are not provided for in these accounts in accordance with the Treasury's instructions and as described in note 2 to the financial statements.

A by-analogy scheme will be established to meet the pension requirements of the Director General. It will offer similar benefits to the PCSPS. A provision will be made once a scheme has been established.

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

Equal opportunities policy

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

Employee involvement

Ofwat attaches great importance to managing, developing and training its staff in accordance with best practice and has a staff committee, which is consulted on a range of issues including our forward programme.

Payment of suppliers

Ofwat achieved 99.7% against the Government target for paying invoices within 30 days of receipt in 2002-03 and is committed to achieving the 100% target.

Audit

Deloitte & Touche provided the internal audit service during 2002-03 on a contract basis. KPMG have been appointed as the providers of our internal audit service on a three-year contract with the first year being 2003-04. Our external auditor is the Comptroller and Auditor General.

Philip Fletcher
Accounting Officer

12 September 2003

STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

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

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

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

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

- observe the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards, as set out in the Resource Accounting Manual, have been followed, and disclose and explain any material departures in the accounts; and
- prepare the accounts on a going concern basis.

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

STATEMENT ON INTERNAL CONTROL 2002-03

1. Scope of responsibility

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

As a non-ministerial government department, Ofwat's accountability is to Parliament. In June 2003 I attended a hearing of the Environment, Food and Rural Affairs Select Committee to answer questions on our 'Annual report 2002-03', published in May 2003. I welcomed this and hope it will become an annual event. I also consider Ofwat has a responsibility to water customers in providing an effective and efficient regulatory function.

We have over the past year further developed our risk management procedures with summaries reported to our Audit Committee and Board.

2. The purpose of the system of internal control

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

The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of departmental policies, aims and objectives; to evaluate the likelihood of those risks being realised; and the impact should they be realised; and to manage them efficiently, effectively and economically. The system of internal control was in place by 31 March 2003 and up to the date of approval of the annual report and resource accounts, and accords with Treasury guidance.

3. Capacity to handle risk

Risk management is a shared responsibility across all Ofwat's senior managers. During 2002-03, we revised and updated the Ofwat and divisional risk registers. The Ofwat Board, Management Committee and Audit Committee received reports summarising key messages from the risk registers and commentaries on our assurance activities. The risk assessment was particularly useful in finalising our budget priorities for 2003-04 based on the forward programme of outputs and objectives. Risk assessment is becoming more embedded into the work of the office. Senior managers, and their staff, realise the importance of reinforcing risk management. This is reviewed in six monthly reports to the Ofwat Board, Management Committee and Audit Committee.

Our policy consultation documents include as required, regulatory impact assessments. They routinely include reference to the need to minimise risk and uncertainty to water companies, investors and customers.

We will continue to take account of risk in our policy development. This is addressed through workshops, briefings and monitoring. The work will routinely include:

- Regular updates to project, divisional and Ofwat risk registers to reflect changes in risk and events.
- A six monthly review of registers, the results of which will be reported to Management Committee, Ofwat Board and Audit Committee.
- Annual risk management workshops within each division.
- Follow up actions arising from internal audit studies.
- Following up the recommendations included in the Cabinet Office report 'Risk: Improving government's capability to handle risk and uncertainty' (Nov 02).

4. Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the senior management team within Ofwat who have responsibility for the development and

maintenance of the internal control framework, and comments made by the external auditors in their management letter, and other reports. I have been advised on the implications of the result of my 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 improvement of the system is in place.

Annually, we consult on and publish our forward programme. This sets out our high level objectives for the coming financial year plus a look forward to the following two years. The forward programme drives divisional plans and ultimately individual staff objectives. On a monthly basis the Management Committee reviews progress against key outputs and projects. There is also a quarterly assessment of achievement of the forward programme objectives. In addition to this, there are formal divisional reviews by the Director General. We have in place a process of individual performance review. On a regular basis, the resource requirements for Ofwat are assessed against the forward programme and developing priorities. The non-executive advisory directors also provide an independent view to the Director General of our performance. In May 2003 Ofwat issued its annual report 2002-03 to Government and Parliament.

WaterVoice, the customer representation arm of Ofwat has similar systems of performance management including publication of its own forward programme and annual report. In addition the Director General held an annual performance review meeting with each of the ten WaterVoice Chairmen.

The Ofwat Board, Management Committee and Audit Committee regularly assess and monitor our performance and related systems of internal control. Our internal auditors review and advise on our risk management processes and internal controls. During the last quarter we commissioned an independent survey of stakeholders, to give feedback on our performance. This report was placed on our website in May 2003.

