report & financial statements

Financial Ombudsman Service Limited
(a company limited by guarantee)

company registration no. 03725015

directors

Sir Christopher Kelly KCB – chairman

Caroline Banks
David Crowther
Richard Hampton
Ed Hucks
Roger Jefferies
Kate Lampard
Julian Lee
Roger Sanders OBE

company secretary

Barbara Cheney

registered office

South Quay Plaza
183 Marsh Wall
London
E14 9SR

bankers

Lloyds TSB Bank plc
1st Floor
25 Gresham Street
London
EC2V 7HN

auditors

Baker Tilly
Chartered Accountants and Registered Auditors
1st Floor
46 Clarendon Road
Watford
Herts
WD17 1JJ

directors' report

The directors of the Financial Ombudsman Service Ltd present their report for the year ended 31 March 2006, together with audited financial statements of the company for the same period.

principal activities

The principal activity of the Financial Ombudsman Service is the provision of an independent and informal dispute resolution service for consumers and providers of financial products. It was created as part of the government's legislation for the financial services market and derives its statutory authority from the *Financial Services and Markets Act 2000*. The company was incorporated in 1999 to consolidate into a single statutory body the complaints-handling and ombudsman services formerly provided by a number of statutory and voluntary schemes.

The company received its powers as the "scheme operator" provided for in Schedule 17 of the *Financial Services and Markets Act 2000* through the enactment of secondary legislation on 1 December 2001.

financial results

The company presents its results for the year to 31 March 2006. During the year, the company had an operating deficit after tax of £325,615 (2005 (restated): deficit of £801,969). This includes the effects of implementing FRS 17 ("Retirement benefits") in full in the accounts for the first time, which has also resulted in the restatement of prior year results. Details are set out in note 10 to the accounts.

The company derives its income from firms covered by the Financial Ombudsman Service, partly from an annual levy and partly from case fees, which become payable when chargeable cases are closed. The amount of the annual levy paid by each firm depends on its size and the industry sector. Consumers do not pay to bring a complaint to the Financial Ombudsman Service and the company receives no government funding.

The deficit stated above was planned as part of the policy of returning to firms, by way of a reduction in the annual levy, any accumulated surplus exceeding 5% of the following year's budgeted expenditure.

The bad debts written off, totalling £0.6m, are as a result of firms going out of business, leaving case fees unpaid. As the Financial Ombudsman Service cannot refuse to take complaints relating to firms, even if they are a poor credit risk, the bad debt charge is likely to be higher than in a normal trading company.

fair review of the business of the company

During the year the Financial Ombudsman Service received 112,923 new complaints, slightly fewer than expected but 2% more than in 2004/05. The majority of these new complaints were about mortgage endowment policies.

A total of 119,432 cases were resolved, which was slightly above budget and an increase of 31% over the previous year. This reflected the investment that was made in increasing productive capacity, mainly by recruiting additional adjudicators.

The productivity of our adjudicators, defined as the average number of cases resolved per week, was 4.5 compared with the budget of 4.3, while 59% of cases were resolved within six months, compared with our target of 45%. The time taken to resolve a complaint is affected by many factors, not least by whether the consumer and the firm are willing to accept a conciliated settlement at an early stage. This has a direct impact on our timeliness, productivity and unit cost figures.

The unit cost, calculated by dividing the total costs before financing charges and any bad debt charge by the total number of resolved complaints, was £433 – compared with the budget of £456 and the previous year's figure of £496. This 13% decrease resulted from the lower than budgeted expenditure being spread across a higher number of resolved cases.

The Financial Ombudsman Service is funded partly by a levy on firms and partly by a case fee for each complaint we investigate. The case fee provides additional funding in years where additional resources are needed to cope with an increasing volume of new complaints. Conversely, if the level of casework should decrease, any short-term cash flow shortfall can be managed by the use of our revolving credit facility.

Looking ahead, in 2006/07 and 2007/08 there is likely to be a gradual decline in the number of new mortgage endowment complaints referred to us, compared with the number we resolve. The number of mortgage endowment cases we expect to resolve is forecast to peak in 2006/07, falling back only slightly in 2007/08. We anticipate that the exceptionally high level of work-in-progress resulting from the growth of mortgage endowment complaints in 2003/04 and 2004/05 will have eroded significantly by March 2008. New complaints about other products are not expected to exceed the number resolved.

