FSA: RESTRICTED

The Financial Services Authority

Financial Statements for the year ended 31 March 2006

Contents

Registered Number 1920623

Independent auditors' report to the members of The Financial Services Authority

We have audited the financial statements which comprise the income statement, the statement of recognised income and expense, the balance sheet, the statement of cash flows and related notes 1 to 22. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Corporate Governance Statement regarding directors' remuneration that is described as having been audited.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the part of the Corporate Governance Statement regarding directors' remuneration to be audited, and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted for use in the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Corporate Governance Statement regarding directors' remuneration to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements and the part of the Corporate Governance Statement regarding directors' remuneration to be audited give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. The other information comprises only the Directors' Report, the unaudited part of the Corporate Governance Statement, the Chairman's Statement and the Financial Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

We report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the directors' report includes the specific information presented in the Financial Review that is cross referred from the Business Review section of the directors' report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Corporate Governance Statement regarding directors' remuneration to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Corporate Governance Statement regarding directors' remuneration to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Corporate Governance Statement regarding directors' remuneration to be audited.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted for use in the European Union, of the state of affairs of the company as at 31 March 2006 and of its surplus for the year then ended.
- The financial statements and the part of the Corporate Governance Statement regarding directors' remuneration to be audited have been properly prepared in accordance with the Companies Act 1985.
- The information given in the Directors' Report is consistent with the financial statements.

Separate opinion in relation to IFRS

As explained in Note 2, the company in addition to complying with its legal obligation to apply IFRSs adopted in the European Union, has also complied with the IFRSs as issued by the International Accounting Standards Board.

In our opinion the financial statements give a true and fair view, in accordance with IFRSs, of the state the company's affairs as at 31 March 2006 and of its surplus for the year then ended

RSM Robson Rhodes LLP

RSM Robson Rhodes LLP
Chartered Accountants and Registered Auditors

London, England
25 May 2006

Income statement
for the year ended 31 March 2006

	Notes	2006 £m	2005 £m
Administrative costs	5	(282.7)	(259.1)
Interest on bank deposits		4.4	3.6
Other finance costs	15	(0.8)	(1.6)
Other revenue	7	17.3	11.1
Net costs for year		(261.8)	(246.0)
Fee revenue		270.6	247.7
Surplus before taxation		8.8	1.7
Taxation	8	(1.3)	(1.0)
Surplus after taxation		**7.5**	**0.7**

All results are derived from continuing operations.

Statement of recognised income and expense for the year ended 31 March 2006

	Notes	2006 £m	2005 £m
Surplus for the year		7.5	0.7
Actuarial gains and losses for the year in respect of the defined benefit pension scheme	15	(20.1)	(3.8)
Total recognised income and expense for the year		(12.6)	**(3.1)**

Balance sheet as at 31 March 2006

	Notes	2006 £m	2005 £m
Non current assets			
Intangible assets	9	10.1	10.9
Property, plant and equipment	10	19.5	22.1
		29.6	**33.0**
Current assets			
Trade and other receivables	11	9.9	18.5
Trading investments	12	18.2	17.0
Cash and cash equivalents	11	37.6	17.7
		65.7	**53.2**
Total assets		**95.3**	**86.2**
Current liabilities			
Trade and other payables	13	(72.9)	(63.0)
Current tax liabilities		(0.8)	(0.6)
		(73.7)	**(63.6)**
Total assets less current liabilities		**21.6**	**22.6**
Non current liabilities			
Trade and other payables	13	(11.9)	(10.9)
Long term provisions	14	(2.5)	(2.9)
Net assets excluding retirement benefit obligation		**7.2**	**8.8**
Retirement benefit obligation	15	(91.3)	(80.3)
Net liabilities, including retirement benefit obligation		**(84.1)**	**(71.5)**
Accumulated deficit	16	**(84.1)**	**(71.5)**

The financial statements were approved and authorised for issue by the Board on 25 May 2006, and were signed on its behalf by:

Callum McCarthy..................................... Chairman
John Tiner... Chief Executive Officer

Statement of cash flows for the year ended 31 March 2006

	Notes	2006 £m	2005 £m
Net cash generated from operations	21	**28.4**	**11.0**
Corporation tax paid		(1.1)	(1.0)
Net cash from operating activities		**27.3**	**10.0**
Investing activities			
Interest received on bank deposits		4.4	3.6
Expenditure on software development	9	(4.5)	(4.8)
Purchases of property, plant and equipment	10	(6.1)	(6.9)
Purchase of trading investments		(1.2)	(11.0)
Net cash used in investing activities		**(7.4)**	**(19.1)**
Net increase / (decrease) in cash and cash equivalents		**19.9**	**(9.1)**
Cash and cash equivalents at the start of the year		17.7	26.8
Cash and cash equivalents at the end of the year		**37.6**	**17.7**

Notes to the accounts – 31 March 2006

1. General information

The Financial Services Authority is a company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is given on page xx. The nature of the Authority's operations and its principal activities are set out on page xx.

These financial statements are presented in pounds sterling because that is the currency of the primary economic environment in which the Authority operates.

At the date of the authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective:

- IFRS 6: Exploration for and Evaluation of Mineral Resources
- IFRS 7: Financial Instruments: Disclosures; and the related amendments to IAS 1 on capital disclosures
- IFRIC 4: Determining whether and Arrangement contains a Lease
- IFRIC 5: Right of Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
- IFRIC 8: Scope of IFRS 2

The directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Authority.

2. Significant accounting policies

The financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') for the first time. The disclosures required by IFRS 1 concerning the transition from UK GAAP to IFRS are given in note 22. The financial statements have also been prepared in accordance with the IFRS adopted for use in the European Union and therefore comply with Articles 4 of the EU IAS Regulations. The Financial Statements have been prepared on an historical cost basis, except for revaluation of financial assets. The principal accounting policies adopted are set out below:

a. Income statement

The format of the income statement on page [xx] has been designed to show costs before fees levied to cover those costs. It is considered that this format best represents the nature of the activities of the FSA, which involves carrying out statutory functions and levying fees to meet the net cost of those functions.

b. Revenue recognition

All fee revenue is receivable under the Financial Services and Markets Act 2000 (FSMA), measured at fair value, and represents the fees to which the FSA was entitled in respect of the financial year.

Interest received on bank deposits is accrued on a time basis by reference to the principal outstanding and the effective interest rate applicable.

c. Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses.
Depreciation is calculated to write off the cost less estimated residual value on a straight-line basis over the expected useful economic lives. The principal annual rates used for this purpose are:

	%
Leasehold improvements	10
Computer equipment (excluding software)	33
Furniture and equipment	10

If events or changes in circumstances indicate the carrying value may not be recoverable then the carrying values of tangible fixed assets are reviewed for impairment.

d. Recognition of enforcement expenses

All costs incurred to the end of the year are included in the accounts, but no provision is made for the costs of completing current work unless there is a present obligation.