The role of internal audit in the past has been largely focussed on finance, human resources and IT systems. Over the past two years, its role has developed by reviewing processes in regulatory policy areas. During 2002-03, our internal auditors reviewed the following policy areas:

- The production of the periodic review 2004 methodology consultation paper. 'Setting price limits for 2005-10: framework and approach – A consultation paper'.
- Complaint handling in WaterVoice offices.

In the coming year, internal audit will be reviewing other policy areas as required.

In November 2002 and April 2003 we commissioned Robson Rhodes (Accountants) to review independently and audit the financial model used for price setting as part of the 2004 periodic review project. The model has been issued to water companies in conjunction with a fit for purpose audit from Robson Rhodes.

During the year Deloitte and Touche, our internal auditors, operated to standards defined in the Government Internal Audit Manual. They submitted regular reports, which included an independent opinion by the Head of Internal Audit on the adequacy and effectiveness of our system of internal control together with recommendations for improvement. KPMG has been appointed as our new internal auditor from April 2003.

Philip Fletcher
Accounting Officer

12 September 2003

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

I certify that I have audited the financial statements on pages 12 to 17 under the Government Resources and Accounts Act 2000. These financial statements have been prepared under the historical cost convention as modified by the revaluation of fixed assets and the accounting policies set out on pages 18 to 20.

Respective responsibilities of the Accounting Officer and Auditor

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

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

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

I review whether the statement on pages 12 to 17 reflects the Department's compliance with Treasury's guidance 'Corporate governance: statement on internal control'. I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information of which I am aware from my audit of the financial statements.

Basis of audit opinion

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

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

Opinion

In my opinion:

- the financial statements give a true and fair view of the state of affairs of the Office of Water Services at 31 March 2003 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the year then ended, and have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by the Treasury; and
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.

John Bourn
Comptroller and Auditor General

17 September 2003

National Audit Office
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SCHEDULE 1

Summary of Resources Outturn
2002–03

	Estimate			Outturn			Net total outturn compared with Estimate saving/ (excess) £000	Prior-year outturn £000
	Gross expenditure	A in A	Net Total	Gross expenditure	A in A	Net Total		
	1	2	3	4	5	6		
	£000	£000	£000	£000	£000	£000	£000	£000
Request for Resource 1	13,051	11,950	1,101	11,825	11,825	—	1,101	0
Non-operating Cost A in A	—	—	—	—	—	—	—	—
Net cash requirement	—	—	1,735	—	—	1,035	700	35
Reconciliation of resources to cash requirement		Note	£000			£000	£000	£000
Net total resources			1,101			—	1,101	—
Capital:								
Acquisition of fixed assets								
Cash purchases		7.1 & 7.2	1,135			1,196	(61)	536
Disposal of fixed assets		7.1 & 7.2	—			(2)	2	—
Investments			—			—	—	—
Non-operating A in A								
Accruals adjustments:								
Non-cash items		3	(600)			(267)	(333)	(211)
Changes in working capital other than cash		6	99			(234)	333	(833)
Changes in Creditors falling due after more than one year			—			—	—	—
Use of provision		11	—			89	(89)	88
Excess Cash receipts to be surrendered to the Consolidated Fund						253	(253)	455
Net Cash Requirement (Schedule 4)			1,735			1,035	700	35

Explanation of the variance between Estimate and outturn (net total resources):

The underspend against the estimate was related to the higher than expected staff turnover and a reduced consultancy requirement.

Explanation of the variance between Estimate net cash requirement and outturn (net cash requirement):

The difference between the Estimate net cash requirement and the outturn is due to the higher than expected staff turnover, where salaries did not need to be funded, and the reduced consultancy requirement. Internal cash flow monitoring recognised the reduced cash requirement and the £700,000 requested from Treasury in the Winter Supplementary was not applied for.

The Estimate is a statement of how much a department requires in the financial year in terms of the planned level of income and expenditure.

Outturn shows the actual level of income and expenditure. Appropriations in Aid is income that the department can retain and offset against its expenditure. This is mainly licence fee income from regulated companies and sales of publications.