The financial resources needed to handle our caseload in 2006/07 are expected to increase. This reflects the full impact of the expansion that has been necessary over the past two years, and essential investment in our infrastructure. We anticipate that the number of cases to be resolved in 2007/08, after the peak in 2006/07, will return to about the current level (2005/06).

Looking further forward to 2008/09 and beyond becomes increasingly speculative. Mortgage endowment complaints should have declined, while at least part of the proposed new consumer credit jurisdiction should have taken effect. The regulation of claims intermediaries should also have begun. Underlying levels of banking, insurance and investment complaints referred to us are unlikely to change dramatically. However, experience has shown that unexpected surges in the number of complaints about particular products can occur.

During 2006/07 we will continue to model the assumptions that affect the level of our work in the longer term, and to plan accordingly.

Further details can be found in this *annual review* and in the *corporate plan & 2006/07 budget,* available in the publications section of our website (www.financial-ombudsman.org.uk).

directors

The Financial Services Authority appoints all members of the board, and HM Treasury also approves the appointment of the chairman. Directors are appointed for a period of up to four years and they may be reappointed for a further term. Their term must not exceed six years in total. The directors of the Financial Ombudsman Service Ltd during the year, and their attendance at board meetings, are shown below as a proportion of the meetings that were held:

director	attendance
Sir Christopher Kelly KCB – chairman	10/10
Caroline Banks	10/10
David Crowther	9/10
Richard Hampton	10/10
Ed Hucks	10/10
Roger Jefferies	9/10
Kate Lampard	10/10
Julian Lee	10/10
Roger Sanders OBE	10/10

No director has any interests in the company. In the event of the winding up or dissolution of the company, each director's responsibility for payment of the company's debts and liabilities is limited to £1.

fixed assets

The movements in fixed assets during the year are set out in note 13 to the accounts.

supplier payment policy

The company's policy is to pay all suppliers within 30 days of date of invoice.

employment policies

The Financial Ombudsman Service continues to monitor its recruitment policy to ensure it provides equal opportunities and fair treatment in all aspects of employment and does not tolerate any form of harassment either by or against employees. There are opportunities for staff to work part-time or flexible hours, to job share and to work from home. The company provides a comprehensive training programme involving internal and external courses. A modular qualification for adjudicators has been developed internally to enhance adjudicators' skills, and includes case-handling, product knowledge and management modules.

diversity

The Financial Ombudsman Service is fully committed to a policy of treating all employees and job applicants equally. All selection and recruitment decisions, both internal and external, and the progression of employees within the company, are based on merit and not on any consideration of race, colour, religion, disability, nationality, ethnic origin, sex, sexual orientation, age, part-time hours or marital status.

The Financial Ombudsman Service complies as far as possible with the contents and aims of the *Code of Good Practice on the Employment of Disabled People* issued by the Employment Service.

The company:

- has ensured that there is full disabled access to its offices and all its facilities;
- considers all applicants for vacancies on merit. Where necessary, special arrangements are made for interviewing disabled applicants;
- raises awareness amongst staff of the assistance needed by their disabled colleagues at work; *and*
- reviews its policy annually and makes changes as required by legislation and best practice.

employee involvement

The company recognises that organisations are most successful where management and staff share a common purpose, work in partnership and communicate openly. During the year, the Employee Communications Forum was replaced by the Information and Consultation Council (ICC) to provide a better means for communication, representation and consultation between staff and the executive team. The first staff members of the ICC were elected in November 2005 to represent all parts of the organisation at a ratio of about one representative to 70 members of staff. There are also four executive team members on the ICC.

The key objectives of the ICC are to:

- enable staff to participate fully in the development of processes which ensure that the Service reflects good practice and is a progressive employer;
- encourage an open and caring environment in which the views of staff are sought as part of the decision-making process;
- ensure full representation of staff views to the executive team so that the treatment of the staff is fair and reasonable;
- canvass and assess the ideas and opinions of staff so that they can be accurately represented to the executive team; *and*
- provide a means for the executive team to give fast and accurate feedback on information and progress to staff on topics currently under discussion.