In the course of its enforcement activities, the FSA gives indemnities to certain provisional liquidators and trustees. Provision is made in the accounts for costs incurred by such liquidators and trustees to the year end and estimated to be recoverable from the FSA under such indemnities. The amount provided is discounted to present value.

e. Retirement benefit costs

The company operates an occupational pension scheme, the FSA Pension Plan, for its employees. There are two sections in the pension plan: the Final Salary section (a defined benefit arrangement which is closed to new members) and the Money Purchase section (a defined contribution arrangement for new entrants).

Defined contribution scheme – payments to the defined contribution section are recognised as an expense in the Income statement, as they fall due.

Defined benefit scheme – the charge to the Income statement is the current service, past service, and interest costs of the scheme liabilities, less the expected return on the scheme's assets.

The obligation in respect of the defined benefit pension scheme represents the present value of future benefits owed to employees in return for their service in the current and prior periods. The discount yield used to calculate present value of those liabilities is the market yield at the balance sheet date of high quality corporate bonds having maturity dates approximating to the terms of those liabilities. The calculation is performed by a qualified actuary using the projected unit credit method at each balance sheet date.

The net liabilities of the defined benefit scheme are calculated by deducting the fair value of the scheme's assets from the present value of its obligations, and disclosed as a long term liability on the balance sheet.

Actuarial gains and losses arising in the defined benefit scheme (for example the difference between actual and expected return on assets, effects of changes in assumptions and experience losses arising on scheme liabilities) are recognised in full in the Statement of recognised income and expense in the period in which they are incurred.

f. Financial penalties received

Under the FSMA, the FSA has the power to levy financial penalties, but it is required to apply those penalties for the benefit of its fee-payers. The FSA's policy for doing so is to use the penalties received in each financial year to reduce the amount owed by fee-payers in the relevant fee block in the following financial year. Penalties received are included in current liabilities: trade and other payables.

g. Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. Finance charges are charged directly against income. All other leases are treated as operating leases.

Rentals payable under operating leases are charged to the income statement on a straight line basis over the term of the lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight line basis over the lease term.

h. Intangible assets

Costs associated with the development of software for internal use are capitalised only if the design of the software is technically feasible, and the FSA has both the resources and intent to complete its development. In addition, costs are only capitalised if the asset can be separately identified, it is probable that the asset will generate future economic benefits, and that the development cost of the asset can be measured reliably. Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Only costs that are directly attributable to bringing the asset to working condition for its intended use are included in its measurement. These costs include all directly attributable costs necessary to create, produce and prepare the asset to be capable of operating in a manner intended by management.

Internally generated intangible assets are amortised on a straight line basis over their expected useful lives, generally between three and seven years with the expense reported as an administration expense in the Income Statement. Subsequent expenditure is only capitalised when it increases the future economic benefits embodied in the specific asset to which it relates.

Where no internally generated intangible asset can be recognised, development expenditure is charged to the income statement when incurred.

i. Impairment of tangible and intangible assets

At each balance sheet date, the FSA reviews the carrying value of its tangible and intangible assets to determine whether there is any indication that those assets have suffered impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and risks to the specific asset for which the estimates of future cash flows have not been adjusted. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

When an impairment loss subsequently reverses, the carrying amount is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

j. Financial instruments

Trade receivables - Trade receivables are measured at amortised cost. Appropriate allowances for estimated irrecoverable amounts are recognised in the income statement when there is objective evidence that the asset is impaired. The allowance recognised is measured as the difference between the asset's carrying value and the estimated future cashflows deriving from the continued use of that asset discounted if the effect is material.

Investments - Cash deposits with a maturity date in excess of 90 days at inception are reported at fair value and are not subject to a significant risk of changes in value.

Trade payables - Trade payables are not interest bearing and stated at nominal value.

The company's financial risk management policy is disclosed on page (x).

k. Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, demand deposits and other short term liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

l. Provisions

Provisions are recognised when the FSA has a present obligation as a result of a past event, and it is probable that the FSA will be required to settle that obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date and are discounted to present value where the effect is material.

Legal challenges
On occasion, legal proceedings are threatened or initiated against the FSA. The FSA provides for the estimated full cost of any such challenges where at the end of the year it is more likely than not that there is an obligation to be settled. The amount provided is discounted to present value where the effect is material.

m. Taxation

The tax expense represents the sum of tax currently payable.

3. Critical accounting judgements and key sources of estimation uncertainty

Critical judgements in applying the Authority's accounting policies

In the process of applying the Authority's accounting policies, which are described in note 2, management has made the following judgements that have the most significant effect on the amounts recognised in the financial statements (apart from those involving estimations, which are dealt with below):

- Intangible assets – under IAS 38, internal software development costs of £21.3m have been capitalised. Management judgement has been applied in quantifying the benefit expected to accrue to the FSA over the useful life of the relevant assets. If the benefits expected do not accrue to the FSA, then the carrying value of the asset will require adjustment.

Key sources of estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to carrying amounts of assets and liabilities in the next financial year are discussed below:

- Pension deficit – the quantification of the pension deficit is based upon actuarial assumptions in relation to rate of increase in salaries, corporate bond discount rates, expected return on scheme assets, retail price inflation and future pension increases. The effect of any change to these assumptions will be accounted for in the next financial year through the Statement of recognised income and expense.

4. Business and geographical segments

Business segments

For management purposes, the FSA is currently organized into four business units – Wholesale & Institutional Markets, Retail Markets, Regulatory Services and Corporate Services. These business units are the basis on which the FSA reports its primary segment information.

The principal activities for the four business units are as follows:

Retail Markets – helping retail consumers obtain a fair deal. This business unit's work is aimed at establishing the four main features of an effective and efficient retail market: capable and confident consumers; clear, simple and understandable information from the industry and the FSA, available for, and used by, consumers; responsible firms who treat their customers fairly, are soundly managed and adequately capitalised; and risk-based regulation, through firm-specific and thematic supervision and policy.

Wholesale and Institutional Markets – maintaining efficient, orderly and clean markets. Much of this business unit's work is aimed at establishing and maintaining high standards in the markets which operate in the UK. This embraces questions of disclosure, corporate governance and market behaviour, for which the FSA has varying degrees of responsibility and of influence, as well as other matters, such as supervision, capital adequacy, or the listing regime where the FSA's responsibilities and powers are unambiguous.

Regulatory services – making the FSA a more effective organisation. Providing an accurate and timely service to firms, consumers and other stakeholders (for example, in processing application for waivers and guidance, handling calls to our consumer help lines, and in receiving and processing regulatory returns). The business unit also manages the FSA's office facilities, IT systems and working capital.

Corporate services and Board – provides the resources that the Board requires to discharge its stewardship and corporate governance responsibilities, and to devise, implement and monitor the FSA's strategy. This includes the cost of the FSA's enforcement activities.

