The Financial Services Authority

Accounts
for the year ended 31 March 2004

Contents

Registered Number 1920623

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

We have audited the financial statements of the Financial Services Authority for the year ended 31 March 2004 which comprise the income and expenditure account, the statement of total recognised gains and losses, the reconciliation of movements in reserves, the balance sheet, the statement of cash flows, and the related notes 1 to 21. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the directors' remuneration report 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

As described in the statement of directors' responsibilities, the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the annual report including the directors' remuneration report. Our responsibility is to audit the financial statements and the part of the directors' remuneration report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if 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 transactions with the company is not disclosed.

We review whether the corporate governance statement reflects the company's compliance with the seven provisions of the Combined Code specified for our review, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the company's corporate governance procedures or its risk and control procedures.

We read the directors' report and the other information contained in the annual report for the above year as described in the contents section including the unaudited part of the directors' remuneration report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes an examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the directors' remuneration report described as having been 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 circumstances of the company, 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 directors' remuneration report described as having been 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 directors' remuneration report described as having been audited.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of the company's affairs as at 31 March 2004 and of its surplus for the year then ended; and
- the financial statements and the part of the directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London

20 May 2004

Income and expenditure account for the year ended 31 March 2004

	Notes	2004 £m	2003 £m
Administrative costs	2	232.2	218.1
Interest payable		-	0.1
Interest receivable		(1.9)	(1.2)
Other finance costs	13d	3.8	-
Other income	5	(9.4)	(8.7)
Net costs for year		224.7	208.3
Fees receivable	6	236.4	209.4
Surplus on ordinary activities before taxation		11.7	1.1
Taxation	7	(0.6)	(0.3)
Surplus on ordinary activities after taxation		**11.1**	**0.8**

All results are derived from continuing operations.

Statement of total recognised gains and losses for the year ended 31 March 2004

	Notes	**2004 £m**	2003 £m
Surplus for the year		11.1	0.8
Actuarial gains and losses for the year in respect of pension scheme	13e	23.7	(69.3)
Total recognised gains and losses for the year		**34.8**	**(68.5)**

Reconciliation of movements in reserves for the year ended 31 March 2004

	2004 £m	2003 £m
Total recognised gains and losses for the year	34.8	(68.5)
Accumulated deficit at beginning of year	(102.2)	(33.7)
Accumulated deficit at end of year	**(67.4)**	**(102.2)**

Balance sheet as at 31 March 2004

	Notes	**2004 £m**	2003 £m
Fixed assets			
Tangible assets	8	25.5	28.2
Current assets			
Debtors – recoverable deferred costs: amounts falling due after more than one year	10	-	8.0
Debtors: amounts falling due within one year	9	20.4	15.0
Cash at bank and in hand		32.8	4.2
		53.2	27.2
Current liabilities			
Creditors: amounts falling due within one year	11	(60.9)	(52.1)
Net current liabilities		**(7.7)**	**(24.9)**
Total assets less current liabilities		17.8	3.3
Provisions for liabilities and charges	12	(4.6)	(3.3)
Net assets, excluding pensions liabilities		13.2	-
Net pensions liabilities	13b	(80.6)	(102.2)
Net liabilities, including pensions liabilities		**(67.4)**	**(102.2)**
Accumulated deficit		**(67.4)**	**(102.2)**

Approved by the Board on 20 May 2004

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

Statement of cash flows for the year ended 31 March 2004

	Notes	**2004 £m**	2003 £m
Net cash inflow from operating activities	15	33.3	8.9
Returns on investments and servicing of finance			
Interest received		1.9	1.2
Interest paid		-	(0.1)
Net cash inflow from returns on investments and servicing of finance		1.9	1.1
Taxation			
Corporation tax paid		(0.3)	(0.4)
Capital expenditure			
Payments to acquire tangible fixed assets	8	(7.1)	(7.5)
Receipts from asset disposals		-	0.1
Net cash outflow from capital expenditure		(7.1)	(7.4)
Net cash inflow before management of liquid resources and financing		27.8	2.2
Management of liquid resources	17	(28.1)	0.8
Financing			
Movement in short term borrowings		-	(5.5)
Movement in long term borrowings		-	(10.9)
Net cash outflow from financing		-	(16.4)
Penalties received		12.4	9.2
Penalties applied against fees receivable		(9.5)	(0.1)
Net cash inflow from penalties		2.9	9.1
Increase/(decrease) in cash	17	**2.6**	**(4.3)**

Notes to the accounts – 31 March 2004

1. Principal accounting policies

The accounts have been prepared under the historical cost convention and in accordance with applicable accounting standards in the United Kingdom. The accounting policies have been consistently applied in the current and prior year. A summary of the principal accounting policies is set out below:

a. Income and expenditure account

The format of the income and expenditure account on page 4 has been modified from the format specified in the Companies Act 1985 to show costs before fees levied to cover those costs. It is considered that the 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. Fees receivable

These represent the fees to which the company was entitled in respect of the financial year.

c. Tangible fixed assets

Depreciation is calculated to write off the cost less estimated residual value of tangible fixed assets on a straight-line basis over the expected useful economic lives of the assets concerned. The principal annual rates used for this purpose are:

	%
Leasehold improvements	10
Computer equipment	33
Furniture and equipment	10

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

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.

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.

e. 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 which will have to be settled.

f. Pension scheme payments

The company operates both a money purchase scheme and a defined benefit pension scheme. The costs of the money purchase scheme are charged to the income and expenditure account as incurred. The costs for the defined benefit pension scheme are accounted for in accordance with FRS 17, so the full service cost of providing the defined benefit scheme, together with the cost of any benefits relating to past service, is charged to the income and expenditure account. A charge equal to the expected increase in the present value of the scheme liabilities (because the benefits are now closer to settlement) and a credit equivalent to the equivalent value of the long-term expected return on the defined benefit scheme's assets (based on the market value of those assets at the start of the period), are included in the income and expenditure account in 'other finance costs'. The difference between the market value of the assets of the scheme and the present value of accrued pension liabilities is shown as a net liability on the balance sheet. Any difference between the expected return on assets and that actually achieved is recognised in the statement of total recognised gains and losses, along with differences which arise from experience or assumption changes.

g. Recoverable deferred costs

Certain costs relating to the formation of the FSA in 1998 and 1999 and the incorporation of the UK Listing Authority have been deferred. These costs are being invoiced to firms over a period of three years following the coming into force of the FSA's powers under the Financial Services and Markets Act 2000 (FSMA), which took effect on 1 December 2001. Certain costs relating to the development of the regime for new areas of regulatory responsibility are also deferred and will be recovered through application fees for those activities. These costs are charged to the income and expenditure account in the period in which they are recoverable.

h. Financial penalties received

Under 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 following financial year. Penalties received are included in creditors: amounts falling due within one year.

i. Operating leases

Operating lease rentals are charged to the income and expenditure account on a straight-line basis.

2. Administrative costs

Of the increase in administrative costs of £14.1m, £9.5m is attributable to the FSA's new responsibilities for the regulation of mortgages and general insurance broking activity.

Administrative costs include:

	2004	2003
	£m	£m
Employment costs (note 4)	147.4	129.0
Operating lease rentals		
Leasehold premises	7.5	5.8
Depreciation (note 8)	9.5	8.9
Amortisation of deferred costs (note 10)	9.9	5.0

	2004		2003	
	£'000	%	£'000	%
Auditors' remuneration	78	10	84	8
Fees paid to the FSA's auditors or their associates in connection with non-audit work				
Secondments	382	47	575	53
Specialist regulatory advice	325	40	425	39
Preparation of specialist training materials	24	3	-	-
Total	**809**	**100**	**1,084**	**100**

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

Non-audit fees paid to Deloitte & Touche LLP during 2002/03 primarily relate to the secondment of a number of partners and staff, originally partners and staff of Arthur Andersen, who from the 1 August 2002 were admitted to the Deloitte & Touche LLP partnership. Secondees 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 on certain consultation papers and other policy-related projects.

The Audit Committee has reviewed the nature and content of non-audit work performed by the auditors to ensure that audit independence is not impaired. Further details of the procurement procedures for these services are included in the corporate governance report on page [x].

3. Directors' remuneration

Information on directors' remuneration is included in the Remuneration Report in the Directors' Report on pages XX to XX, and forms part of these financial statements.