There is also a Sports & Social Committee, run by members of staff, which organises a wide range of social and sporting events.

corporate governance

The Financial Ombudsman Service Ltd is a company limited by guarantee, without shareholders, which is a common structure for not-for-profit organisations. The directors remain committed to high standards of best practice in corporate governance. While not bound by the provisions of the Code of Best Practice identified within the *Combined Code*, the Financial Ombudsman Service aims to ensure that it complies with best practice in all relevant areas.

corporate governance (continued)

The board consists of the chairman and eight directors, all of whom are non-executive directors. Members of the board are appointed in the public interest and represent a wide range of business, financial and consumer expertise. The board has no involvement in considering individual complaints. The role of the board is to establish the corporate strategy, ensuring that the company is properly resourced and able to carry out its functions effectively, impartially and independently – free from any control or influence by those whose disputes are resolved by the Financial Ombudsman Service.

The board met ten times during the year. Detailed papers were circulated in advance of each meeting to ensure that the directors were able to make informed decisions at meetings. The company secretary attended and minuted all meetings of the board and its committees. The directors believe they have full and timely access to all relevant information required to carry out their functions. Registers of directors' and ombudsmen's interests are maintained. The board meeting in June 2005 was held away from the office over a full day to give the directors an opportunity to review their strategic direction, responsibilities, objectives and the *corporate plan*.

In addition to the provision of strategic direction and management, decisions taken by the board include:

- the appointment of ombudsmen and of the independent assessor;
- the making of rules in respect of the scheme's voluntary jurisdiction, subject to the approval of the Financial Services Authority;
- the making of rules relating to the charging of case fees, subject to the approval of the Financial Services Authority; *and*
- the approval of the annual budget and its recommendation to the Financial Services Authority.

The chairman met each director individually to assess the board's view of the performance of the Financial Ombudsman Service, the operation of the board (including its method of operation, contributions by directors and the sub-committee structure), the role and performance of the executive team and proposals for further development.

committees

The terms of reference for the board committees are on the website (www.financial-ombudsman.org.uk) in the "about us" section under "our board members". Details of the board committees are as follows:

audit committee

The audit committee met four times during the year. Its remit is to:

- make recommendations to the board in respect of the external auditors' appointment;
- review the draft report and financial statements before submission to the board;
- discuss with the auditors issues arising from the external audit;
- receive reports from the internal auditors and approve the internal audit programme;
- ensure compliance with all requirements governing financial reporting; *and*
- review risk management controls.

Members of the audit committee are:

director	**attendance**
Kate Lampard – chairman	4/4
David Crowther	4/4
Ed Hucks	4/4
Roger Jefferies	4/4
Julian Lee	4/4

The committee reviewed and approved the financial statements and external auditors' report. Risk management controls were maintained and considered with the assistance of the internal auditors. Key risks identified formed the basis for drawing up the internal audit plan for the year. The committee considered various internal audit reports (including reports about case-handling, quality assurance, human resources, cash and bank, payroll, communications, facilities management, IT and management information) and an internal audit plan for the coming year. The company's business continuity plan was also reviewed and approved.

The company's former auditors, Deloitte & Touche LLP, chose to resign during the year for their own business reasons. Following a tendering and selection process, the committee recommended to the board the appointment of Baker Tilly as external auditors.

During the year the committee carried out a self-assessment evaluation of its performance in accordance with the *Combined Code Guidance* in the Smith Report.

remuneration committee

The remuneration committee met once during the year. Its remit is to:

- consider and agree proposals from the chief ombudsman about the remuneration of senior executive staff and ombudsmen;
- give advice about the policy for, and scope of, pension arrangements for all staff;
- review and note annually the remuneration trends across the organisation; *and*
- advise on any proposals for major changes to employee benefit structures.

Members of the remuneration committee are:

director	attendance
Sir Christopher Kelly KCB – chairman	1/1
Caroline Banks	1/1
Richard Hampton	1/1
Roger Sanders OBE	1/1

The committee reviewed and approved proposals for the remuneration of senior staff and ombudsmen at the Financial Ombudsman Service.

IT strategy committee

This committee was formed during the year to consider strategic IT issues.
Its remit is to:

- oversee the development of a long term IT/IS strategy;
- approve significant or high-risk IT projects or any significant or high-risk changes to existing IT systems;
- optimise IT costs;
- review the high level progress, performance, cost-effectiveness, ongoing business relevance, delivery and timeliness of IT projects and systems;
- consider exposure to IT risks (including information security), compliance risk, and the containment of risks; *and*
- request and review IT internal audit reports.

committees (continued)

Members of the committee are:

director	attendance
Ed Hucks – chairman	2/2
Caroline Banks	2/2
David Crowther	2/2
Richard Hampton	2/2

executive team member	attendance
Tony Boorman – decisions director	2/2
Nick Clansey – head of IT development	2/2
Estelle Clark – quality director	2/2
Roy Hewlett – operations director	2/2
Jeremy Kean – finance & IT director	2/2

auditors' independence

The company has reviewed its relationship with its auditors, Baker Tilly, and has concluded that there are sufficient controls in place to ensure the required level of independence. During the year no fees, other than for audit and tax advice, were paid to Baker Tilly.