Segment information about the FSA's continuing operations is presented below:

2006	Wholesale & Institutional Markets	Retail Markets	Regulatory Services	Corporate Services and Board	Total for continuing operations
	Year ended 31 March 2006	Year ended 31 March 2006	Year ended 31 March 2006	Year ended 31 March 2006	Year ended 31 March 2006
	£m	£m	£m	£m	£m
Revenue					
Fees			270.6		270.6
Sundry income	5.5	0.9	7.5	3.4	17.3
Result					
Segmental surplus / (deficit)	(61.4)	(95.4)	224.6	(62.6)	5.2
Unallocated expenses					-
Operating profit from continuing operations					5.2
Investment revenues					4.4
Other gains and losses					(0.8)
Surplus before tax					8.8
Income tax expense					(1.3)
Surplus for year					7.5
Other information					
Capital additions			10.6		10.6
Depreciation			8.7		8.7
Amortisation			5.3		5.3
Trade receivables impairment losses recognised			(0.7)		(0.7)
Current and past pension service costs	1.8	2.7	2.0	2.0	8.5

2005	Wholesale & Institutional Markets	Retail Markets	Regulatory Services	Corporate Services and Board	Total for continuing operations
	Year ended 31 March 2005	Year ended 31 March 2005	Year ended 31 March 2005	Year ended 31 March 2005	Year ended 31 March 2005
	£m	£m	£m	£m	£m
Revenue					
Fees			247.7		247.7
Sundry income	3.5		5.2	2.4	11.1
Result					
Segmental surplus / (deficit)	(53.5)	(88.3)	203.9	(62.4)	(0.3)
Unallocated expenses					-
Operating profit from continuing operations					(0.3)
Investment income					3.6
Other gains and losses					(1.6)
Surplus before tax					1.7
Income tax expense					(1.0)
Surplus for year					0.7
Other information					
Capital additions			11.7		11.7
Depreciation			10.3		10.3
Amortisation			3.4		3.4
Trade receivables impairment losses			1.5		1.5
Current and past pension service costs	2.1	3.1	2.2	2.2	9.6

Balance Sheet analysis

Whereas the FSA allocates its costs to business segments, as set out above, it does not allocate assets and liabilities to those segments. This is for two reasons, first as fees are not set on the basis of the costs we incur in regulating individual firms, our working capital cannot be allocated to business segments, and second as we are not a profit making organisation, we do not consider return on capital measures.

Geographical analysis

The FSA regulates entities that operate within the UK Financial Services Industry including the regulation of foreign domiciled entities operating within the UK. The foreign domiciled entities account for less than 10% of the fee base of the FSA. No further geographical analysis is presented.

5. Administrative costs

Administrative costs include:

	2006 £m	2005 £m
Depreciation of property, plant and equipment	8.7	10.3
Amortisation of intangible assets	5.3	3.4
Staff costs (note 6)	175.6	153.0
Amortisation of deferred costs	-	10.6
Operating lease rentals	10.6	9.8
Repairs and maintenance on P,P&E	1.4	1.4
Trade receivables impairment	(0.7)	1.5

Auditor's remuneration for audit services (see below).

During the year, mindful of the need to ensure the actual and perceived independence of its auditor, and wishing to ensure that it can call on the assistance of all the 'Big Four' accountancy firms for specialist regulatory advice and secondments, the FSA decided to replace Deloitte & Touche LLP as its auditor. Consequently, Deloitte & Touche resigned as auditor on 26 September 2005. They charged no fees for audit services in 2005/06.

RSM Robson Rhodes LLP accepted appointment as our auditor on 13 January 2006. Their audit fee for 2005/06 includes non-recurring costs of £21,150 (including VAT) for work they undertook to review our implementation of IFRS.

Amounts payable to RSM Robson Rhodes LLP and their associates by the FSA in respect of non-audit services was £46,000 (2005: £753,000 to Deloitte & Touche LLP). A more detailed analysis of each auditor's remuneration is provided below:

Deloitte & Touche LLP	**2006**		2005	
	£'000	**%**	£'000	%
Auditor's remuneration	-	-	82	11
Fees paid to the FSA's auditor or their associates in connection with non-audit work (to the date of their resignation)				
Secondments	74	9	397	53
Specialist regulatory advice	717	91	261	34
Other non-audit services	-	-	13	2
Total	**791**	**100**	**753**	**100**

RSM Robson Rhodes LLP	**2006**		2005	
	£'000	**%**	£'000	%
Auditor's remuneration	98	68	-	-
Fees paid to the FSA's auditor or their associates in connection with non-audit work				
Secondments	46	32	78	100
Total	**144**	**100**	**78**	**100**

All fees payable to the auditors are stated inclusive of VAT, as VAT is not generally recoverable by the FSA.

Secondees work under the control and direction of FSA staff to contribute towards the discharge of our regulatory objectives, as set out in Section 1, paragraph 2(2) of the FSMA 2000, and do not have any involvement in either the management of the FSA, or the preparation of our accounting records. 'Specialist regulatory advice' has been provided in relation to the achievement of one, or more, of our regulatory objectives, for example the production of independent reviews of regulated firms, and policy-related projects. 'Other non-audit services' are connected with general management issues, but our auditor is only permitted to provide such services in circumstances where doing so would not place them in the position of having to reviewing their own work when acting as our auditor.

All services provided by our auditor are subject to the FSA's normal procurement procedures. So, where our auditor is appointed to undertake particular assignments, this is only done after competitive tender. In addition, our auditor is not permitted to tender for either any work within the FSA that might lead to the perception of any element of self review, or for internal audit work. The Audit Committee is updated on the outcomes of the tendering process, including those relating to secondments. Each year the Audit Committee reviews the nature and content of non-audit work performed by the auditor to ensure that audit independence is not impaired.

6. Employee information

The average number of employees (including executive directors) during the year was 2,610 (2005: 2,356). The average number of employees in each function during the current year was as follows:

	2006	**2005**
Retail Markets Business Unit	738	596
Wholesale & Institutional Markets Business Unit	506	458
Regulatory Services Business Unit	703	712
Corporate Services and Board (excluding enforcement)	427	377
Enforcement	236	213
	2,610	**2,356**

At 31 March 2006, the FSA had 2,667 (2005: 2,467) employees.

Employment costs (including executive directors) comprise:	**Notes**	**2006 £m**	2005 £m
Gross salaries and taxable benefits		144.8	124.0
Employer's National Insurance costs		13.4	12.3
Employer's pension costs			
Included in administrative costs:			
Past service cost		0.3	0.9
Current service costs of			
Final salary scheme		8.2	8.7
Unfunded pensions liabilities		0.4	0.1
Defined contribution scheme		7.9	6.4
Administration and other costs		0.6	0.6
	5	175.6	153.0
Employer's pension costs			
Included in other finance costs	15	0.8	1.6

Included in statement of total recognised income and expenditure	15	20.1	3.8
Total employment costs		**196.5**	**158.4**

7. Other revenue

Other revenue comprises:

	2006 £m	2005 £m
Information and training services	8.4	4.9
Application fees and other regulatory income	5.4	4.7
Other sundry income	3.5	1.5
	17.3	**11.1**

8. Tax

The tax charge on ordinary activities is:

	2006 £m	2005 £m
Current tax on continuing operations	1.3	1.0
Corporation tax charge for the year	**1.3**	**1.0**

Corporation tax is calculated at 30% (2005: 30%) of the estimated assessable surplus for the year.