4. Employee information

a. The average number of employees (including executive directors) during the year was:

	2004	2003
Supervision and policy	1,300	1,337
Enforcement and consumer relations	499	475
Central departments	151	136
Operations and support	353	325
	2,303	2,273

At 31 March 2004, the FSA had 2,312 (2003: 2,288) employees.

b. Employment costs comprise:	**Notes**	**2004 £m**	2003 £m
Gross salaries and taxable benefits		120.2	104.8
Employer's National Insurance costs		10.6	9.4
Employer's pension costs			
Included in administrative costs:			
current service cost		16.6	14.8
	2	147.4	129.0
Employer's pension costs			
Included in other finance costs	13d	3.8	-
Included in statement of total recognised gains and losses	13e	(23.7)	69.3
Total employment costs		**127.5**	198.3

5. Other income

Other income comprises:

	2004	2003
	£m	£m
Information and training services	4.5	4.0
Application fees and other regulatory income	3.5	3.0
Other sundry income	1.4	1.7
	9.4	8.7

In the year ended 31 March 2004, other sundry income included £0.7m (2003: £1.0m), which related to adjustments to the amounts due to fee payers in respect of pre-N2 fees paid to predecessor regulators. These amounts will reduce fees payable in 2004/05.

6. Fees receivable

All fees are payable under the Financial Services and Markets Act 2000. Fees for 2003/04 include £4.9m (2003: £nil) in respect of applications from firms wishing to conduct mortgages and general insurance broking activities.

7. Taxation

a) Analysis of tax charge on ordinary activities

	2004	2003
	£m	£m
United Kingdom corporation tax at 30% (2003: 30%)	**0.6**	0.3

b) Factors affecting tax charge for the current period

The tax assessed for the period is higher than that resulting from applying the standard rate of corporation tax in the United Kingdom: 30%.

The differences are explained below:

	2004 £m	2003 £m
Surplus on ordinary activities before tax	11.7	1.1
Tax at 30% thereon	3.5	0.3
Effects of:		
Activities not subject to corporation tax	(4.1)	-
Other finance income reported under FRS 17	1.2	-
Current tax charge for the period	**0.6**	0.3

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

8. Tangible fixed assets

	Leasehold *improvements* £m	**Computer *equipment* £m**	**Furniture and *equipment* £m**	***Total* £m**
Cost				
At 1 April 2003	**19.8**	**32.8**	**10.1**	**62.7**
Additions	-	6.9	0.2	7.1
Disposals	-	(9.2)*	-	(9.2)
At 31 March 2004	**19.8**	**30.5**	**10.3**	**60.6**
Depreciation				
At 1 April 2003	**8.0**	**20.0**	**6.5**	**34.5**
Charge for year	1.9	7.0	0.6	9.5
Disposals	-	(8.9)*	-	(8.9)
At 31 March 2004	**9.9**	**18.1**	**7.1**	**35.1**
Net book value				
At 31 March 2004	**9.9**	**12.4**	**3.2**	**25.5**
At 31 March 2003	11.8	12.8	3.6	28.2

* included within disposals is an elimination of £8.7m of fully depreciated assets no longer in use.

9. Debtors: amounts falling due within one year

	2004 £m	2003 £m
Trade debtors	5.0	0.9
Recoverable deferred costs (note 10)	10.6	5.0
Other debtors	1.4	1.3
Prepayments	3.4	7.8
	20.4	**15.0**

10. Debtors – recoverable deferred costs

	Mainstream regulation £m	**Mortgages and general insurance broking £m**	**Total £m**
At 1 April 2003	8.3	4.7	13.0
Additions: during the year	-	7.5	7.5
	8.3	12.2	20.5
Less: recovered in year	(5.0)	(4.9)	(9.9)
At 31 March 2004	**3.3**	**7.3**	**10.6**

At 31 March 2004 £nil (31 March 2003: £8.0m) of the amount recoverable falls due after more than one year.

The costs relating to the formation of the FSA in 1998 and 1999 and the incorporation of the UK Listing Authority function are being invoiced to firms and recovered evenly over a period of three years from 1 December 2001, the date when the full powers under FSMA became effective. The costs relating to mortgages and general insurance broking will be recovered primarily from application fees payable by firms who will undertake these activities. We expect that all of these costs will be fully recovered by 31 March 2005. From 15 January 2004, when we started to receive applications for mortgages and general insurance broking activities, all costs relating to the regulation of these activities have been expensed as incurred.

11. Creditors: amounts falling due within one year

	2004 **£m**	2003 £m
Bank overdraft	-	2.1
Trade creditors	4.7	10.6
Corporation tax	0.6	0.3
Other taxation and social security	2.2	0.3
Financial penalties to be applied against fees receivable	12.1	9.2
Accruals and other creditors	25.4	22.0
Fees in advance	15.9	7.6
	60.9	**52.1**

12. Provisions for liabilities and charges

a) Costs on Gavrelle House

	2004 **£m**	2003 £m
Provision at 1 April	0.4	0.6
Utilised in the year	(0.2)	(0.2)
Charge in the year	1.4	-
Provision at 31 March	**1.6**	**0.4**

During 1998/99 the FSA vacated its previous premises at Gavrelle House, 2/14 Bunhill Row, London. The Gavrelle House lease, which was for 25 years from 16 July 1990, has been assigned by the FSA to a third party for the remaining term of the lease from 26 May 1998.

The provision was set up to provide for the total rent and associated costs payable until the end of the lease period, 16 July 2015, net of rent receivable from the assignee. During 2003/04, the market has weakened and further provision has been made to cover the remaining period of the lease to 2015.

b) Repairs and replacement costs

	2004	2003
	£m	£m
Provision at 1 April	2.9	2.1
Utilised in the year	-	(0.1)
Charge in the year	0.1	0.9
Provision at 31 March	**3.0**	**2.9**
Total of provisions a) and b) at 31 March	**4.6**	**3.3**

Under the terms of its lease on 25 The North Colonnade, Canary Wharf, London, the FSA is obliged to repair and replace certain items of equipment in the premises and to make good the condition of the building at the end of the lease. The estimated cost of this obligation is charged to the income and expenditure account over the life of the lease and the cumulative cost, less amounts spent is included in provisions for liabilities and charges.

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

	2004	2003
	£m	£m
Within one year	0.3	0.1
Between one and two years	0.2	0.1
Between two and five years	0.9	0.1
In five years or more	3.2	3.0
	4.6	**3.3**

After the year end the FSA agreed a Deed of Variation which altered its repair and replacement obligations, as described in note 21.

13. Accounting for pensions costs

The FSA operates a tax-approved pension scheme open to permanent employees. The pension scheme was established on 1 April 1998 and operates on both a defined benefit and defined contribution (money purchase) 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 defined contribution section of the scheme. Since the defined benefit section of the scheme is closed to new members and the age profile of the active members is increasing, under the projected unit method, the current service cost will increase as members of the scheme approach retirement. The defined benefit section of the scheme is non-contributory for members. The defined contribution 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.

Defined benefit scheme

The latest full actuarial valuation of the FSA pension scheme was carried out as at 1 April 2002 by an independent actuary, using the projected unit method. The actuary has also valued the scheme as at 31 March 2003 for the purposes of FRS 17 and updated the valuation at 31 March 2004.

a) Actuarial assumptions used in valuing the liabilities of the defined benefit pension scheme

The major assumptions used by the actuary were:

	At 31 March 2004	At 31 March 2003	At 31 March 2002
Rate of increase of salaries	4.0%	4.0%	5.0%
Corporate bond discount rate	5.5%	5.4%	6.0%
Inflation assumption	2.5%	2.5%	2.5%
Pension Increases	2.5%	2.5%	2.5%

b) Fair values and expected rates of return on the assets of the defined benefit pension scheme

The assets and liabilities in the scheme and the expected rates of return were:

	Expected rate of return at 31 March 2004	Fair value at 31 March 2004 £m	Expected rate of return at 31 March 2003	Fair value at 31 March 2003 £m	Expected rate of return at 31 March 2002	Fair value at 31 March 2002 £m
Equities	7.75%	124.1	7.5%	91.4	8.0%	119.1
Corporate Bonds	5.5%	15.5	5.4%	13.0	6.0%	14.2
Gilts	4.75%	15.6	4.5%	13.0	5.3%	13.2
Cash		1.3		1.0		1.2
Total market value of scheme assets		156.5		118.4		147.7
Less: Present value of scheme liabilities		(235.8)		(219.3)		(178.9)
Deficit in the scheme		**(79.3)**		(100.9)		(31.2)
Unfunded pension liabilities		(1.3)		(1.3)		(1.1)
Net pension liabilities		**(80.6)**		(102.2)		(32.3)

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

c) Amounts included within the income and expenditure account

	2004	2003
	£m	£m
Current service cost included within administrative costs	9.8	9.3

The contribution rate for 2003/04 was 20.3% of pensionable earnings plus £2.5m (5.6% of pensionable earnings) as an additional deficit reduction contribution. The agreed contribution rate for 2004/05 is 21.3% of pensionable earnings plus £5.0m (approximately 12% of pensionable earnings) as an additional deficit reduction contribution.