Details of fees payable to the former auditors, Deloitte & Touche LLP, and to the current auditors, Baker Tilly, are set out in note 12 to the accounts.

statement as to disclosure of information to auditors

The directors who were in office on the date of approval of these financial statements have confirmed that, as far as they are aware, there is no relevant audit information of which the auditors are unaware. Each of the directors has confirmed that they have taken all the steps they ought to have taken as directors to make themselves aware of any relevant audit information, and to establish that it has been communicated to the auditors.

internal controls

The board of the Financial Ombudsman Service has overall responsibility for establishing key procedures designed to achieve a sound system for internal control and reviewing its effectiveness. The system is designed to provide reasonable, but not absolute, assurance against material mis-statement or loss. As part of this process, the board and audit committee initiate reports from either the executive team or the internal auditors, where necessary.

directors' report (continued)

internal controls (continued)

The Financial Ombudsman Service's key internal control and monitoring procedures include:

financial reporting
There is a comprehensive budgeting system, with the annual budget (which sets out workload assumptions, financial plans and priorities) being approved by the boards of both the Financial Ombudsman Service and the Financial Services Authority. Monthly results with revised forecasts are reviewed at each board meeting.

monitoring systems
The audit committee reviews regular reports from the internal auditors. At each of its meetings the board receives a management information pack of key performance indicators.

risk management
The Financial Ombudsman Service operates a risk management process that identifies the key risks facing the company, making use of a risk management model which identifies key risks, the current risk management strategy, its effectiveness, any further action required and the risk owner. It also analyses the impact of each risk. This model is reviewed by the audit committee and the executive team.

quality assurance
The quality assurance process has been reviewed and refined to check that the quality of work is maintained at satisfactory levels. A system to measure quality levels constantly monitors our output.

auditors

Baker Tilly has expressed its willingness to continue in office as auditors of the company and a resolution to reappoint the firm will be proposed at the forthcoming Annual General Meeting.

Approved by the board of directors and signed on behalf of the board.

BCheney

Barbara Cheney
company secretary
8 June 2006

directors' responsibilities in respect of the financial statements

United Kingdom company law requires the directors to prepare financial statements for each financial year, in accordance with United Kingdom Generally Accepted Accounting Practice, which give a true and fair view of the state of affairs of the company as at the end of the financial year, and of the income and expenditure of the company for that period. In preparing these financial statements, 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; *and*
- prepare the financial statements on the "going concern" basis, unless it is inappropriate to presume that the company will continue in business.

The directors confirm that the financial statements comply with these requirements.

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 financial statements comply with the *Companies Act 1985*. They are also responsible for the system of internal control, for 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 responsible for the maintenance and integrity of the corporate and financial information included on the company's website. The legislation in the United Kingdom governing the preparation and dissemination of the financial statements and other information included in annual reviews may differ from legislation in other jurisdictions.

independent auditors' report to the members of the Financial Ombudsman Service Limited

We have audited the financial statements of the Financial Ombudsman Service Limited for the year ended 31 March 2006 which comprise the income and expenditure account, the balance sheet, the statement of total recognised gains and losses, the cash flow statement and related notes. These financial statements have been prepared under the accounting policies set out therein.

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

respective responsibilities of directors and auditors

The directors' responsibilities for preparing the directors' report and financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with the relevant legal and regulatory requirements and International Standards of Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the *Companies Act 1985*, and whether the information given in the directors' report is consistent with the financial statements. 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 other transactions is not disclosed.

basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material mis-statement, 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.

opinion

In our opinion the financial statements give a true and fair view in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs at 31 March 2006, and its deficit and cashflow for the year then ended, and have been properly prepared in accordance with the *Companies Act 1985* and the information given in the directors' report is consistent with the financial statements.