Analysis of income payable to the Consolidated Fund

In addition to appropriations in aid the following income relates to the Ofwat and is payable to the Consolidated Fund (*cash receipts being shown in italics*):

	2002-03 Forecast		2002-03 Outturn	
	<u>Income</u>	<u>Receipts</u>	<u>Income</u>	<u>Receipts</u>
	<u>£000</u>	<u>£000</u>	<u>£000</u>	<u>£000</u>
Operating income and receipts not classified as A in A (see note 4)	—	—	—	—
Non-operating income and receipts – excess A in A	—	—	—	—
Other operating income and receipts not classified as A in A	—	—	—	—
Other non-operating income and receipts not classified as A in A	—	—	—	—
Other amounts collectable on behalf of the Consolidated Fund (see note 1.11)	—	—	—	—
Excess cash receipts to be surrendered to the Consolidated Fund	—	—	253	<i>253</i>
Total	—	—	253	<i>253</i>

Actual outturn - resource

Request for resource 1: Actual net resource outturn is nil. Actual amount of saving in resources over estimate £1,101,000.00

Actual outturn - cash

Net cash requirement: Outturn net requirement £1,035,000, which is £700,000 less than our estimate. The actual receipts (surrenderable to the Consolidated Fund) were £253,110.72. Ofwat is not permitted to retain excess cash receipts at the end of the financial year, they are surrendered to the Consolidated Fund.

SCHEDULE 2

**Operating Cost Statement
for the year ended 31 March 2003**

	Note	£000	2002–03 £000	£000	2001–02 £000
Administration costs					
Staff costs	2	7,312		6,610	
Other administration costs	3	4,513		4,222	
Gross administration Costs			11,825		10,832
Operating income	4		(11,825)		(11,563)
Net administration costs			–		(731)
Net operating surplus	5		–		(731)
Net resource outturn	5		–		–

The surplus in 2001-02 equates to Consolidated Fund Extra Receipts, the main element was £709k recovered on behalf of the Competition Commission. This year Ofwat has no Consolidated Fund Extra Receipts. No recoveries have taken place on behalf of the Competition Commission and other income streams have been reclassified as Appropriations in Aid.

All income and expenditure are derived from continuing operations

**Statement of Recognised Gains and Losses
for the year ended 31 March 2003**

	2002–03 £000	2001–02 £000
Net operating surplus	–	(731)
Unrealised surplus arising on revaluation of tangible fixed asset	(5)	(7)
Total recognised (gains) for the financial year	(5)	(738)

The notes on pages 18 to 29 form part of these accounts.

SCHEDULE 3

Balance Sheet
as at 31 March 2003

	Note	31 March 2003		31 March 2002	
		£000	£000	£000	£000
Fixed assets					
Tangible assets	7.1	680		343	
Intangible assets	7.2	1,018		435	
			1,698		778
Current assets					
Debtors	8	573		466	
Cash at bank and in hand	9	253		458	
		826		924	
Creditors (amounts falling due within one year)					
Creditors	10	(3,042)		(2,906)	
Net current assets			(2,216)		(1,982)
Total assets less current liabilities			(518)		(1,204)
Provision for liabilities and charges	11	(561)		(605)	
			(561)		(605)
Total Net Liabilities			(1,079)		(1,809)
Taxpayers' equity:					
General Fund	13	(1,191)		(1,916)	
Revaluation reserve	12	112		107	
			(1,079)		(1,809)

Philip Fletcher
Accounting Officer

12 September 2003

Further details on the negative taxpayers' equity is included on page 5.

SCHEDULE 4

Cash Flow Statement
for year ended 31 March 2003

		2002-03	2001-02
	Note	£000	£000
Net cash inflow from operating activities (Note a)		412	2,258
Capital expenditure and financial investment (Note b)		(1,194)	(536)
Payments of amounts due to the Consolidated Fund		(458)	(2,174)
Financing (Note c)		1,035	35
(Decrease) in cash in the period		(205)	(417)
Note a: Reconciliation of operating cost to operating cash flows			
Net Operating Surplus	5.1	—	(731)
Adjustment for non-cash transactions	3	(267)	(211)
Adjustment for movements in working capital other than cash	6	(234)	(1,404)
Use of Provisions	11	89	88
Net cash (inflow) from operating activities		(412)	(2,258)
Note b: Analysis of capital expenditure and financial investment			
Intangible fixed asset additions	7.2	698	432
Tangible fixed assets additions	7.1	498	104
Proceeds from disposal of fixed assets	7.1	(2)	—
Net cash outflow from investing activities		1,194	536
Note c: Analysis of financing, and reconciliation to the net cash requirement			
From the Consolidated Fund (Supply) – current year ^{1, 2}		1,035	35
Advance from the Contingencies Fund		2,000	2,000
Repayment to the Contingencies Fund		(2,000)	(2,000)
Net Financing		1,035	35
Decrease in cash	9	205	417
Net cash flows other than financing		1,240	452
Adjustment for payments and receipts not related to Supply:			
Amounts due to the Consolidated Fund – Received in a prior year and paid over		(458)	(1,344)
Amounts due to the Consolidated Fund – Received and not paid over		253	458
Transitional adjustment	6	—	469
Net cash requirement (Schedule 1)		1,035	35

¹Amount of grant actually issued to support the net cash requirement = £1,035,000.00.²Amount of grant actually issued to support the prior year net cash requirement = £35,000.00.