d) Amounts included as other finance costs

		2004	2003
		£m	£m
Expected return on assets		8.4	11.3
Less: Interest cost on scheme liabilities		(12.2)	(11.3)
Net finance return included as other finance costs	4b	**(3.8)**	-

e) Amounts included in the statement of total recognised gains and losses

		2004	2003
		£m	£m
Difference between actual and expected return on assets		21.0	(48.2)
Experience losses arising on scheme liabilities		(2.6)	(2.4)
Effects of changes in assumptions underlying the present value of the scheme liabilities		5.3	(18.7)
Total actuarial gains and losses recognised in the statement of total recognised gains and losses	4b	**23.7**	(69.3)

f) Analysis of movement in the scheme deficit during the year

	2004	2003
	£m	£m
Opening deficit in the scheme	(100.9)	(31.2)
Less: current service cost	(9.8)	(9.3)
Add: contributions	11.5	8.9
Other finance costs	(3.8)	-
Actuarial gains/(losses)	23.7	(69.3)
Closing deficit in the scheme	**(79.3)**	(100.9)

g) History of experience gains and losses

	2004	2003	2002
Difference between the expected and actual returns on scheme assets:			
Amount (£m)	21.0	(48.2)	(6.1)
percentage of scheme assets	13%	(41%)	(4%)
Experience gains and losses on scheme liabilities:			
Amount (£m)	(2.6)	(2.4)	2.9
percentage of the present value of scheme liabilities	(1%)	(1%)	2%
Total amount recognised in statement of total gains and losses:			
Amount (£m)	23.7	(69.3)	(3.2)
percentage of the present value of scheme liabilities	10%	(32%)	(2%)

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 2004 the liability is £1.3m (2003: £1.3m) to cover the cost of these promises. An amount of £nil (2003: £0.2m) is included in the total pension cost for the year in note 4, representing the value of the additional benefits accrued.

Defined contribution scheme

The cost of the defined contribution scheme during 2004 was £5.4m (2003: £4.0m).

14. Capital expenditure

The FSA had entered into contracts at 31 March 2004 for capital expenditure totalling £0.6m (2003: £0.1m), which are not provided for in the accounts.

15. Reconciliation of the surplus on ordinary activities to net cash inflow from operating activities

The income and expenditure account on page 4 is prepared on an accruals basis and reflects all costs and revenues relating to each financial year, whereas the cash flow statement on page 7 reflects cash movements only. The statement set out below relates cash flows to items shown in the income and expenditure account:

	Notes	2004 £m	2003 £m
Surplus on ordinary activities before tax		11.7	1.1
Items not affecting operating cash flow but which relate to the year:			
Depreciation	8	9.5	8.9
Loss on sale of assets		0.3	-
Interest receivable		(1.9)	(1.2)
Interest payable		-	0.1
Movements in:			
Recoverable deferred costs		2.4	1.7
Trade debtors		(4.1)	12.3
Other debtors and prepayments		4.3	(3.5)
Trade creditors		(5.9)	0.6
Other creditors and social security		13.6	(12.3)
Net movement in provision for liabilities and charges	12b	1.3	0.6
Defined benefit pension costs			
current service cost	13f	9.8	9.3
contributions	13f	(11.5)	(8.9)
normal contribution		(9.0)	*(6.9)*
additional deficit reduction contributions		(2.5)	*(2.0)*
other finance costs	13f	3.8	-
unfunded pension liabilities		-	0.2
		2.1	0.6
Net cash inflow from operating activities		**33.3**	8.9

16. Reconciliation of net cash flow to movement in net funds/(net debt)

	2004	2003
	£m	£m
Increase/(decrease) in cash	2.6	(4.3)
Cash outflow/(inflow) from increase/(decrease) in liquid resources	28.1	(0.8)
Cash outflow from decrease in debt financing	-	16.4
Movement in net funds in the year	30.7	11.3
Net funds/(debt) at beginning of year	2.1	(9.2)
Net funds at end of year	**32.8**	2.1

17. Analysis of changes in net funds

	At 1 April 2003	**Cash flows**	**At 31 March 2004**
	£m	**£m**	**£m**
(Bank overdraft)/cash at bank	(2.1)	2.6	0.5
Liquid resources	4.2	28.1	32.3
	2.1	**30.7**	**32.8**

Liquid resources consist of bank deposits with a maturity period greater than one day and less than one year. These balances are included within cash at bank in the balance sheet.

18. Lease commitments

Annual commitments under non-cancellable operating leases are as follows:

	Land and buildings	
	2004	2003
	£m	£m
Operating leases which expire:		
After five years	8.2	8.2
	8.2	8.2

The lease on 25 The North Colonnade, Canary Wharf, London contained provisions for an upward-only rent review on 4 November 2003. At 31 March 2004, the negotiations on the rent review had not been finalised. They were concluded after the year end and the main terms of the agreement reached are described in note 21.

19. 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. FSCS came into operation on 30 November 2001. It is considered that FSCS is 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 2004 was £0.2m (2003: £0.1m). The charge for the service was £0.2m (2003: £0.1m), and other costs invoiced by FSCS to the FSA amounted to £nil (2003: £0.1m).

The FSA is a party to the lease agreement for FSCS's premises, occupied from 18 June 2001 at Lloyd's 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 outgoings 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. FOS is regarded as a related party.

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 2004/05 fees. At 31 March 2004 £1.8m of on-account fees for 2004/05 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 (2003: £15m) available for draw down from 24 January 2003 and repayable by 2008. Amounts outstanding under the facility are guaranteed by the FSA. As at 31 March 2004, £7.5m (2003: £9.5m) of the facility was drawn down.

c) HM Treasury

In 2002/03 £2.4m was transferred from HM Treasury to the FSA, being the last four months' of the annual fees insurance firms had paid to HM Treasury in 2001/02. This amount has since been credited against fees due to the FSA by insurance firms. At 31 March 2003 £1.6m of these funds had still not been so applied.

Before 1 December 2001, the FSA recharged costs that it had incurred in relation to the review of Equitable Life to HM Treasury. Those costs have been recovered through the fees paid by insurance firms, to reimburse HM Treasury. The balance of fees collected on HM Treasury's behalf at 31 March 2004 was £1.5m (2003: £1.4m). This will be paid to HM Treasury during 2004/05.

d) The SROs (IMRO, PIA and SFA)

The FSA became a corporate member of the PIA and IMRO in June 2000 and the SFA in April 2001, with power to appoint board members.

On 30 November 2001 the reserves of the SROs were transferred to the FSA to be held to the account of the former members of the SROs. The amounts transferred have since been credited against fees due to the FSA by the former members during the period from 1 December 2001 to 31 March 2004. The balances on these accounts were £nil at 31 March 2004 (2003: IMRO £0.5m, PIA £0.5m and SFA £1.1m).

The SROs entered into members' voluntary liquidation on 11 March 2002.

Other than disclosed above, there were no related party transactions during the year (2003: £ 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. Post Balance Sheet Event

On [14] May 2004 the FSA agreed a Deed of Variation with the landlord of its main premises at 25 The North Colonnade. The principal terms of that Deed are as follows:

a) The FSA gave up its option to terminate the lease in 2013. The lease will expire in 2018.
b) The provisions for upward-only rent reviews every five years have been removed (see note 18). The rent for the period from 4 November 2003 to 3 November 2004 has been 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 2013 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. The impact of this change is to reduce the rent due from 4 November 2003 to 31 March 2004 by £0.2m compared to the amount provided for in these accounts.
c) The FSA's obligations to repair and replace certain items of equipment in the premises and to make good the condition of the building at the end of the lease have been made less onerous. The impact of this is to reduce by £0.9m the provision for repairs and replacement costs (see note 12(b)) which is required as at 31 March 2004.

The impact of these changes will be accounted for in 2004/05.

Statement of allocation of costs for the year ended 31 March 2004

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 29 shows the allocation of costs for the year ended 31 March 2004, analysed by those fee blocks.

Costs are allocated according to the method set out in note 1 on page 28. The report of the auditors is set out on page 30.

Notes to the statement of allocation of costs for the year ended 31 March 2004

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 FRS 17 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 and expenditure account to net costs for the year as shown on the cost allocation statement

	Year ended 31 March 2004 £m
Net costs for the year	224.7
Less: non-cash elements of pension costs (see below)	(4.6)
Add: Pension deficit reduction contribution	2.5
Add: Taxation	0.6
Net costs for the year on statement of allocation of costs	**223.2**

While adopting FRS 17 provides greater transparency of the impact on 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 FRS 17 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 (£3.8m). 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 2004/05 are in the Feedback statement on CP04/02**, published in May 2004.