Baker Tilly
Chartered Accountants and Registered Auditors
1st Floor
46 Clarendon Road
Watford
Herts
WD17 1JJ

8 June 2006

income and expenditure account

for the year ended 31 March 2006

	notes	2006 £'000	2005* £'000
turnover	2, 3	51,521	43,645
administrative costs		(52,055)	(44,613)
		(534)	(968)
other operating income	4	230	147
operating deficit		**(304)**	**(821)**
interest receivable	5	258	244
interest payable and similar charges	6	(270)	(214)
deficit on ordinary activities before taxation	7	**(316)**	**(791)**
tax charge on deficit on ordinary activities	8	(9)	(11)
deficit on ordinary activities after taxation		**(325)**	**(802)**

*(as restated – note 10)

All amounts relate to continuing activities in the current and prior year.

Notes a to f to the cash flow statement and notes 1 to 18 to the accounts form an integral part of these financial statements.

statement of total recognised gains and losses

for the year ended 31 March 2006

	notes	2006 £'000	2005* £'000
deficit for the year		(325)	(802)
actuarial losses for the year in respect of the pension scheme	10(e)	(247)	(1,270)
total recognised losses for the year		**(572)**	**(2,072)**
prior year adjustment in respect of the adoption of FRS 17	10(i)	(2,280)	
total recognised losses since the last annual report		**(2,852)**	

*(as restated – note 10)

Notes a to f to the cash flow statement and notes 1 to 18 to the accounts form an integral part of these financial statements.

reconciliation of movements in reserves

for the year ended 31 March 2006

	notes	2006 £'000	2005* £'000
total recognised losses for the year		(572)	(2,072)
accumulated surplus at 1 April			
– as previously reported		*6,769*	*8,561*
– prior year adjustment in respect of the adoption of FRS 17		*(2,280)*	*(2,000)*
– as restated		4,489	6,561
accumulated surplus at 31 March		**3,917**	**4,489**

*(as restated – note 10)

Notes a to f to the cash flow statement and notes 1 to 18 to the accounts form an integral part of these financial statements.

balance sheet as at 31 March 2006

	notes	2006 £'000	2006 £'000	2005* £'000	2005* £'000
fixed assets					
tangible assets	13		5,210		7,382
current assets					
debtors	14	8,615		8,064	
cash at bank and in hand		4,674		3,780	
		13,289		11,844	
current liabilities					
creditors: amounts falling due within one year	15	(4,810)		(4,957)	
net current assets			8,479		6,887
total assets less current liabilities			**13,689**		**14,269**
creditors: amounts falling due after more than one year	16		(7,500)		(7,500)
net assets, excluding pensions liabilities			**6,189**		**6,769**
net pensions liabilities	10(f)		(2,272)		(2,280)
net assets, including pensions liabilities			**3,917**		**4,489**
capital and reserves					
accumulated surplus			3,917		4,489
			3,917		**4,489**

*(as restated – note 10)

signed on behalf of the board of directors

Sir Christopher Kelly KCB
chairman

8 June 2006

Notes a to f to the cash flow statement and notes 1 to 18 to the accounts form an integral part of these financial statements. These financial statements were approved by the board of directors on 8 June 2006.

cash flow statement

for the year ended 31 March 2006

	notes	2006 £'000	2005 £'000
net cash inflow from operating activities	a	1,704	892
returns on investments and servicing of finance	b	(47)	20
taxation	c	(9)	9
capital expenditure and financial investment	d	(754)	(2,229)
net cash inflow/(outflow) before financing		894	(1,308)
financing			
movement in long-term borrowings		–	–
increase/(decrease) in cash in the year	**e,f**	**894**	**(1,308)**

notes to the cash flow statement

for the year ended 31 March 2006

a reconciliation of operating deficit to net cash inflow from operating activities

	2006 £'000	2005* £'000
operating deficit for the year	(304)	(821)
depreciation	2,926	2,706
increase in debtors	(551)	(1,698)
(decrease)/increase in creditors	(147)	1,685
defined benefit pension costs		
service cost	*1,027*	*830*
contributions		
normal contributions	*(870)*	*(810)*
additional deficit reduction contributions	*(377)*	*(1,000)*
	(220)	(980)
net cash inflow from operating activities	**1,704**	**892**