SCHEDULE 5

Resources by Departmental Aims and Objectives
for the year ended 31 March 2003

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

	Gross	2002–03 Income	Net	Gross	2001–02 Income	Net
	£000	£000	£000	£000	£000	£000
Objective 1	4,138	—	—	3,869	—	—
Objective 2	2,602	—	—	3,190	—	—
Objective 3	3,075	—	—	2,027	—	—
Objective 4	2,010	—	—	1,746	—	—
Net operating costs	11,825	(11,825)	—	10,832	(11,563)	(731)

The department's objectives were as follows:

Objective 1 – To assess and report on company progress towards improving water and environmental quality, security of supply and representing consumers.

Objective 2 – To monitor and report on company efficiency, regulatory accounts and taking action as required.

Objective 3 – To prepare for the forthcoming periodic review of price limits.

Objective 4 – To facilitate effective competition and approving tariffs.

Note:

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

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

The Department's capital is employed exclusively for administration purposes and supporting our regulatory function. Its distribution between objectives is therefore not markedly different from the related gross administration cost.

Notes to the accounts

1. Statement of accounting policies

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

1.1 Accounting convention

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

1.2 Fixed assets

Tangible fixed assets consist of furniture and fittings, office machinery, website development costs, IT and telecommunications equipment. Tangible assets have been stated at current cost using appropriate indices. The minimum level for the capitalisation fixed assets is £1,000.

Intangible assets consist of proprietary software licences and bespoke software. The development of the financial model (Aquarius 3) has been capitalised as this asset will have a useful economic life of four years.

With the exception of PCs and office furniture, individual assets must exceed a capitalisation threshold of £1,000 for inclusion as fixed assets. PCs and office furniture items falling below the threshold are capitalised as groups.

1.3 Depreciation and amortisation

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

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

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

1.4 Stocks

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

1.5 Leases

Assets held under finance leases are included under tangible fixed assets at their capital value and depreciated over their useful economic lives. Leasing payments consist of capital and interest elements with the interest element charged to the operating cost statement. Ofwat had no finance leases as at 31 March 2003 (31 March 2002:nil). Rentals due under operating leases are charged over the lease term on a straight-line basis or on the basis of actual rental payable where this fairly reflects usage.

1.6 Research and development

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

1.7 Operating income

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

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

1.8 Administration and programme expenditure

Administration costs are recorded in the operating cost statement. They include the costs of running the Department, as defined under the administration cost-control regime, together with associated operating income. There was no programme expenditure in 2002-03 (2001-02: £nil). Programme costs reflect non-administration costs, including payments of grants and other disbursements by the department.

1.9 Capital charge

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

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

1.10 Pensions

The majority of present and past employees are covered by the provisions of the PCSPS which is a multi-employer defined benefit scheme and unfunded. Employee contributions are payable in respect of widow(er) benefits and by employees who are members of the Classic Plus and Premium Schemes. Further details of the Classic Plus and Premium Schemes are set out in note 2.

Ofwat recognises the expected cost of providing pensions on a systematic and rational basis over the period during which it benefits from 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 elements of the scheme, Ofwat recognises the contributions payable for the year.

Ofwat is unable to identify its share of the underlying assets and liabilities of this scheme. A full actuarial valuation was carried out at 31 March 1999 and details can be found in the separate scheme statement of the PCSPS.

There is also a partnership pension available to employees. This is a stakeholder type arrangement. Further details are available in note 2.

1.11 Value Added Tax

Most of the activities of the department 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 fixed assets. Where output tax is charged or input VAT is recoverable, the amounts are stated net of VAT.

1.12 Comparative amounts

Comparative amounts are re-analysed where necessary to conform to current presentation.

1.13 Provisions

The department provided for legal or constructive obligations which are of uncertain timing or amount at the balance sheet date 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 Treasury discount rate of 6 per cent in real terms.

1.14 Contingent liabilities

- In addition to contingent liabilities disclosed in accordance with FRS12, the department discloses for parliamentary reporting and accountability purposes certain contingent liabilities where the likelihood of a transfer of economic benefit is remote. These comprise: items over £100,000 (or lower, where required by specific statute) that do not arise in the normal course of business and which are reported to Parliament by departmental minute prior to the Department entering into the arrangement;

Notes to the Departmental Resource Accounts (*continued*)

- all items (whether or not they arise in the normal course of business) over £100,000 (or lower, where required by specific statute or where material in the context of resource accounts) which are required by the RAM to be noted in the resource accounts.