Statement of allocation of costs for the year to 31 March 2004

	Fee Block	Net assets, excluding pensions liabilities at 1 April 2003 £m	Net costs for the year £m	Fees for the year £m	Net assets, excluding pensions liabilities, at 31 March 2004 £m
A.1	Deposit acceptors	1.7	49.3	51.3	3.7
A.3	General insurers	0.6	12.3	13.6	1.9
A.4	Life insurers	-	31.1	32.9	1.8
A.5	Lloyd's Managing Agents	-	0.7	0.8	0.1
A.6	The Society of Lloyd's	0.1	1.1	1.1	0.1
A.7	Fund managers	0.3	22.4	24.2	2.1
A.9	CIS operators, trustees and depositories	(0.6)	4.2	4.7	(0.1)
A.10	Firms dealing as principal	(0.3)	11.5	12.7	0.9
A.12	Advisory arrangers holding client money and/or assets	(0.8)	14.5	16.0	0.7
A.13	Advisory arrangers not holding client money and/or assets	0.9	34.9	36.1	2.1
A.14	Corporate Finance Advisors	0.2	5.2	5.4	0.4
A.16	Pensions review	(2.0)	7.6	13.5	3.9
B	RBs	0.5	4.4	4.2	0.3
C	CIS	(0.2)	1.7	1.7	(0.2)
D	DPBs	0.1	0.4	0.3	-
E	UKLA	(0.5)	11.0	11.4	(0.1)
F	Registrant only	-	1.4	1.6	0.2
	Mortgages and general insurance broking*	-	9.5	4.9	(4.6)
Total		-	223.2	236.4	13.2

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.

* The fee blocks covering these activities are A.2, A.18 and A.19. The allocation of costs to these individual fee blocks will be finalised during 2004/05.

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 organisations for the year ended 31 March 2004 and the related notes 1 to 3. This 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 Deloitte

The company's directors are responsible for the preparation of the statement of allocation of costs in accordance with the basis set out in note 1. It is our responsibility to form an independent opinion, based on our examination, on the statement of allocation of costs and to report our opinion to you.

Basis of opinion

Our examination, which was substantially less in scope than an audit performed in accordance with United Kingdom auditing standards, consisted primarily of checking whether the figures in the statement of costs had been compiled from the amounts recorded in the accounting records and an assessment of the significant estimates and judgements made by the directors in the preparation of the statement of allocation of costs. There is no assurance that our review will reveal all matters of significance related to the cost allocations.

Opinion

In our opinion, the statement of allocation of costs has been compiled from amounts recorded in the accounting records and has been properly prepared in accordance with the basis set out in note 1.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants
London

20 May 2004

Report of the Directors for the year ended 31 March 2004

The directors of the Financial Services Authority (FSA) present their report for the year ended 31 March 2004 together with the audited financial statements of the company for the same period.

Principal activities

The FSA is the single statutory regulator of financial services in the UK. It regulates and supervises banks and deposit takers, investment businesses, wholesale markets, insurance companies and markets, and supervises the listing of UK traded securities. The Financial Services and Markets Act 2000 (FSMA) sets the FSA four regulatory objectives in connection with its regulation of financial services in the UK:

- maintaining confidence in the financial system;
- promoting public understanding of the financial system;
- securing the appropriate degree of protection for consumers of financial services; and
- reducing the extent to which regulated financial services businesses can be used for purposes connected with financial crime.

Review of the FSA's activities

In pursuit of the objectives outlined above, the FSA has continued to undertake a range of regulatory activities during the year on which information can be found in the main body of this report. These activities include: maintaining efficient, orderly and clean financial markets; protecting consumers; and improving the FSA's business capabilities.

The FSA has updated and amended its regulatory policy during the year in the light of its changing regulatory responsibilities, and developments in the European Union and elsewhere. It has carried out cost benefit analysis and research in line with the requirements of FSMA. Details of recent policy developments, and the supporting research, can be found in the list of Consultation and Discussion Papers on the FSA's website.

Financial position

The main source of the FSA's income is the fees from those whom it recognises, authorises or permits. The fees are retained and applied to the costs of discharging its statutory functions. The accounts show that in the year ended 31 March 2004 the FSA had a surplus of income over expenditure of £11.1m (2003 - £0.8m). This surplus arose because of the need for the FSA to increase its reserves from the level at 31 March 2003. The FSA expects its income and expenditure in 2004/05 to be broadly equal.

The accounts also show that the FSA had net liabilities of £67.4m at 31 March 2004 (2003 £102.2m) because of the deficit of £80.6m (2003: £102.2m) on the pension scheme, as measured by Financial Reporting Standard 17 (FRS 17). The pensions liabilities will not crystallise for many years. The FSA's approach to managing its pensions liabilities and funding the pensions deficit is explained in the Financial Review, on page xx. Despite the large deficit as currently reported under FRS 17, the FSA believes that it remains able to meet its liabilities as they fall due. This belief is underpinned by the FSA's statutory powers to raise fees.

Supplier payment policy

The FSA's policy is to pay all suppliers within 30 days of receipt of invoice. It is not the FSA's policy to follow any published code or standard on payment practice or necessarily to agree terms of payment with suppliers in advance.

Directors

All FSA directors are appointed by HM Treasury (HMT). The directors during the year were as follows. The dates of expiry of appointment, or of retirement, are shown in brackets.

Callum McCarthy (21 September 2008)*
Stewart Boyd QC (Deputy Chairman) (31 March 2004)
Moira Black CBE (30 November 2004)
Howard Davies (21 September 2003) *

James Crosby (14 January 2007)

Tom de Swaan (18 January 2007)

Michael Foot, CBE (31 May 2004) *

Kyra Hazou (18 January 2007)

Deirdre Hutton, CBE (10 December 2006)

Sir Andrew Large (10 September 2005)+

Gillian Nott OBE (30 November 2004)

Christopher Rodrigues (10 December 2003)

Dr Shamit Saggar (30 November 2004)

Carol Sergeant (7 November 2003) *

Stephen Thieke (1 November 2005)

John Tiner (21 September 2006) *

Sir Keith Whitson (30 May 2003)

Clive Wilkinson (18 January 2007)

* Executive directors

+ Sir Andrew Large, Deputy Governor, Financial Stability, Bank of England, is an ex-officio member of the Board of the FSA. In a reciprocal arrangement with the Bank of England, Callum McCarthy serves (and previously Howard Davies served) as a member of the Court of the Bank of England. John Tiner and Michael Foot do not hold any external directorships.

Changes to the composition of the Board during the year were as follows. Sir Keith Whitson retired on 30 May 2003 and Christopher Rodrigues retired on 10 December 2003. Howard Davies resigned with effect from 21 September 2003. Carol Sergeant resigned on 7 November 2003. Callum McCarthy was appointed as Chairman of the FSA for a five year term with effect from 22 September 2003. On the same date, John Tiner was appointed as Chief Executive, and re-appointed as a director by HMT, for a period of three years. All other directors are appointed for three year terms.

Stewart Boyd stepped down from his position as Deputy Chairman and senior non-executive director on 31 March 2004. Following consultation with the Office of the Commissioner for Public Appointments, Deirdre Hutton was appointed for a third term with effect from 11

December 2003 and took up the position of Deputy Chairman and senior non-executive Director with effect from 1 April 2004. James Crosby was appointed to the Board with effect from 15 January 2004. Tom de Swaan, Kyra Hazou and Clive Wilkinson were appointed for further three year terms with effect from 18 January 2004.

After the year end, David Miles was appointed to the Board with effect from 1 April 2004. Clive Briault and David Kenmir were appointed as executive directors with effect from 1 April 2004 and Hector Sants from 4 May 2004. Biographical information for current directors is on page xx.

Under the terms of the FSA's Memorandum and Articles of Association, all directors are members of the FSA and each has undertaken to guarantee the liability of the FSA up to an amount not exceeding £1. There are no other members.

<u>Directors' responsibilities in respect of the accounts</u>

UK company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and of its income and expenditure for that period. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures as explained in the accounts; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for ensuring that proper accounting records are kept which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for the system of internal controls, safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are satisfied that the company has adequate resources to continue its business for the foreseeable future and consequently the going concern basis continues to be appropriate in preparing the financial statements. The Financial Review, on page xx, contains further detail on the action the FSA is taking to manage its pensions liabilities and to fund its pensions deficit.

Corporate governance

A statement setting out the FSA's approach to compliance with the Combined Code is set out on pages xx to xx.

Corporate social responsibility

The FSA takes its corporate social responsibility seriously and details of the key activities are provided below.