The total charge for the year can be reconciled to the accounting surplus as follows:

	2006 £m	2005 £m
Surplus before tax on continuing operations	8.8	1.7
Tax at 30% thereon	2.6	0.5
Effects of:		
Activities not subject to corporation tax	(1.3)	0.5
Current tax charge for the period	**1.3**	**1.0**
Effective tax rate for the period	**15%**	**59%**

Under an agreement with the Inland Revenue the company is not subject to corporation tax on income arising from its regulatory activities. Consequently, the tax charge arises solely on interest receivable.

9. Other intangible assets

	Software Development costs £m
Cost	
At 1 April 2004	**12.0**
Additions – internally generated	4.8
At 1 April 2005	**16.8**
Additions – internally generated	4.5
At 31 March 2006	**21.3**
Amortisation	
At 1 April 2004	**2.5**
Charge for the year	3.4
At 1 April 2005	**5.9**
Charge for year	5.3
At 31 March 2006	**11.2**
Net book value	
At 31 March 2006	**10.1**
At 31 March 2005	10.9

At 31 March 2006 expenditure totalling £0.8m had been capitalised on software developments that had not yet gone into operation (2005: £1.2m).

10. Property, plant and equipment

	Leasehold improvements £m	Computer equipment £m	Furniture and equipment £m	Total £m
Cost				
At 1 April 2004	**19.8**	**30.5**	**10.3**	**60.6**
Additions	-	6.5	0.4	6.9
Disposals	-	(0.2)	-	(0.2)
At 1 April 2005	**19.8**	**36.8**	**10.7**	**67.3**
Additions	0.1	5.2	0.8	6.1
Disposals	-	(0.4)	-	(0.4)
At 31 March 2006	**19.9**	**41.6**	**11.5**	**73.0**

Accumulated depreciation and impairment				
At 1 April 2004	**9.9**	**18.1**	**7.1**	**35.1**
Charge for year	2.0	7.7	0.6	10.3
Disposals	-	(0.2)	-	(0.2)
At 1 April 2005	**11.9**	**25.6**	**7.7**	**45.2**
Charge for year	2.0	6.0	0.7	8.7
Disposals	-	(0.4)	-	(0.4)
At 31 March 2006	**13.9**	**31.2**	**8.4**	**53.5**
Carrying amount				
At 31 March 2006	**6.0**	**10.4**	**3.1**	**19.5**
At 31 March 2005	7.9	11.2	3.0	22.1

The FSA has reviewed the residual values used for the purposes of depreciation calculations. The review did not identify any requirement for adjustment to the residual values used in the current or prior periods. Residual values will be reviewed and updated annually.

11. Other financial assets

Trade and other receivables

	2006 £m	2005 £m
Fee receivables	2.7	1.0
Other debtors	0.9	0.9
Prepayments and accrued income	6.3	16.6
	9.9	**18.5**

The average credit period taken is 50 days. A late penalty fee of £250 is payable on periodic fees not paid by the due date. If payment is not received within 15 days of the due date interest is charged on the outstanding balance at Bank of England Repo rate plus 5%.

An allowance has been made for the estimated irrecoverable amounts from fees invoiced of £0.7m (2005: £1.8m). This allowance has been determined by reference to past default experience.
The directors consider that the carrying amount of trade and other receivables approximates their fair value.

Bank balances and cash

Bank balances and cash comprise cash held by the FSA and short term bank deposits with an original maturity of three months or less. The carrying amount of these assets approximates their fair value.

The effective interest rate on short term deposits is 4.54% (2005: 4.8%) and the average maturity of 29 days (2005: 47 days).

Credit risk

The FSA's principal financial assets are bank balances and cash and fee and other receivables. The credit risk on liquid funds is limited because the counterparties are banks with high credit ratings assigned by international credit rating agencies.

The FSA's credit risk is primarily attributable to its fee receivables. The amounts presented in the balance sheet are net of allowances for doubtful receivables. An allowance for impairment is made where there is an identified loss event which, based on past experience and management's forecasts, is evidence of a reduction in the recoverability of the cashflows.

The FSA has no significant concentration of credit risk as its exposure is spread over a large number of counterparties.

12. Investments

	2006	2005
	£m	£m
Available for sale investments – fair value	18.2	17.0

Investments relate to cash deposits with an original maturity date in excess of 90 days.

13. Trade and other payables

Current

	2006	2005
	£m	£m
Trade creditors and accruals	46.6	30.1
Other taxation and social security	2.8	2.5
Financial penalties to be applied against fees receivable	16.9	22.2

Fees in advance	6.6	8.2
	72.9	**63.0**

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade payables is 16 days. The directors consider the carrying amount of trade payables approximates their fair value.

Non-current

A lease accrual of £11.9m (2005 £10.9m), being the cumulative difference between cash paid and expense recognised on operating leases for land and buildings, is recognised as a long term liability.

14. Provisions

	Sutherland House	Repairs	Total
	£m	£m	£m
At 1 April 2005	0.6	2.3	2.9
Utilised in the year	(0.6)	(0.3)	(0.9)
(Release of provision) / Charge in the year	-	0.5	0.5
At 31 March 2006	-	**2.5**	**2.5**

The provisions at 31 March are expected to be utilised as follows:

	2006	2005
	£m	£m
Current liabilities	0.9	0.2
Non-current liabilities	1.6	2.7
	2.5	**2.9**

Sutherland House

During 2004/05 the FSA committed formally to relocating from its existing premises in Edinburgh, Sutherland House, to new premises at Quayside House. Agreement was reached with our landlord of Sutherland House on 20 January 2006, to renounce our liability under that lease in exchange for a payment totalling £0.4m. Payments of £0.2m, in relation to the lease, were expensed as incurred.

Repairs

Under the terms of Deed of Variation on the lease for 25 The North Colonnade, the FSA has obligations to repair and replace certain items of equipment in the premises. The estimated cost of the FSA's remaining obligation is charged to the Income Statement over the life of the lease and the cumulative cost less amounts spent is included in provisions for liabilities and charges.

15. Retirement benefit schemes

The FSA operates a tax-approved pension scheme, the FSA Pension Plan, open to permanent employees. The pension scheme was established on 1 April 1998 and operates on both a defined benefit (the Final Salary section) and defined contribution (the Money Purchase section) basis. Since 1 June 1998, all employees joining the FSA, other than those joining from other regulatory bodies whose functions were transferred to the FSA, have been eligible only for the Money Purchase section of the scheme. Since the Final Salary section of the scheme is closed to new members and the age profile of the active members is increasing, under the projected unit credit method, the current service cost will increase as members of the scheme approach retirement. The Final salary section of the scheme is non-contributory for members. The Money Purchase section is part of a flexible benefits programme and members can, within limits, select the amount of their overall benefits allowance that is directed to the pension scheme.

Final Salary section

The most recent actuarial valuation of the FSA Pension Plan was carried out as at 1 April 2004 by an independent actuary, using the projected unit method. The results of this valuation have been updated for the purpose of IAS 19 as at March 2006, in order to allow for any changes in assumptions and movements in liabilities over the period. The next full actuarial valuation is expected to be carried out as at 1 April 2007.