Where the time value of money is material, contingent liabilities which are required to be disclosed under FRS 12 are stated at discounted amounts and the amount reported to Parliament separately noted. Contingent liabilities that are not required to be disclosed by FRS 12 are stated in the amounts reported to Parliament.

2. Staff numbers and costs

Staff costs consist of:

	<u>2002-03</u>	<u>2001-02</u>
	£000	£000
Wages and salaries	6,055	5,442
Agency costs	102	99
Social security costs	397	364
Pension costs	773	722
Sub total	7,327	6,627
Inward Secondments	54	52
Total	7,381	6,679
Less recoveries in respect of outward secondments	(69)	(69)
Total Net Costs	7,312	6,610

PCSPS is an unfunded multi-employer defined benefit scheme and Ofwat is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out at 31 March 1999 and details can be found in the separate scheme statement of the PCSPS.

For 2002-03 contributions of £772,592 were payable to the PCSPS (2001-02: £721,756) at one of four rates in the range 12 to 18.5 per cent of pensionable pay, based on salary bands. Rates will remain the same for the next year, subject to revalorisation of the salary bands. Employer contributions are to be reviewed every four years following a full scheme valuation of the PCSPS by the Government Actuary. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme.

Included in wages and salaries costs is £252k relating to WaterVoice Committee Chairmen's remuneration for 2002-03.

The average number of whole-time equivalent persons employed (including senior management, staff on secondment or loan into the department and temporary staff, but excluding staff on secondment to other organisations, agency, WaterVoice Chairmen and WaterVoice members) by objective during the year was as follows:

	<u>2002-03</u>	<u>2001-02</u>
	Number	Number
Objective 1 – Assessing company progress towards improving water and environmental quality, security of supply and representing consumers	103	106
Objective 2 – Monitoring company efficiency, regulatory accounts and taking action as required	44	52
Objective 3 – Setting price limits	54	31
Objective 4 – Facilitating competition and approving tariffs	28	30
Total	229	219

The salary and pension entitlements of Ofwat's senior managers of the Department were as follows:

Name and Title	Age Years	Salary**a	Real	Total	Benefits in kind ^c (rounded to the nearest £100)
		(as defined below)	increase in pension at age 60 ^b	accrued pension at age 60 at 31 March 2003 (Note e)	
		£000	£000	£000	
Philip Fletcher Director General	56	130-135	—	— <i>Note d</i>	—
Keith Mason Director of Regulatory Finance	45	75-80	0-2.5	5-10	—
Mike Saunders Director of Consumer Affairs	59	90-95	0-2.5	10-15	—
Roger Dunshea Director of Operations	47	80-85	0-2.5	5-10	—
Bill Emery Director of Cost & Performance and Chief Engineer	51	85-90	0-2.5	10-15	200
Roy Wardle Head of Consumer Representation	51	70-75	0-2.5	25-30	—
Julia Havard Head of External Relations	48	55-60	0-2.5	15-20	—
Allan Merry Legal Advisor	58	60-65	0-2.5	10-15	—

All senior managers opted to join the PSCPS's classic scheme.

Non-executive advisory directors

Name	Age Years	Salary ^a
		(as defined below)
		£000
John Baker CBE	65	10-15
Martin Cave	54	10-15
Jane May	46	10-15
Roger Munson (appointed 7 July 2002)	58	10-15

These appointments do not receive pension entitlement or benefits in kind.

Notes:

- "Salary" includes gross salary, performance pay or bonuses; overtime; reserved rights to London weighting or London allowances; recruitment and retention allowances; private office allowances and any other allowance to the extent that it is subject to UK taxation.
- Pension benefits are provided through the Civil Service pension arrangements. From 1 October 2002, civil servants may be in one of three statutory "final salary" defined benefit schemes (**Classic, Classic plus and Premium**). New entrants after 1 October 2002 may choose between membership of Premium Scheme or joining a good quality "money purchase" stakeholder based arrangement with a significant employer contribution (partnership pension account).

Classic Scheme

Benefits accrue at the rate of 1/80th of pensionable salary for each year of service. In addition, a lump sum equivalent to three years' pension is payable on retirement. Members pay contributions of 1.5 per cent of pensionable earnings. On death, pensions are payable to the surviving spouse at a rate of half the member's pension. On death in service, the scheme pays a lump sum benefit of twice pensionable pay and also provides a service enhancement on computing the spouse's pension. The enhancement depends on length of service and cannot exceed 10 years. Medical retirement is possible in the event of serious ill health. In this case, pensions are brought into payment immediately without actuarial reduction and with service enhanced as for widow(er).