Community affairs

The FSA works with the East London Business Alliance, Tower Hamlets Education Business Partnership and Business in the Community to provide a varied programme focused on education and regeneration to support the local community. A number of students from the Newham Training and Education Centre have joined the FSA on work placements, resulting in two permanent jobs for local people.

Staff who participate in the community affairs programme acquire skills consistent with the FSA's capabilities framework, and this is seen as an integral part of the staff development package. Approximately 17% of staff are involved and act as volunteers in numeracy, literacy and IT schemes at schools and colleges in Tower Hamlets through a local recruitment project and mentoring scheme.

Health and safety and environmental policy

The FSA's health and safety policy, and the organisation and arrangements for its implementation, are fully endorsed by senior management. The focus of the policy is to provide processes that build and maintain a safe environment for everyone who works at or visits the FSA, and positively to promote good health amongst all employees.

The FSA reviews its environmental policy annually and sets targets to improve its performance. Its involvement in the government's Making a Corporate Commitment Campaign (MACC2) has continued. During the year, energy usage was reduced by 2% and the waste sent to landfill sites by 17%, against a projected target of 10%. The Staff Environment Group has produced a booklet with information on environmental issues, targets and achievements.

Employees and equal opportunity

The FSA aims to recruit, motivate and retain people with the right capabilities, skills and attitudes to ensure delivery of its business priorities. The staff remuneration package comprises four elements: salary, pension, flexible benefits and performance-related bonus. Staff development is underpinned by an extensive training programme, including courses on personal development and the financial markets in which the FSA operates.

The FSA is committed to providing equal opportunity and fair treatment in all aspects of employment without regard to colour, race, nationality, ethnic origin, disability, age, sex, marital status, sexual orientation, religion, trades union or Staff Consultative Committee membership and to providing a workplace that tolerates no form of harassment.

As part of the FSA's commitment to being a flexible employer, a range of working practices is in place. At 31 March 2004, 7% of staff were working part-time and a number were working beyond the normal retirement age of 60 years.

Employment of disabled persons

The training, career development and promotion opportunities offered to disabled employees[1] are continually monitored to ensure that they meet current requirements. Recruitment processes are designed to ensure that disabled people applying for employment or promotion have the opportunity to demonstrate their aptitudes and abilities for the specific role. Members of staff becoming disabled, or returning to work after a significant period of absence, are given access to a rehabilitation programme and all reasonable

[1] As defined by the Disability Discrimination Act 1995

adjustments are made to take account of any change in that individual's aptitude or ability. This includes the provision of specialist equipment where appropriate. Modifications have been made to the FSA's office in Canary Wharf to ensure that it is accessible to all.

Employee involvement

The FSA communicates with staff using a variety of methods, including an intranet site and regular briefings on current issues and regulatory developments. The Staff Consultative Committee (SCC) provides a formal means to consult staff on matters affecting their interests. The SCC considers a variety of issues, including those on which the FSA is obliged by law to consult with staff, and provides staff with an opportunity to contribute to the development of the FSA. The FSA also has a subsidised Sports and Social Committee, which is run by a group of staff.

Charitable donations

In December 2003 the FSA, along with a number of other companies, made a donation of £10,000 to Crisis instead of producing a corporate Christmas card. An advertisement in the Financial Times gave details of the scheme. During the year, the FSA provided £700 to enable the Isle of Dogs Community Foundation to print one of its regular newsletters. The FSA is a member of the Foundation, which is a partnership between local businesses, the voluntary sector and other intermediary agencies, helping support deprived communities in the area. The FSA's Sports and Social Committee funded entry fees to a sponsored sporting event for a number of staff, which totalled £285. The entry fees and sponsorship monies were paid to Cancer Research UK.

Remuneration report

The remuneration report, and information on the Remuneration Committee, is included as part of the Corporate Governance Statement and committee reports, on page xx.

Economy and efficiency

Section 2 of the FSMA, requires the FSA to 'have regard to the need to use its resources in the most economic and efficient way'. The Board is committed to ensuring that the FSA is economic and efficient in the pursuit of its statutory objectives.

The Board has overseen the development of a framework (the 'Resource Strategies') within which to manage the FSA's resources economically and efficiently. The framework contains a number of outcomes that the FSA believes are consistent both with the requirement to be economic and efficient and with the need to manage the operational risks to which the FSA is exposed. A number of internal measures have been developed that allow the Board to monitor the economy and efficiency with which the FSA's resources are used and these will be developed further in the coming year.

The FSA has concluded that its resources can be best considered under four headings:

People In 2003/04 an average of 2,303 people were employed by or contracted to work for the FSA.

Information The FSA has a substantial amount of data in its possession, stored on paper and electronically. This data includes databases of regulated firms and individuals, the results of research studies and consultation exercises and correspondence relating to matters within its responsibilities. The volume of data stored electronically is around six terabytes. The FSA also operates a large website with a wide range of facilities, including the online comparative tables, which receives around 300,000 visits per month.

Space The FSA's principal office in Canary Wharf provides around 350,000 sq. ft. of office space and a range of meeting rooms and other facilities. The FSA also has an office of around 3,750 sq. ft. in Edinburgh.

Cash The FSA's total expenditure in 2003/04 was £210.9m, including £192.9m on its mainstream regulatory activities (the 'control total').

The FSA has undertaken a number of specific projects during the year to improve economy and efficiency and some examples are explained in the following paragraphs.

People - The successful recruitment, retention and motivation of people with the right capabilities, skills and attitudes are high priorities and are key in ensuring the delivery of our business priorities. There are encouraging signs that the abilities of staff are perceived to be improving (e.g. the latest BBA survey of the industry) but there remains much more to do. Building on the foundations previously developed, the people management capabilities have been embedded into the performance management system (which in essence requires managers to deliver outcomes through effective management of their teams and individuals). Managers have been formally assessed against these capabilities in the January appraisal round and this year's pay review has explicitly taken into account managers' demonstration of them. To support this work, there has been extensive training to drive up the quality of people management capabilities.

The learning and development programme has been reviewed to ensure that it is fully aligned with delivery of the FSA's business priorities. This has included a wholesale review of technical and behavioural skills training. A programme to address high risk internal skills gaps in fund management, insurance and Basel II has also been delivered.

Work has begun on revising a number of key elements of the people strategy including:

- the development of a leadership model which defines the capabilities that senior staff need to lead the FSA through the next phase of development;
- embedding a culture of individual accountability throughout the FSA;
- the reward strategy;
- the technical training to ensure that staff possess the skills and knowledge needed to deliver successfully; and
- expanding the range of inward and outward secondments to help ensure that we stay in touch with developments in the market and elsewhere.

The Human Resources Division has been merged with the various communication functions to form the People and Communications Division. This brings together the people and internal/external communications agenda, which are key to helping the FSA become a more effective and delivery-based organisation.

Information – Further releases of e-regulation software, particularly in the authorisation process for mortgage and general insurance firms, has led to a significant increase in the number of forms submitted electronically. From a survey of a sample of users we know the system is proving popular with firms as they benefit from having an easier and faster submission mechanism whilst the FSA benefits from not having to re-key data into systems.

The implementation and further enhancement of the Electronic Listing Management System, which replaced the main system used by the UK Listing Division, is also bringing significant savings in costs.

The first phase of the workflow management system which is primarily concerned with correspondence logging has been implemented. It will reduce the risk to the FSA of lost correspondence, failure to resolve outstanding issues and the poor handling of cases which cross divisional boundaries. We have also successfully implemented workflow management technology to improve the processing of Collective Investment Scheme applications.

Significant improvements in the fee process have also been implemented during the year. This has meant that the overall level of fee queries has fallen by more than 50% compared to last year and cash has been collected significantly faster.

A system to deliver published material to firms through bulk emailing, and where possible, more specific targeting has been implemented. The FSA now has the proven capability to reach a bulk email audience and segment it in a number of different ways. This facility has enabled the streamlining of delivery of communication material and reduced the cost of printing and distribution, in particular by reducing the quantity of irrelevant publications.

Space - The space planning processes in place are enabling the FSA to respond successfully to the recruitment of additional staff to support the take-on of 20,000 Mortgage and General Insurance firms without having to resort to expensive additional accommodation.

Cash - The FSA spends some £57m annually with its top 50 suppliers. To supplement the framework agreements in place with a number of professional service providers, improvements have been made to the purchasing process and to the skills of relevant staff in the management of relationships with suppliers.

Good progress is being made in building an integrated billing system for next year's invoicing run. This will reduce the level of manual work and enable the system to be tested ready for the billing of Mortgage and General Insurance firms in June 2005.

Savings have accrued from the work on establishing a 'part managed' service for the payroll process and bringing in-house the administration of the flexible benefits scheme.