The major assumptions used for the purpose of actuarial assumptions were as follows:

	At 31 March 2006	At 31 March 2005
Rate of increase of salaries	4.0%	4.0%
Corporate bond discount rate	4.9%	5.4%
Expected return on scheme assets	6.9%	7.2%
Retail price inflation (RPI)	2.8%	2.5%
Future pension increases	2.8%	2.5%

The amount recognised in the balance sheet is as follows:

	2006 £m	2005 £m
Fair value of plan assets	250.6	182.2
Less: Present value of funded obligations	(340.1)	(261.1)
Deficit in the scheme	**(89.5)**	**(78.9)**
Unfunded pension liabilities	(1.8)	(1.4)
Net *liability* recognised in the balance sheet	**(91.3)**	**(80.3)**

A small number of current and former employees have benefit promises that cannot be delivered entirely through the tax-approved scheme described above. At 31 March 2006 the liability is £1.8m (2005: £1.4m) to cover the cost of these promises. An amount of £0.4m (2005: £0.1m) is included in the total pension cost for the year in note 6, representing the value of the additional benefits accrued.

Amounts recognised in the Income Statement in respect of the defined benefit plan are as follows:

	2006 £m	2005 £m
Current service cost	8.2	8.7
Past service cost	0.3	0.9
Administration expenses	**8.5**	**9.6**
Expected return on plan assets	13.7	11.7
Interest on scheme liabilities	(14.5)	(13.3)
Other finance costs	**(0.8)**	**(1.6)**

Current service costs and past service costs are disclosed as administration expenses, expected return on plan assets and interest cost are disclosed as interest income in the Income Statement and actuarial gains and losses of £2.8m (2005 £3.8m) are recognised in the period in which they occur as part of the Statement of recognised income and expense.

The actual return on plan assets was £52.5m (2005 £14.2m).

Changes in the present value of the defined benefit obligation are as follows:

	2006 £m	2005 £m
Opening obligation	(261.1)	(235.8)
Current service cost	(8.2)	(8.7)
Past service cost	(0.3)	(0.9)
Benefits paid	2.9	3.8
Interest cost	(14.5)	(13.3)
Changes in assumptions underlying the plan liabilities	(58.9)	(6.2)
Closing obligation	**(340.1)**	**(261.1)**

Changes in the fair value of plan assets are as follows:

	2006 £m	2005 £m
Opening fair value of plan assets	182.2	155.8
Expected return on plan assets	13.7	11.7
Actual return less expected return on plan assets	38.8	2.4
Contributions by the employer	18.7	16.1
Benefits paid	(2.8)	(3.8)
Closing fair value of plan assets	**250.6**	**182.2**

The fair value of plan assets and the expected rates of return were:

	Expected rate of return at 31 March 2006	Fair value at 31 March 2006 £m	Expected rate of return at 31 March 2005	Fair value at 31 March 2005 £m
Equities	7.4%	199.3	7.7%	144.0
Corporate Bonds	4.9%	45.1	5.4%	36.5
Cash	4.5%	5.9	4.75%	1.7
Closing fair value of plan assets	**6.9%**	**250.3**	**7.2%**	**182.2**

There are no deferred tax implications of the above deficit as corporation tax is only payable on interest receivable by the company.

The plan assets do not include any of the FSA's own financial instruments, nor any property occupied by, or other assets used by the FSA.

The expected rates of return on individual categories of plan assets are determined by reference to relevant market expectations at the measurement date for returns over the lifetime of the obligations.

The history of differences between expected and actual returns on plan assets and gains and losses on scheme liabilities are as follows:

	2006	2005
Experience adjustments on scheme assets:		
Amount (£m)	38.8	2.4
percentage of scheme assets	15.5%	1.0%
Experience gains and losses on scheme liabilities:		
Amount (£m)	(0.1)	(0.3)
percentage of the present value of scheme liabilities	0%	0%

The contribution rate for 2005/06 was 23% of pensionable earnings plus £9.8m (26.7% of pensionable earnings) as an additional deficit reduction contribution. The agreed contribution rate for 2006/07 is 23% of pensionable earnings plus £6.0m (approximately 15.4% of pensionable earnings) as an additional deficit reduction contribution.

Defined contribution scheme

The total expense recognised in the income statement of £7.9m (2005: £6.4m) represents contributions payable to the plan by the FSA at rates specified in the rules of the plan.

16. Accumulated deficit

	£m
At 1 April 2004	(68.4)
Surplus for the year	0.7
Actuarial gains and losses for the year in respect of the defined benefit pension scheme	(3.8)
At 1 April 2005	(71.5)
Surplus for the year	7.5
Actuarial gains and losses for the year in respect of the defined benefit pension scheme	(20.1)
	(84.1)

The Financial Services Authority is a company limited by guarantee. The members of the company have agreed to contribute £1 each to the assets of the company in the event of it being wound up.

17. Capital commitments

The FSA had entered into contracts at 31 March 2006 for capital expenditure totaling £0.5m (2005: £1.4m), which are not provided for in the accounts.

18. Operating lease arrangements

	2006 £m	2005 £m
Minimum lease payments under operating leases recognised as an expense in the year	10.6	9.8

At the balance sheet date, the FSA has outstanding commitments under non-cancellable operating leases which fall due as follows:

	2006 £m	2005 £m
Within 1 year	11.0	10.8
Between 2 and 5 years	43.9	43.7
After five years	96.5	107.8
	151.4	**162.3**

Operating lease payments represent rentals payable by the FSA for certain of its office properties. The lease on 25 The North Colonnade, Canary Wharf, London will expire in 2018. Under the terms of the lease, the rent for the period from 4 November 2003 to 3 November 2004 was agreed at £9.5m. Thereafter, the rent payable until 3 November 2008 will increase by 2.5% each year. From 4 November 2008 until 3 November 2018 rent will increase in line with RPI subject to a minimum annual increase of 2.5% per annum and a maximum of 5% per annum. As mentioned in note 14, our current assumptions for RPI is 2.8%.

The lease on 16th Floor, 25 Bank Street, Canary Wharf, London, was taken out in March 2005 and contains no provisions for rent reviews. The lease will expire in 2008.

The lease on Quayside, Edinburgh was taken out in September 2005, contains provision for a rent review in September 2010 and September 2015 and is due to expire in August 2020.

19. Related party transactions

Remuneration of key management personnel

The remuneration of directors, who are the key management personnel of the Authority, is set out below in aggregate for each of the categories specified in IAS 24 Related Parties Disclosures. Further information on individual directors is provided in the audit part of the Corporate Governance Statement on pages x to x.

	2006	2005
	£m	£m
Short term benefits	2.5	2.3
Post-employment benefits	0.1	0.4
Other long term benefits	-	-
Termination benefits	-	-
	2.6	**2.7**

There were no other transactions with directors in either year.

Significant transactions with other financial services regulatory organisations

The FSA enters into transactions with a number of other financial services regulatory organisations. The significant transactions were:

a) The Financial Services Compensation Scheme Limited (FSCS)

The FSA appoints, and has the right to remove, directors to the board of FSCS and it establishes the rules under which the Scheme operates. Under statute (FSMA) and the Memorandum of Association of FSCS, the FSA has to ensure that the terms of appointment of the directors procure their operational independence from the FSA. Accordingly, the FSA does not control FSCS, but does consider it to be a related party.