Premium Scheme

Benefits accrue at a rate of 1/60th of pensionable salary for each year of service. Unlike classic, there is no automatic lump sum, but members may commute some of their pension to provide a lump sum up to a maximum of 3/80th of final pensionable earnings for each year of service or 2.25 times pension if greater (the commutation rate is £12 of lump sum for each £1 of pension given up). For the purposes of senior staff pension disclosure the tables assume

Notes to the Departmental Resource Accounts (*continued*)

maximum commutation. Members pay contributions of 3.5 per cent of pensionable earnings. On death, pensions are payable to the surviving spouse or eligible partner at a rate of 3/8ths the member's pension (before any commutation). On death in service, the scheme pays a lump sum benefit of three times pensionable earnings and also provides a service enhancement on computing the spouse's pension. The enhancement depends on length of service and cannot exceed 10 years. Medical retirement is possible in the event of serious ill health. In this case, pensions are brought into payment immediately without actuarial reduction. Where the member's ill health is such that it permanently prevents them undertaking any gainful employment, service enhanced to what they would have accrued at age 60.

Classic Plus Scheme

This is essentially a variation of the **Premium Scheme**, but with benefits in respect of service before 1 October 2002 calculated broadly as per the **Classic Scheme**.

Pensions payable under Classic, Premium and Classic Plus Schemes are increased in payment in line with the Retail Price Index.

Partnership Pension Account

This is a stakeholder-type arrangement where the employer pays a basic contribution of between 3% and 12.5% (depending on the age of the member) into a stakeholder pension product. The employee does not have to contribute but where they do make contributions, these will be matched by the employer up to a limit of 3% (in addition to the employer's basic contribution). Employers also contribute a further 0.8% of pensionable salary to cover the cost of risk benefit cover (death in service and ill health retirement). The members may retire at any time between the ages of 50 and 75 and use the accumulated fund to purchase a pension. The member may choose to take up 25% of the fund as a lump sum.

c) Benefits in kind

The estimated monetary value of benefits in kind covers any benefits provided and treated by the Inland Revenue as taxable income. Payments to the Director of Costs & Performance covered home IT equipment.

d) The pension arrangements have yet to be established for Philip Fletcher, the Director General. This should be completed by 31 March 2004. Ofwat will set up a provision when the transfer valuation has been calculated.

e) The total accrued pension takes into account previous employment with other Government departments in addition to the period of employment with Ofwat.

3. Other administration costs

	2002-03	2001-02
	£000	£000
Rentals under operating leases:		
Accommodation	1,083	984
Office equipment	86	101
Other	—	10
	1,169	1,095
Non cash items:		
Depreciation of tangible fixed assets	146	112
Amortisation of intangible fixed assets	112	6
(Profit)/Loss on disposal of fixed asset	(2)	1
Cost of capital charge	(86)	(77)
Auditors' remuneration*	29	27
Increase in provision	45	55
Permanent diminution of fixed asset	23	87
	267	211

	2002-03	2001-02
	£000	£000
Other expenditure:		
Consultancy services	578	561
Training	173	226
Travel and subsistence	334	300
Rates	282	257
Computer hire and maintenance	109	102
Other hire and maintenance	43	30
Seminars, meetings and conferences	116	103
Publications	292	243
Books and periodicals	143	174
Postal services and couriers	77	76
Telecommunications	120	120
Recruitment costs	206	156
Other	604	568
	3,077	2,916
	4,513	4,222

*During the year there was no remuneration for non-audit work.

4. Income and appropriations in aid

Operating income

Operating income not appropriated-in-aid (i.e. transferred to the Consolidated Fund) is analysed for resource budget purposes between that included in public expenditure and that which is not (see note 5). In 2002-03, all operating income not classified as appropriations in aid was within public expenditure.

There are two categories of operating income:

- Appropriations in aid (A in A): income due to Ofwat that can be retained and offset against other public expenditure.
- Consolidated Fund Extra Receipts (CFER): which are analysed for resource budget purposes into those:
 - included in public expenditure. In 2001-02 all income not classified as A in A fell into this category.
 - not included in public expenditure.

Publication sales, rent and utilities income has been re-classified from CFER income to A in A from 2002-03.