Re-organisation

During the year, the Chief Executive has re-organised the FSA and focused it around three major business units: Retail Markets; Wholesale Markets; and Regulatory Services. The new structure has come into effect from the beginning of the 2004/05 financial year, and has involved substantial changes to the roles and responsibilities of many staff in the FSA. The Board is grateful to the staff for the positive way in which they have contributed to the re-organisation.

The Board believes that the new structure will contribute to improvements in the FSA's effectiveness in meeting its statutory objectives and improve the extent to which it will take into account the principles of good regulation, including economy and efficiency, which are set out in the FSMA.

Auditors

On 1 August 2003 Deloitte & Touche transferred their business to Deloitte & Touche LLP, a limited liability partnership incorporated under the Limited Liability Partnerships Act 2000. The FSA's consent has been given to treating the appointment of Deloitte & Touche as extending to Deloitte & Touche LLP with effect from 1 August 2003 under the provisions of section 26(5) of the Companies Act 1989.

A resolution to re-appoint Deloitte & Touche LLP as Auditors will be put to members at the Annual General Meeting.

By Order of the Board
Geoffrey King
Secretary
20 May 2004

Corporate governance statement

Corporate governance and accountability arrangements

The FSA is a company limited by guarantee without shareholders, which is a corporate structure common amongst charitable, not-for-profit and regulatory organisations.

Although the FSA has no shareholders, and is not a listed company, the Board remains committed to achieving high standards of corporate governance, in line with the responsibilities set out in Section 7 of the Financial Services and Markets Act 2000 (FSMA), which require the FSA to "have regard to such generally accepted principles of good corporate governance as it is reasonable to regard as applicable to it".

The Board believes, therefore, that it is appropriate for the FSA to report on its compliance, as far as is practicable and appropriate, with the relevant provisions of the Combined Code (the Code). The approach to compliance is intended to be proportionate and consistent with the FSA's responsibilities as a regulator, which are different from those of a listed company.

This statement describes how, throughout the accounting period to 31 March 2004, the FSA has applied the provisions of the revised Code issued by the Financial Reporting Council in July 2003 that it considers to be relevant, and notes those areas where compliance would not be appropriate. The Code includes the additional requirements intended to apply to reporting periods beginning on or after 1 November 2003.

In addition to the Code, the FSA is subject to a number of other oversight and accountability mechanisms, which help to ensure that it takes account of the interests of all stakeholders in its regulatory work. These include a strong body of non-executive directors (NEDs), whose powers of oversight in committee are referred to below, and regular calls on the Chairman and Chief Executive to give evidence to the Treasury Select Committee. During the year, the FSA continued to consult the Financial Services Consumer Panel and the Financial Services Practitioner Panel, which have statutory status under the FSMA, and to seek advice from the panels on its general policies and practices. The panels have a right under section 11 of the FSMA to make representations to the FSA, to which the FSA is required to respond formally should it disagree with the representation. The Small Business Practitioner

Panel (SBPP) also provides advice to the FSA on the impact of its policies and procedures on small businesses.

The Chairs of the panels met the Board during the year to discuss their respective Annual Reports. The FSA's management response to each is available on the FSA's website.

Callum McCarthy was appointed as Chairman of the FSA on 22 September 2003, and John Tiner was appointed as Chief Executive, and re-appointed as a director by HMT, for a period of three years. A paper setting out the division of responsibilities between the Chairman and Chief Executive has been agreed by the Board and is available on the FSA's website.

The Directors

The role of the Board of the FSA is to: exercise the FSA's legislative functions; make strategic decisions affecting the future operation and resourcing of the FSA; oversee the discharge by the executive management of day to day business; set appropriate policies to manage risks to the FSA's operations and the achievement of its regulatory objectives; and to seek regular assurance that the system of internal control is effective in managing risks in the manner it has approved. Attendance at Board meetings during the year is shown below, with the attendance shown as a proportion of the numbers of meetings individual Board members were eligible to attend.

Board Member	**Attendance at meetings**
Howard Davies	5/5
Callum McCarthy	6/6
Stewart Boyd	8/11
Moira Black	11/11
James Crosby	3/3
Tom de Swaan	8/11
Michael Foot	11/11
Kyra Hazou	11/11

Deirdre Hutton	10/11
Sir Andrew Large	9/11
Gillian Nott	10/11
Christopher Rodrigues	6/7
Shamit Saggar	9/11
Carol Sergeant	6/6
Stephen Thieke	9/11
John Tiner	11/11
Sir Keith Whitson	1 / 2
Clive Wilkinson	11/11

The members of the Board undertake a range of other duties in addition to attendance at formal Board meetings.

The Board has adopted a Schedule of Matters Reserved to it for collective decision and made a formal resolution setting out the arrangements for the discharge of its functions and those delegated to executive Board members, as well as the terms of reference of the Board Committees. Copies of these documents are available on the FSA's website.

The members of the Board of the FSA are appointed by HMT, in line with the Code of Practice issued by the Commissioner for Public Appointments. The majority of the FSA's directors are non-executive; at 31 March 2004 there were eleven NEDs and three executive directors. Information on the membership of the Board during the year, and the dates on which the directors' terms of office expire, are in the Directors' Report on page xx.

The directors of the FSA bring a wide range of business, financial and consumer experience, to the Board's deliberations. Details are provided in the directors' biographies on the FSA's website.

Given the nature of the FSA's statutory objectives, and the complexity and breadth of the financial markets in which it operates, it is considered essential that the NEDs bring a broad range of experience of financial services to the FSA. This includes experience as financial services practitioners, and of the interests of consumers of financial services. The range of experience provides for an appropriate balance of expertise and views to be brought to the deliberations on the range of issues affecting the strategic direction of the Authority. The Board is satisfied that the NEDs are independent of the FSA management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement, even if there exists a regulatory connection between the FSA and the NEDs who work for regulated firms. The members of the Board recognise that conflicts can arise for all Board members, given the wide range of issues with which the FSA deals. Arrangements are in place to handle any conflicts that might arise during the consideration of Board business.

Board members believe that, to the best of their knowledge, they have been provided with sufficient accurate, timely and clear information on the FSA's activities during the year. However, the NEDs did not have access to the Penrose Report prior to publication, as a result of restrictions imposed on the FSA by HMT.

The Board meets formally at least 11 times a year and informally as appropriate. A Board awayday is held once a year, at which strategic, regulatory, policy and organisational issues are considered. Board papers are provided in good time before meetings. The Company Secretary ensures that the Board is provided regularly with information and updates on current activities. He also organises a regular programme of presentations to ensure that Board members' skills and knowledge of current issues are regularly updated and refreshed. A number of changes have been made to the procedures, agendas and papers of the Board during the year.

The Company Secretary (or his deputy) attends and minutes all meetings of the Board and its Committees and provides a link with the NEDs in the event of any query on governance or other issues. He is also responsible for providing appropriate training and induction for new directors, which is tailored to individual requirements.

Any Board member who requires professional advice on a matter relating exclusively to the duties of a Board member may, by request to the Secretary, have direct access to the Authority's professional advisers.

All directors are equally accountable under the law for the proper stewardship of the FSA's affairs. The NEDs are fully involved in the Board's decision taking and have a particular responsibility for ensuring that the strategies proposed by executive directors for the achievement of the FSA's objectives are considered fully and critically examined, and that they take proper account of the interests of all those affected by the activities of the FSA.

The Board intends to carry out a review of its effectiveness in the coming year, using external consultants.

Committees of the Board

The reports of the Board committees (Non-Executive, Remuneration, Audit, Risk and Appointments Committee) are set out on the following pages. The membership of the committees comprises only NEDs apart from the Appointments Committee, which is chaired by the FSA Chairman. Members of the committees, apart from NedCo, are appointed by the Board. A table showing the membership of each committee, and a note of attendance by committee members at each meeting, is set out below. The quorum for committee meetings is three and the terms of reference for each committee are available on the FSA's website.

Board member	**NedCo**	**RemCo**	**AuditCo**	**RiskCo**
Stewart Boyd	5/5	6/6	3/4	4/5
Moira Black	5/5			
James Crosby	1/1			
Tom de Swaan	5/5			3/5
Kyra Hazou	5/5		4/4	5/5
Deirdre Hutton	5/5	5/6		5/5
Sir Andrew Large	3/5			
Gillian Nott	4/5	6/6	3 / 4	
Christopher Rodrigues	2/3	¾	3/3	

Shamit Saggar	4/5		3/5
Stephen Thieke	4/5		4/5
Keith Whitson	1/1		
Clive Wilkinson	5/5	4/4	

The Committee of non-executive directors (NedCo)

The FSA's non-executive Committee (NedCo) has been established in line with the provisions of Schedule 1 to the FSMA. The members of the Committee are the FSA's NEDs, who undertake these responsibilities in addition to participating fully in the work of the Board, which is the FSA's principal decision-making body. The Chairman of NedCo is appointed by HMT. Stewart Boyd QC relinquished this role on 31 March 2004, and Deirdre Hutton was appointed with effect from 1 April 2004. The FSA Chairman attends meetings of NedCo by invitation. NedCo's statutory functions are as follows:

- keeping under review whether the FSA is using its resources efficiently and economically;
- *keeping under review whether the FSA's internal financial controls secure the proper* conduct of its financial affairs;
- determining the remuneration of the Chairman and other executive directors; and
- making a report each year, for inclusion in the FSA's Annual Report to HMT, on the discharge of the functions listed above.