During the year, the FSA provided an agency service to FSCS to collect tariff data, issue levy invoices and collect levy monies on its behalf. The net amount of fees collected that remained to be paid over by the FSA to FSCS at 31 March 2006 was £0.1m (2005: £0.6m). The charge for the service was £0.2m (2005: £0.2m).

In our Business Plan 2005/06, we explained that, when the Pensions Review is completed, we expected to be left with a small surplus on the Pensions Review fee-block (A.16), and that we intended to transfer that surplus, together with a small financial penalty that we are still holding for the benefit of A.16 fee-payers, to the FSCS. The FSCS will subsequently use these funds to provide redress for Pensions Review claims, and thus reduce the amount that the Scheme itself will have to raise by way of future levies. On 30 March 2005, as a first step in carrying out that transfer of funds we paid the FSCS £0.75m, which was included as a reduction in fees receivable in note 11 above. The balance of the projected surplus was settled with the FSCS in the year to 31 March 2006.

The FSA is a party to the lease agreement for FSCS's premises, occupied from 18 June 2001 at the 7th floor at Lloyds Chambers, Portsoken Street, London, as guarantor of performance of the lease. This lease is for a term from 13 February 2001 to 21 June 2018 at a current annual rental and related out-goings of £1.1m.

b) The Financial Ombudsman Service Limited (FOS)

The FSA established FOS, a company limited by guarantee, in accordance with FSMA to exercise the functions of the operator of the ombudsman scheme. Under the FSMA and the Memorandum of Association of FOS, the FSA has to ensure that the terms of appointment of the directors procure their operational independence from the FSA. Accordingly, the FSA does not control FOS, but does consider it to be a related party.

The FSA is the principal employer in the FSA Pension Scheme described in note 15. FOS is also a participating employer in the same scheme making contributions at the same overall rate as the FSA. The assets and liabilities disclosed in note 15 represent only those that relates to the employees of the FSA. The total number of scheme members is 2,237 (2005: 2,242) of which 2,098 are, or were, employees of the FSA (2005: 2,102) and 139 of the FOS (140).

During the year, the FSA entered into an agency agreement with FOS to collect tariff data, issue levy invoices and collect levy monies on its behalf in respect of 2005/06 fees. At 31 March 2006 £1.0m of on-account fees for 2006/07 had been collected but not paid to FOS.

The FSA is a party to the lease agreement for part of the FOS premises at South Plaza II, London as guarantor of performance of the lease, which is for a 15-year term from 2 November 1999, at a current annual rental of £1.1m.

FOS has a revolving loan facility of £15m (2005: £15m) available for draw down from 24 January 2003 and repayable by 2011. Amounts outstanding under the facility are guaranteed by the FSA. As at 31 March 2006, £7.5m (2005: £7.5m) of the facility was drawn down.

The Office of the Complaints Commissioner

The FSA funds the activities of the Complaints Commissioner through the periodic fees it raises. Up to 31 August 2004, the costs of those activities were met directly by the FSA. In August 2004, however the Office of the Complaints Commissioner (OCC), a company limited by guarantee, was incorporated. Since 1 September 2004, the purpose of this company has been to administer complaints against the FSA that are handled by the Complaints Commissioner. In doing so, it employs staff, owns assets used by the Commissioner and his staff, and enters into contracts for goods and services in furtherance of complaints handling activities. During 2005/06, the FSA has transferred £0.5m (2005: £0.4m) to the OCC to cover the latter's running costs, which have been expensed in the FSA's income and expenditure account. At 31 March 2006, the balance owing to the FSA from the OCC was £0.1m (2005: £0.1m).

By virtue of certain provisions contained in the Memorandum of Association of the OCC the FSA has the right to appoint and remove the Complaints Commissioner, who is both a member, and a director of the company. Because of this, the OCC is actually a subsidiary of the FSA. However, the scale of the activities of the OCC is immaterial compared to that of its parent company. Accordingly, the FSA has not prepared group accounts, including the OCC, on the grounds that the exclusion of the OCC from the FSA's accounts is not material to those accounts providing a true and fair view.

Other than disclosed above, there were no related party transactions during the year (2005: £ nil).

20. Contingent Liabilities

As described in note 19 the FSA acts as guarantor for leases entered into by FSCS and FOS, and also the banking loan facility of FOS.

The FSA is aware that certain parties are considering the possibility of making claims against it relating to the regulation of Independent Insurance Limited and Equitable Life. No material claims have been made against the FSA. On the basis of the information presently available to it, the FSA believes that any claims would have no real prospect of success. Accordingly, no provision has been made in the accounts for these matters.

21. Notes to the cash flow statement

	Notes	**2006 £m**	2005 £m
Surplus for the year from continuing operations		7.5	0.7
Adjustments for:			
Interest received on bank deposits		(4.4)	(3.6)
Corporation tax expense	8	1.3	1.0
Amortisation of other intangible assets	9	5.3	3.4
Depreciation of property, plant and equipment	10	8.7	10.3
Increase / (decrease) in provisions	14	(0.4)	(1.7)
Operating cash flows before movements in working capital		18.0	10.1
Decrease / (increase) in receivables	11	8.6	1.9
Increase / (decrease) in payables	13	10.8	3.8
Increase / (decrease) in defined benefit fund	15		
Service cost		8.5	9.6
Contributions – normal		(8.2)	(9.4)
Contributions – additional deficit reduction		(10.5)	(6.7)
Other finance costs		0.8	1.6
Unfunded pension liability		0.4	0.1
		(9.0)	(4.8)
Net cash generated from operations		**28.4**	**11.0**

Cash and cash equivalents comprise cash at bank and other short term highly liquid investments with a maturity of three months or less.

22. Explanation of transition to IFRS

This is the first year that the FSA has presented its financial statements under IFRS. The following disclosures are required in the year of transition. The last financial statements under UK GAAP were for the year ended 31 March 2005 and the date of transition to IFRS was therefore 1 April 2004.

The adoption of IFRS has resulted in changes to the FSA accounting policies in the following areas that have a material effect on the amounts reported for the current or prior years:

- Cash flow statements (IAS 7);
- Leases (IAS 17); and

- Intangibles (IAS 38).

In addition, the FSA has elected to adopt the amendments to IAS 19 Employee Benefits issued in December 2004 in advance of their effective date of 1 January 2006. The impact of these amendments has been to expand the disclosures provided in these financial statements in relation to the FSA's defined benefit retirement benefit plan (see note 15). The FSA has elected to recognise actuarial gains and losses arising in its defined benefit plan in the Statement of recognised income and expense.

The FSA, in adopting IFRS, has taken advantage of only one of the exemptions available under IFRS 1. That exemption, under paragraph 20A of IFRS 1, permits disclosure of the amounts required by paragraph 120A(p) of IAS 19 (concerning the present value of our final salary pension scheme's liabilities, the fair value of its assets, and the experience adjustments arising on those assets and liabilities) as the amounts determined for each accounting period prospectively from the date of transition, rather than for the current period and the previous four financial years. Further, no accounting estimates have been adjusted as a result of the adoption of IFRS.