	2002-03			Income included in Operating Cost Statement £000
	Resource outturn A in A £000	Netted off gross expenditure in sub-head £000	Operating cost statement Payable to Consolidated Fund £000	
Operating income analysed by classification and activity is as follows:				
Administration income:				
Allowable within administration cost limit				
Licence fees	11,900	—	—	11,900
Licence fees received in advance – Prior year	2,262	—	—	2,262
Licence fees received in advance – Current year	(2,400)	—	—	(2,400)
Publication sales	16	—	—	16
Rent and Utilities	47	—	—	47
Total	11,825	—	—	11,825

Notes to the Departmental Resource Accounts (*continued*)

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

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

4.1 Administration costs limits

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

	2002-03		2001-02	
	Outturn	Limits	Outturn	Limits
	£000	£000	£000	£000
Request for resources 1 (Net limit)	—	1,735	—	35

5. Reconciliation of net operating surplus to control total and net resource outturn

	2002-03	2001-02
	£000	£000
Net Operating Surplus		
Operating income not classified as A in A	—	(731)
Net resource outturn (Note a)	—	731
	—	—

Note a:

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

6. Movement in working capital other than cash

The movements in working capital used in the Reconciliation of resources to cash requirements comprise:

	2002-03	2001-02
	£000	£000
Movement in working capital other than cash		
Increase/(Decrease) in debtors (see note 8)	107	(377)
(Increase)/Decrease in creditors (see note 10)	(341)	(1,027)
Total movement in working capital recognised in Schedule 4	(234)	(1,404)
<i>Adjustments:</i>		
Movements not relating to voted Resource consumption (net), being movements on debtors/creditors not related to Supply	—	102
Transitional adjustment, being adjustment for outstanding balance relating to the department's Appropriations Accounts for 2000-01	—	469
Working capital movement recognised in Schedule 1	(234)	(833)

7.1 Tangible fixed assets

	Furniture, fixtures and fittings	Office machinery	Telecom- munications	IT equipment	Total
	£000	£000	£000	£000	£000
Cost or valuation					
At 1 April 2002	782	162	110	502	1,556
Additions	70	13	—	415	498
Disposals	(26)	(8)	—	(144)	(178)
Reclassifications	—	—	—	—	—
Revaluation	6	1	—	(20)	(13)
At 31 March 2003	832	168	110	753	1,863
Depreciation					
At 1 April 2002	581	112	104	416	1,213
Charged in year	49	25	2	70	146
Disposals	(26)	(8)	—	(144)	(178)
Reclassifications	—	—	—	—	—
Revaluation	3	—	—	(1)	2
At 31 March 2003	607	129	106	341	1,183
Net book value at 31 March 2003	225	39	4	412	680
Net book value at 31 March 2002	201	49	6	87	343

Assets originally purchased to the value of £251,146 were disposed of during 2002-03. Those assets had a net book value of £1,248 for which £1,864 was received. The resulting profit on disposal of £616 was credited to the operating cost statement.

Notes to the Departmental Resource Accounts (*continued*)

7.2 Intangible fixed assets

	Purchased software licences	Assets under develop- ment	Total
	£000	£000	£000
Cost or valuation			
At 1 April 2002	100	409	509
Additions	698	—	698
Reclassification	409	(409)	—
Revaluation	(3)	—	(3)
At 31 March 2003	1,204	—	1,204
Amortisation			
At 1 April 2002	74	—	74
Charged in year	112	—	112
Reclassification	—	—	—
Revaluation	—	—	—
At 31 March 2003	186	—	186
Net book value at 31 March 2003	1,018	—	1,018
Net book value at 31 March 2002	26	409	435

Assets under development included the financial model, which has been transferred to bespoke software.

Tangible and intangible fixed asset additions include a £68k capital accrual.

Tangible and intangible assets are revalued using indices supplied by the Office of National Statistics in the publication 'Current cost accounting'.

8. Debtors

	2002-03	2001-02
	£000	£000
Amounts falling due within one year:		
Trade debtors	56	30
Advances	14	24
Prepayments	444	368
HM Customs and Excise (Vat)	59	44
	573	466

Advances comprise:

Staff advances. At 31 March 2003 loans were outstanding for season tickets in respect of 23 employees and a bicycle advance for one employee.