NedCo met five times formally during the year to satisfy itself that the functions outlined above were being satisfactorily discharged, and that it was able to provide updates to the Board on progress with its work during the year.

Report of the non-executive directors

In order to achieve a balance between fulfilling NedCo's statutory functions without undermining the role of the unitary Board, NedCo has relied as far as possible on the processes established for, and work undertaken by, the Board. As explained below, NedCo has delegated some of its functions to the Remuneration Committee. Other functions are shared with the Audit Committee, which works alongside NedCo to fulfil their complementary responsibilities. The outcomes of the work undertaken by the Remuneration Committee are considered by the NEDs before being reported to the Board.

Efficiency and economy

In fulfilling its responsibilities under the FSMA, NedCo has kept under review during the year the question of whether the FSA, in discharging its functions in accordance with the decisions of the Board, has used its resources in the most efficient and economic way. This year's statement on the efficient and economic use of resources is included in the Directors' Report on page XX. In the opinion of NedCo, which has followed progress throughout the year by means of a detailed report from the Chief Operating Officer (COO) at each of its meetings, this evaluation is a fair statement of the FSA's performance in relation to the efficient and economic use of its resources.

Internal financial controls

During the year, NedCo has kept under review, in conjunction with the Audit Committee, whether the FSA's internal financial controls secure the proper conduct of its financial affairs. A detailed report is on page xx. In the opinion of NedCo, the evaluation contained in the report is a fair statement of the position.

Remuneration of the executive directors

NedCo has delegated to the Remuneration Committee the function of determining the remuneration of the Chairman, Chief Executive and the executive directors. Information on the Committee and its procedures is on page xx, together with the remuneration report.

Remuneration Committee

The Remuneration Committee is a sub-committee of NedCo, and has the same Chairman. The Committee met six times during the year and a table showing attendance at meetings is included on page xx. The functions of the Remuneration Committee are to:

- determine the remuneration package of the Chairman and executive members of the Board, including their participation in annual incentive arrangements, contract terms, pension rights and entitlement to compensation for loss of office;
- report annually to NedCo on its determinations; and
- make recommendations to the Board on policy in relation to the remuneration of the FSA's senior executives.

The remuneration of the NEDs is set by an independent panel, the membership of which comprises the Chairs of the Practitioner and Consumer Panels, or their nominees, and an external moderator. There have been no changes in the year under review.

All decisions taken by the committee on the remuneration packages for the executive directors are reported to NedCo and then to the Board, but the executive directors take no part in the discussion. The FSA Chairman attends by invitation where the remuneration of his executive colleagues is under discussion.

Remuneration report

The Committee appointed Watson Wyatt as consultants during the year to provide market comparisons on how the elements of the remuneration package of the executive directors compared with those in broadly comparable roles in the financial services markets, and other institutions with a regulatory or public role.

The executive directors are appointed to the Board by HMT for a fixed period. Their FSA employment contracts, which for all except the Chairman are not fixed term contracts, provide for twelve months' prior notice of termination by either party, with up to twelve months' total remuneration (including a sum equivalent to the value of the flexible benefits described in paragraph xx below) in the event of early termination of contract. The current directors' contracts also provide for post-employment restrictions to protect the FSA's interests. Details of retirement dates and length of terms are provided on page xx. The total remuneration package of the executive directors, as with those of other employees of the FSA, consists of four elements.

a) *Basic pensionable salary*

The basic pensionable salaries of the Chief Executive and Managing Directors were reviewed at the start of the year, and the process for the review is described below. Details of individual salaries are included in the table on page xx.

b) *Performance related bonus*

A performance related bonus plan, which relates to the financial year, is in place for the executive directors as for all staff. Howard Davies participated in this scheme but Callum McCarthy, at his own request, does not. Although long-term incentive plans are a major feature of remuneration in the financial services industry they are considered inappropriate for the FSA. The bonuses awarded to individual directors in respect of the year to 31 March 2004 are on page xx. Directors no longer in service with the FSA at the end of the year are not eligible for a bonus payment.

c) *Other benefits*

A flexible benefits plan is in operation for all employees and the executive directors participate in this plan. A sum is set aside for each employee and he or she is able to choose, from a range of benefits, how this sum is spent. This sum is included in 'other emoluments' in the table on page xx. Certain executive directors are provided with a car and driver and a proportion of those costs are also included in 'other emoluments'.

d) *Pensions*

There are two sections to the pension plan operated by the FSA – a defined benefit section (closed to new entrants) and a defined contribution section. Both are non-contributory. Howard Davies and Carol Sergeant were members, and Michael Foot is a member, of the defined benefit section. Howard Davies's benefits accrued at 1/30th per year of service and those of Michael Foot and Carol Sergeant accrued at 1/60th per year of service. Callum McCarthy is a member of the defined contribution section of the pension plan. John Tiner is not a member of the pension plan and is entitled, under his contract, to receive a non-pensionable supplement in lieu of this, of which details are on page xx.

The overall framework for the evaluation of the performance of the executive directors was set by NedCo in 2003. Objectives were set for each director, based partly on the FSA's overall objectives, as set out in the Plan and Budget, and partly on the individual's particular areas of responsibility. The process was informed by 360° appraisal from colleagues, and soundings from the Chairs of the Practitioner and Consumer Panels and HMT.

During its assessment of the performance of the executive directors, and in setting salaries based on performance, the Committee has taken into account the effect of an increase in each individual's basic pensionable salary on his or her total remuneration package.

This section of the Report contains audited information

Directors' emoluments comprise:

	Board fee	**Salary**	**Performance related bonuses**	**Other emoluments and benefits**	**2004 Total**	**2003 Total**
Executive Directors	**£**	**£**	**£**	**£**	**£**	**£**
Howard Davies (Chairman until 21.9.03)[1,3]	-	154,933	-	38,073	193,006	397,287
Callum McCarthy (Chairman from 22.9.03)	-	159,131	-	64,638	223,769	-
Michael Foot[3]	-	262,500	39,000	44,675	346,175	322,017
Carol Sergeant	-	235,577	-	18,770	254,347	293,452
John Tiner [2]	-	310,971	52,000	108,685	471,656	361,904
Non-executive Directors[4]						
Stewart Boyd (Deputy Chairman)[5]	45,000	-	-	-	45,000	45,000

[1] Howard Davies resigned as Chairman on 21 September 2003. The figure for other emoluments and benefits paid during the year includes £20,000 for the provision of advice during a three month transitional period.

[2] The total emoluments of the highest paid director during the year, John Tiner, were £471,656 (2003: £361,904), including a supplement of £47,741 (2003: £58,140), paid during the year towards the funding of his personal pension.

[3] *The prior year totals have been restated to include a revised estimate of the proportion of the costs of the car* and driver with which the directors were provided.

[4] The fee for a non-executive director was set by the independent panel, established with the approval of HMT, at £20,000 per annum with effect from 1 December 2001. An additional fee of £5,000 per annum is paid to any non-executive director (other than the Deputy Chairman) who has been appointed to chair a committee of the Board. There were none in this category during the year, as the Deputy Chairman or the Chairman chaired all relevant committees. Otherwise, the fee covers all duties as directors.

[5] The fee payable to the Deputy Chairman was set by the independent panel at £45,000 per annum with effect from 1 December 2001.

	Board fee	Salary	Performance related bonuses	Other emoluments and benefits	2004 Total	2003 Total
Moira Black [6]	23,750	-	-	-	23,750	27,500
James Crosby[8]	4,308	-	-	-	4,308	-
Tom De Swaan	20,000	-	-	-	20,000	20,000
Kyra Hazou	20,000	-	-	-	20,000	20,000
Deirdre Hutton	20,000	-	-	-	20,000	20,000
Sir Andrew Large [7]	-	-	-	-	-	-
Gillian Nott	20,000	-	-	-	20,000	20,000
Christopher Rodrigues [8]	13,846	-	-	-	13,846	20,000
Dr Shamit Saggar	20,000	-	-	-	20,000	20,000
Stephen Thieke	20,000	-	-	-	20,000	8,333
Sir Keith Whitson [8]	3,333	-	-	-	3,333	20,000
Clive Wilkinson [6]	23,750	-	-	-	23,750	20,000
	233,987	1,123,112	91,000	274,841	1,722,940	1,615,493
Of which fees for service as						
Directors					233,987	240,833
Remuneration as executives					1,488,953	1,374,660
					1,722,940	1,615,493

At the end of the year retirement benefits were accruing for the former Chairman and two of the executive directors as a result of their participation in the defined benefit scheme, as set out below. Information on John Tiner's pension arrangement is provided on page xx.