The impact of the above changes in accounting policies is as follows:

Reconciliation of Reserves at 1 April 2004

	note	UK GAAP £m	IFRS adjustments £m	IFRS £m
Non current assets				
Intangible assets	c)	-	9.5	9.5
Property, plant and equipment		25.5	-	25.5
		25.5	9.5	35.0
Current assets				
Trade and other receivables		20.4	-	20.4
Trading investments	a)	-	6.0	6.0
Cash and cash equivalents	a)	32.8	(6.0)	26.8
		53.2	-	53.2
Total assets		**78.7**	**9.5**	**88.2**
Current liabilities				
Trade and other payables		(60.3)	-	(60.3)
Current tax liabilities		(0.6)	-	(0.6)
		(60.9)	-	(60.9)
Total assets less current liabilities		**17.8**	**9.5**	**27.3**
Trade and other payables	b)	-	(9.8)	(9.8)
Long term provisions		(4.6)	-	(4.6)
Net assets excluding retirement benefit obligation		**13.2**	**(0.3)**	**12.9**
Retirement benefit obligation		(80.6)	(0.7)	(81.3)
Net liabilities, including retirement benefit obligation		**(67.4)**	**(1.0)**	**(68.4)**
Accumulated deficit		**(67.4)**	**(1.0)**	**(68.4)**

Reconciliation of Reserves at 31 March 2005

	Notes	UK GAAP £m	IFRS adjustment £m	IFRS £m
Non current assets				
Intangible assets	c)	-	10.9	10.9
Property, plant and equipment		22.1	-	22.1
		22.1	10.9	33.0
Current assets				
Trade and other receivables		18.5	-	18.5
Trading investments	a)	-	17.0	17.0
Cash and cash equivalents	a)	34.7	(17.0)	17.7
		53.2	0	**53.2**
Total assets		**75.3**	**10.9**	**86.2**
Current liabilities				
Trade and other payables		(63.0)	-	(63.0)
Current tax liabilities		(0.6)	-	(0.6)
		(63.6)	-	(63.6)
Total assets less current liabilities		**11.7**	**10.9**	**22.6**
Trade and other payables	b)	-	(10.9)	(10.9)
Long term provisions		(2.9)	-	(2.9)
Net assets excluding retirement benefit obligation		**8.8**	**-**	**8.8**
Retirement benefit obligation		(79.5)	(0.8)	(80.3)
Net liabilities, including retirement benefit obligation		**(70.7)**	**(0.8)**	**(71.5)**
Accumulated deficit		**(70.7)**	**(0.8)**	**(71.5)**

Reconciliation of Surplus for the year ended 31 March 2005

	UK GAAP £m	IFRS adjustments £m	IFRS £m
Administrative costs	(259.4)	0.3	(259.1)
Investment revenue	3.6	-	3.6
Other finance costs	(1.6)	-	(1.6)
Other revenue	11.1	-	11.1
Net costs for year	**(246.3)**	**0.3**	**(246.0)**
Fee revenue	247.7	-	247.7
Surplus on ordinary activities before taxation	**1.4**	**0.3**	**1.7**
Taxation	(1.0)	-	(1.0)
Surplus on ordinary activities after taxation	**0.4**	**0.3**	**0.7**

The net IFRS adjustment is analysed as follows:

	note	£m
Rent free period on property lease	b)	(1.1)
Capitalisation of software development costs	c)	4.8
Amortisation of software development costs	c)	(3.4)
		0.3

Reconciliation of cashflow for the year ended 31 March 2005

	Note	UK GAAP £m	IFRS adjustments £m	IFRS £m
Operating activities				
Surplus for the year		**0.4**	**0.3**	**0.7**
Adjustments for:				
Investment revenues		(3.6)	-	(3.6)
Corporation tax expense		1.0	-	1.0
Amortisation of other intangible assets	c)	-	3.4	3.4
Depreciation of property, plant and equipment		10.3	-	10.3
Increase / (decrease) in provisions		(1.7)	-	(1.7)
Operating cash flows before movements in working capital		**6.4**	**3.7**	**10.1**
Decrease / (increase) in receivables		1.9	-	1.9
Increase / (decrease) in payables	b)	2.7	1.1	3.8
Increase / (decrease) in defined benefit fund				
Service cost		*9.6*	-	*9.6*
Contributions – normal		*(9.4)*	-	*(9.4)*
Contributions – additional deficit reduction		*(6.7)*	-	*(6.7)*
Other finance costs		*1.6*	-	*1.6*
Unfunded pension liability		*0.1*	-	*0.1*
		(4.8)	-	(4.8)
Cash generated from operations		**6.2**	**4.8**	**11.0**

Cash generated from operations		**6.2**	**4.8**	**11.0**
Corporation tax paid		(1.0)	-	(1.0)
Net cash from operating activities		**5.2**	**4.8**	**10.0**
Investing activities				
Interest received		3.6	-	3.6
Purchases of other intangibles	c)	-	(4.8)	(4.8)
Purchases of property, plant and equipment		(6.9)	-	(6.9)
Purchase of trading investments	a)	-	(11.0)	(11.0)
Net cash used in investing activities		**(3.3)**	**(15.8)**	**(19.1)**
Net increase / (decrease) in cash and cash equivalents		**1.9**	**(11.0)**	**(9.1)**
Cash and cash equivalents at the start of the year		32.8	(6.0)	26.8
Cash and cash equivalents at the end of the year		**34.7**	**(17.0)**	**17.7**

The material changes to accounting policies and individual financial impacts are as follows:

a) IAS 7 – Cash flow statements

IAS 7 defines cash as cash on hand and demand deposits and cash equivalents as short term (maturity of less than three months), highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value.

The balance sheet at 31 March 2005 has been restated to reflect the recognition of £17m (2004: £6m) of cash deposits with a term in excess of three months as other receivables. There is no impact on income.

b) IAS 17 (revised) – Leases

IAS 17 requires a lease to be treated as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. If not, then the lease is treated as an operating lease. The assessment must be performed separately for both the land and building components of a lease. Prior to the adoption of IAS 17, the FSA treated all property leases as operating leases and did not differentiate between land and buildings components, spreading rent free periods to the date of the next rent review and charged the lease rental as an expense when incurred.

In accordance with the transitional provisions of IAS 17, the Standard has been applied retrospectively to all leases in place at 1 April 2004. All leases continue to be treated as operating leases with both the land and buildings components having been assessed separately. The rent free period is spread over the life of the lease, rather than to the next rent review, and the lease payments are charged as an expense on a straight line basis over the life of the lease. The payments on 25 The North Colonnade lease are spread on a straight line basis for the remaining life of the lease from November 2003, the date the major terms of the lease were renegotiated.

For 2004/05, the change in accounting policy has resulted in a net increase in the deficit for the year of £1.1m. The balance sheet at 31 March 2005 has been restated to reflect an accrual of £10.9m, being the cumulative difference between cash paid on the lease and the expense charged to the Income statement by spreading the sum of the lease payments including the rent free period on a straight line basis to date.