9. Cash at bank and in hand

	2002-03	2001-02
	£000	£000
Balance at 1 April	458	875
Net cash flow:	(205)	(417)
Balance at 31 March	253	458
The following balances are held at:		
Office of HM Paymaster General (OPG)	248	452
Commercial banks and cash in hand	5	6
	253	458
The balances at 31 March comprise:		
Cash due to be paid to the Consolidated Fund:		
Consolidated Fund extra receipts received and due to be paid to the Consolidated Fund	—	3
Excess cash receipts to be surrendered to the Consolidated Fund	253	455
	253	458

10. Creditors

	2002-03	2001-02
	£000	£000
Amounts falling due within one year:		
Trade creditors	165	44
Accruals	224	142
Deferred income	2,400	2,262
Consolidated Fund:		
Excess cash to be surrendered to Consolidated Fund	253	455
Actual surplus to be surrendered	—	—
Other	—	3
	3,042	2,906

Within trade creditors and accruals as at 31 March 2003 £68k is capital creditors and accruals (31 March 2002: nil).

11. Provision for liabilities and charges

	Director General's (retired) pension commit- ments	Early retirement	2002-03 Total	2001-02 Total
	£000	£000	£000	£000
Balance at 1 April 2002	490	115	605	638
Provided in year	38	—	38	47
Provision utilised in year	(58)	(31)	(89)	(88)
Unwinding of discount	—	7	7	8
Balance at 31 March	470	91	561	605
Of which:				
Payable within 1 year	58	30	88	87
Payable within 2 to 5 years	250	61	311	317
Payable after 5 years	162	—	162	201

Early retirement

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

Notes to the Departmental Resource Accounts (*continued*)

Director General's pension

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

The retired Director General is covered by a "by-analogy pension scheme" which offers similar benefits to the PCSPS. It is an unfunded, defined benefit scheme. An actuarial assessment of the scheme was completed as at 31 March 2003. The assessment uses a discount rate of 3.5% pa.

12. Revaluation reserve

	2002-03	2001-02
	£000	£000
Balance at 1 April 2002	107	100
Arising on revaluation during the year (see note 7)	5	7
Balance at 31 March	112	107

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

13. Reconciliation of net operating cost to changes in the general fund

	2002-03	2002-03	2001-02
	£000	£000	£000
Net Operating Income for the year (Schedule 2)		–	731
Income not appropriated-in-aid payable to the Consolidated Fund		–	(731)
		–	–
Net Parliamentary funding		1,035	35
Consolidated Fund creditor for cash unspent		(253)	(455)
Non-cash charges:			
Cost of capital charge	(86)		(77)
Auditor's remuneration	29	(57)	27
Net increase in the General Fund		725	(470)
General Fund at 1 April		(1,916)	
General Fund at 1 April as restated			(1,446)
General Fund at 31 March (Schedule 3)		(1,191)	(1,916)

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

14. Related-party transactions

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

15. Capital and other commitments

	2002-03	2001-02
	£000	£000
Contracted capital commitments for which no provision has been made	–	586

16. Commitments under operating leases

At 31 March 2003 the Department was committed to making the following annual payments in respect of operating leases. The building costs include, a service charge and insurance. This is based on the current information available and these estimates may be revised under the lease. The payments to which the department is committed during 2003-04, analysed by the period during which the commitment expires are as follows.

	Buildings	Other	2002-03 Total	2001-02 Total
	£000	£000	£000	£000
Expiry within 1 year	123	71	194	—
Expiry within 2 to 5 years	364	6	370	555
Expiry thereafter	524	—	524	554
Total	1,011	77	1,088	1,109

17. Contingent liabilities

There were no contingent liabilities at 31 March 2003.

18. Post balance sheet events

There were no post balance events at 31 March 2003.

19. Future events

A Water Bill was introduced by Government to Parliament in February 2003. It proposes:

- The formation of a Water Services Regulatory Authority which will take over the functions of the Director General of Water Services.
- The creation of a new independent Consumer Council for Water to replace the statutory Ofwat Customer Service Committees.
- New duties including promoting competition,

The pension arrangements have yet to be established for Philip Fletcher, the Director General. This should be completed by 31 March 2004. Ofwat will set up a provision when the transfer valuation has been calculated.

20. Derivatives and other financial instruments

Ofwat's activities are largely non-trading. Ofwat is therefore not exposed to financial risks faced by business entities. Ofwat has no independent powers to borrow or invest surplus funds. Except for financial assets and liabilities which are generated by day-to-day operational activities and are not held to change the risks facing Ofwat in undertaking its activities.

Liquidity risk

Ofwat has no borrowings and relies primarily on Licence fee income and Contingency Fund loans for its cash requirements, and is therefore not exposed to liquidity risks.

Interest rates and foreign currency risks

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

	Book value	Fair value
	£000	£000
Primary financial instruments		
Financial assets		
Cash at Bank	253	253
Financial liabilities		
Provisions (see note 11)	561	561

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