[6] Two directors chaired the Board of the FSA Pension Plan Trustee Ltd in the year; Moira Black from 1 April 2003 to 30 September 2003, and Clive Wilkinson from 1 October 2003 to 31 March 2004. The annual fee was set at £7,500 with effect from 1 April 2002 and was pro-rated between each director.

[7] Sir Andrew Large waived his Board fee in respect of the year.

[8] The fees for James Crosby (HBOS), Christopher Rodrigues (Bradford and Bingley plc) and Sir Keith Whitson (HSBC Holdings plc) were paid direct to their employers, as shown in brackets. Christopher Rodrigues and Sir Keith Whitson retired during the year and their fees were pro-rated.

	Total accrued annual pension as at 31 March 2003 £ '000	Increase, excl inflation, in accrued annual pension in year £ '000	Inflation £'000	Total accrued annual pension as at 31 March 2004 £ '000 [9]
H Davies	82	3	2	87
M Foot	156	2	4	162
C Sergeant	119	13	3	135

The following table sets out the transfer values of the directors' benefits under the scheme calculated in a manner consistent with "Retirement Benefit Schemes - Transfer Values (GN11)" published by the Institute of Actuaries and the Faculty of Actuaries.

	Transfer value at 31 March 2003 £ '000	Transfer value of real increase in accrued pension [10] £ '000	Other changes To transfer value [10] £ '000	Transfer value at 31 March 2004 £ '000
H Davies	952	40	90	1,082
M Foot	2,358	30	224	2,612
C Sergeant	1,316	153	125	1,594

[9] The pension entitlement is that which would have been paid annually on retirement based on service to the end of the year on the assumption that the director left service on that date.
[10] Members of the FSA Pension Plan have the option to pay Additional Voluntary Contributions; neither the contributions nor the resulting benefits are included.

Audit Committee

The Audit Committee met four times during the year and reported to the Board on its activities after each meeting. The COO and Director, Business Review and Audit Division (BRAD) were invited to attend all meetings of the Committee. The Director of BRAD has had a meeting with the Committee without other staff present. The external auditors have also attended all meetings, and have met the Committee without management present.

Financial statements - The Committee formally reviewed and questioned management on the content of the draft statutory accounts (including the effect of the provisions of FRS 17 on accounting for pension costs). It has also considered the content of the financial review and proposed amendments to the information provided on particular issues, including the contributions made to the pension plan and the effect on the control total, in order to ensure clarity of reporting for all stakeholders.

Internal financial control and risk management systems - The Audit Committee collaborates closely with NedCo to ensure that functions shared by both committees, including those relating to internal controls, are discharged as efficiently as possible. The Audit and Risk Committees also co-ordinate their respective work closely in order to ensure that risk management processes are robust, whilst minimising the potential for overlap. Reports on issues of interest, such as the Risk Framework Review undertaken by BRAD, are provided to both committees.

The Committee has reviewed in detail the statement on internal controls and questioned management on the development and management of the underlying processes.

At the request of the Committee, the COO provided regular reports on the development of processes for dealing with communications from external stakeholders. The results of reviews of the adequacy of the arrangements for dealing with internal whistle-blowing, and the professional indemnity insurance have also been considered.

External auditors - The Committee received reports from Deloitte & Touche LLP on the audit and has engaged in detailed discussion with the auditor on the content of those reports in order to ensure that any issues raised are handled appropriately.

Deloitte & Touche LLP are not permitted to tender for internal audit work or for any other work within the FSA that might lead to the perception of any element of self review. Where Deloitte & Touche LLP are appointed to undertake particular assignments, this is only done after competitive tender and is subject to monitoring by the Audit Committee. Further information is provided in Note 2 of the Accounts on page xx. All services bought in by the FSA are subject to defined procurement procedures.

The Committee considered the issues raised by the auditors in their management letter, and the mitigation strategies proposed by management.

Internal audit function - The Director of BRAD, or his deputy, has reported at each meeting on current and future work plans. As part of this work, BRAD has considered the impact of the re-structuring on the business. The response of senior management to BRAD's findings from its completed projects was considered. Where appropriate, the Committee has challenged BRAD on those responses, in order to satisfy itself as to the robustness of the review mechanisms. Issues reviewed by BRAD, and reported on to the Committee, have included the implementation of the ARROW risk management processes and the Enforcement referral criteria.

Internal controls

The FSA's Board acknowledges its responsibility for the FSA's system of internal controls, and for reviewing its effectiveness. The system is designed to provide reasonable, but not absolute, assurance against material misstatement or loss and to manage rather than eliminate risks of failure to achieve the FSA's statutory objectives. In setting its policy on internal controls and risk management, the Board has established an on-going process for identifying, evaluating and managing the significant risks faced by the FSA. This process of review by the Board has been in place throughout the year, and up to the date of the approval of the Report and Accounts. The processes include robust procedures for identifying and managing any issues or problems that could arise. These processes ensure that, in the event of a problem arising, the issue is drawn to the attention of management in a timely way and appropriate remedial action taken.

The Board believes that the process comprises a sound system of internal control in line with the guidance set out in the Turnbull Report on Internal Controls.

Regular reports are provided to the Board on the detailed reviews of risk management and control processes carried out by the Non-Executive, Audit and Risk Committees. These reports have included:

- quarterly updates on the internal risk mapping process as it applies to risks to the regulation of firms and markets, the protection of consumers and external risks;
- progress reports on the development and implementation of the ARROW process and the risk management framework;
- information from BRAD on progress with and plans for its programme of audit reviews, which includes feedback on and timetable for proposed remedial action from the executive;
- reviews of correspondence handling procedures;
- resources allocated to risk management; and
- the auditor's review of the FSA's internal controls.

The Regulatory Strategy and Risk Division (RSRD), BRAD and the Finance and Business Planning Division, through the COO, have provided regular reports to the Committee on the operation of the system of internal controls and risk management.

RSRD manages the FSA's strategic planning framework, which provides the FSA with processes, information and risk management arrangements for assessing and evaluating risks efficiently and effectively. RSRD is responsible for the development of mechanisms for measuring delivery of the strategic aims set out in the FSA's Business Plan, which are reviewed in detail by the Board.

BRAD provides objective assurance to the Board that a robust and fit for purpose risk management framework, which complies with Turnbull requirements, is maintained and operated by management in compliance with agreed processes and standards. BRAD's work programme is drawn from a risk focused audit plan, using the risk profile developed by RSRD. The audit plan is updated as necessary to reflect changes in the risk profile. BRAD monitors the progress being made by Divisions in implementing audit recommendations to ensure that they are addressed in a timely and effective manner.

The Board has also received regular reports from the COO on the control and commitment of funds against the budget and the performance against the control total during the year. The Board has been closely involved in the preparation of the Business Plan, a public document which sets out the budget for the year ahead.

Risk Committee

The Risk Committee advises the Board on the quality of the risk management processes in the FSA and, as noted above, works alongside the Audit Committee to maximise efficient and focused oversight of the FSA's risk management processes. Papers and reports on issues of common interest are shared between the committees and there is common membership. A member of the Audit Committee has attended a RiskCo meeting as an observer to facilitate understanding of the issues with which the Committees are dealing.

The Committee presented its second annual report to the Board in February 2004, in addition to the updates provided after each of its meetings. The report noted that the focus of the Committee's work had been on assessing the techniques used to identify, prioritise, and mitigate risks to the FSA's objectives. It explained that the Committee has been briefed on internal reviews of the operation of the risk management framework and received updates on the methodology for allocating aggregate resources to risk management. The Committee confirmed to the Board in the report that it was content with the on-going development of risk management processes within the FSA, on which it continued to challenge the executive.

Appointments Committee

The Appointments Committee is chaired by the FSA Chairman and its members during the year were: Moira Black; Stewart Boyd; and Sir Keith Whitson (until 15 May 2003). The Committee is not responsible for appointing Board members, as that function is fulfilled by HMT. Its role is to: make proposals to the Board on the appointment of, and remuneration package for, senior executives; consider issues of executive succession planning; and make representations to HMT about the composition of the Board. The Committee did not meet during the year as all relevant issues were considered and decided upon by the Board.