For 2005/06, the impact is a net charge to the Income statement of £1.1m, and an accrual of £11.9m. The expense being charged to administration costs.

c) IAS 38 – Intangible assets

IAS 38 requires certain internal software development costs to be capitalised and amortised overt their estimated useful life of the relevant assets. Prior to the adoption of IAS 38, the FSA expensed such costs when incurred.

In accordance with the transitional provisions of IAS 38, the Standard has been applied retrospectively to all software development costs incurred since 1st April 2000.

For 2004/05, the change in accounting policy has resulted in a net decrease in the deficit for the year of £1.4m (asset amortisation of £3.4m, capitalised costs of £4.8m). The balance sheet at 31 March 2005 has been restated to reflect the recognition of an intangible asset at cost of £16.8m, and accumulated amortization of £5.9m.

For 2005/06, the impact is a net debit to income of £0.8m being capitalised costs of £4.5m and amortization of £5.3m and a net asset value of £10.1m. The expense is charged to administration costs.

Statement of allocation of costs for the year ended 31 March 2006

Introduction

The FSA sets fees by reference to blocks of fee payers conducting similar activities, which so far as possible, reflect the FSA's costs applicable to the respective fee blocks. The statement of allocation of costs on page [ ] shows the allocation of costs for the year ended 31 March 2006, analysed by those fee blocks.

Costs are allocated according to the method set out in note 1 on page [ ]. The report of the auditors is set out on page [ ].

Notes to the statement of allocation of costs for the year ended 31 March 2006

1 Method of allocation

The Financial Services and Markets Act 2000 provides that the FSA may make rules providing for the payment of fees to meet its expenses in carrying out its function, or for any incidental purposes and to maintain adequate reserves.

Under the current fee-raising arrangements, the FSA's fees are set by reference to costs applicable to categories of firms or bodies or individual bodies (fee-payers). These categories are known as fee blocks. The allocation of costs to fee blocks is primarily made by reference to costs applicable to each fee payer. Where costs cannot be directly attributed to individual fee payers they have been allocated to fee blocks on a basis considered appropriate by the Directors, such as on the headcount of departments, or the estimated time or resources spent on the supply of services for each fee payer within departments.

2 Allocation of net liabilities, excluding pensions liabilities

We apply IAS 19 in accounting for the costs of our defined benefit pension scheme. Given the long term nature of our final salary pension liabilities, and the fact that we cannot predict with certainty how our resources will be allocated over this time scale, we do not allocate those pensions liabilities to fee blocks.

3 Reconciliation from the Income statement to net costs for the year as shown on the cost allocation statement

	Year ended 31 March 2006 £m
Net costs for the year	263.1
Add: difference between accounting changes for provisions in the statutory accounts and the cash costs of pension contributions paid	9.1
Net costs for the year on statement of allocation of costs	**272.2**

While adopting IAS 19 provides greater transparency of the impact of pension costs on our financial position, it introduces significant volatility into both the figures reported in our income and expenditure account and in our balance sheet. In order to prevent IAS 19 transmitting this volatility into our fee calculations, we exclude any non-cash elements of pension costs from our Annual Funding Requirement (AFR). The main non-cash item excluded is the net finance cost (£0.8m). Our AFR is calculated to include only the cash value of the pension contributions we need to make in a year to cover the increase in the scheme's final salary liabilities due to additional years' service and to salary increases. Also, the AFR includes any deficit reduction contributions aimed at reducing the size of the scheme's deficit to ensure that it can meet its obligations. This is consistent with the fact that, as mentioned above, we have not allocated the pensions liabilities to fee blocks.

Full details of the calculation of the AFR for 2006/07 are included in Final regulatory fees levies 2006/07 including feedback on CP06/2, published in May 2006.

Statement of allocation of costs for the year to 31 March 2006

	Fee Block	Net assets, excluding pensions liabilities at 1 April 2005 £m	Net costs for the year £m	Fees for the year £m	Net assets, excluding pensions liabilities, at 31 March 2006 £m
A.1	Deposit acceptors	5.4	54.4	52.3	3.3
A.2	Mortgage lenders and administrators	(1.1)	4.4	4.9	(0.6)
A.3	General insurers	1.7	16.5	14.0	(0.8)
A.4	Life insurers	2.2	39.5	38.3	1.0
A.5	Lloyd's Managing Agents	(0.2)	0.7	0.7	(0.2)
A.6	The society of Lloyd's	-	1.1	1.2	0.1
A.7	Fund managers	1.0	24.7	25.5	1.8
A.9	CIS operators, trustees and depositories	0.3	4.4	4.6	0.5
A.10	Firms dealing as principal	1.8	14.0	12.3	0.1
A.12	Advisory arrangers holding client money and/or assets	(0.4)	16.1	16.8	0.3
A.13	Advisory arrangers not holding client money and/or assets	3.5	37.0	36.3	2.8
A.14	Corporate Finance Advisors	0.7	5.7	5.8	0.8
A.16	Pensions review	0.2	0.2	-	-
A.18	Mortgage lenders, advisers, and arrangers	(1.9)	7.2	8.0	(1.1)
A.19	General insurance mediation	(4.9)	23.8	27.7	(1.0)
B	RBs	0.3	4.5	4.5	0.3
C	CIS	0.2	1.3	1.2	0.1
D	DPBs	0.1	0.1	0.3	0.3
E	UKLA	(0.5)	14.7	14.7	(0.5)
F	Registrant only	0.4	1.9	1.5	-
Total		8.8	272.2	270.6	7.2

The fee block descriptions above have been summarised for the purposes of this statement. A full description of the fee block can be found in the relevant section of the FSA's Handbook.

REPORT BY INDEPENDENT AUDITORS TO THE DIRECTORS OF THE FINANCIAL SERVICES AUTHORITY ON THE STATEMENT OF ALLOCATION OF COSTS

We have examined the statement of allocation of costs to regulated fee payers ("the Statement") for the year ended 31 March 2006 and the related notes 1 to 3, as prepared by the directors of the company. The Statement has been prepared on the basis set out in note 1.

This report is made solely to the directors of the company. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the directors of the company, as a body, for our review, for the statement, or for the opinions we have formed.

Respective responsibilities of directors and RSM Robson Rhodes LLP

The company's directors are responsible for the assumptions and basis on which the costs are allocated to fee payers and the preparation of the Statement in accordance with note 1. We have performed certain procedures on the Statement, in accordance with our engagement letter dated 2 December 2005, to verify that the assumptions made by the directors have been applied to the allocated amounts.

Basis of opinion

The procedures we performed did not constitute a review or an audit of any kind and consisted primarily of verifying whether the figures in the Statement have been compiled from amounts extracted from the company's accounting records, and in accordance with the basis set out in note 1.

The procedures we performed were not designed to and are not likely to reveal fraud and there is no assurance that our procedures will reveal all matters of significance related to the Statement.

Opinion

In our opinion, the Statement has been compiled from amounts extracted from the accounting records and has been prepared in accordance with the basis set out in note 1.

RSM Robson Rhodes LLP

RSM Robson Rhodes LLP
Chartered Accountants
London

25 May 2006