*(as restated – note 10)

notes to the cash flow statement for the year ended 31 March 2006 (continued)

b returns on investments and servicing of finance

	2006 £'000	2005 £'000
interest received	223	234
interest paid	(270)	(214)
	(47)	**20**

c taxation

	2006 £'000	2005 £'000
UK corporation tax paid	(9)	(8)
UK corporation tax recovered	–	17
	(9)	**9**

d capital expenditure and financial investment

	2006 £'000	2005 £'000
payments to acquire tangible fixed assets	(754)	(2,229)
	(754)	**(2,229)**

e reconciliation of net cash flow to movement in net debt

	2006 £'000	2005 £'000
increase/(decrease) in cash	894	(1,308)
movement in net debt for year	894	(1,308)
net debt at 1 April	(3,720)	(2,412)
net debt at 31 March	**(2,826)**	**(3,720)**

f analysis of changes in net debt

	at 1 April 2005 £'000	cash flows £'000	at 31 March 2006 £'000
cash at bank and in hand	3,780	894	4,674
long-term loans	(7,500)	–	(7,500)
	(3,720)	**894**	**(2,826)**

notes to the accounts

for the year ended 31 March 2006

1 status of the company

Financial Ombudsman Service Ltd is a company limited by guarantee and registered in England and Wales (company registration no. 03725015). The liability of each of the members is limited to the amount of £1 guaranteed in the Memorandum of Association.

2 principal accounting policies

The financial statements have been prepared under the historical cost convention and in accordance with applicable United Kingdom company law and accounting standards. The accounting policies have been consistently applied in the current year, except for the adoption of FRS 17 ("Retirement benefits"). A summary of the principal accounting policies is set out below:

turnover

annual levy – each firm that comes under the jurisdiction of the Financial Ombudsman Service is required to pay an annual levy based on the permissions given to that firm by the Financial Services Authority.

case fees – each firm that has a chargeable complaint referred for investigation to the Financial Ombudsman Service is required to pay a case fee upon closure of the third and subsequent complaint in any one financial year.

service charges – the Financial Ombudsman Service provides accounting and other services to some of the former schemes.

recognition of income – levy and service charge income is recognised on invoicing for the period to which the invoices relate. From 1 April 2002, case fee income is recognised at the date when invoices are raised, this being the end of the month in which the case is closed. For cases transferred from the Personal Investment Authority Ombudsman Bureau at 30 November 2001, and for cases billed by the Financial Ombudsman Service, at the time a case fee became chargeable, between 1 December 2001 and 31 March 2002, income is recognised upon closure of the case (see "deferred income" accounting policy).

2. principal accounting policies (continued)

tangible fixed assets

Depreciation is calculated so as to write off the cost, less estimated residual value, of tangible fixed assets on a straight-line basis over the expected useful economic life of the asset concerned.

leasehold improvements	over ten years
premises fees and stamp duty	over five years
computer hardware	over three years
computer software	over five years
computer systems development and fees	over five years
office furniture and equipment	over five years
fixtures and fittings	over ten years

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

pension scheme payments

The company operates both a defined benefit pension (final salary) scheme and a defined contribution (money purchase) scheme, both being part of the Financial Services Authority tax-approved pension plan.

The costs of the contributions to the defined benefit scheme are accounted for in accordance with FRS 17, which has had to be adopted in full this year, resulting in the restatement of comparative figures (see note 10). 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 equal 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 year), are included in the income and expenditure account in "interest receivable".

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.

The costs of the contributions to the money purchase scheme are charged to the income and expenditure account as incurred.

operating lease commitments
Operating lease costs are charged to the income and expenditure account to reflect usage of the assets leased.

deferred income
The accounting policy used by the Personal Investment Authority Ombudsman Bureau for billing chargeable cases was continued in the Financial Ombudsman Service from 1 December 2001 to 31 March 2002. Case fees were billed to firms and credited to the deferred income account at the time the case fee became chargeable. Amounts are released to case fee income only on closure of the case. The balance in the deferred income account therefore represents the number of open cases being:

- those chargeable cases originally billed in the Personal Investment Authority Ombudsman Bureau prior to 1 December 2001 and transferred to the Financial Ombudsman Service at that date; *and*
- those chargeable cases billed in the Financial Ombudsman Service between 1 December 2001 and 31 March 2002.

Amounts billed by the Financial Services Authority in advance for levy due for the year from 1 April 2006 are shown as deferred income at 31 March 2006.

3 turnover

	2006 £'000	2005 £'000
annual levy	11,710	12,408
case fees	39,799	31,222
service charges	12	15
	51,521	**43,645**

4 other operating income

	2006 £'000	2005 £'000
conference fees	48	20
publications	175	127
miscellaneous	7	–
	230	**147**

notes to the accounts for the year ended 31 March 2006 (continued)

5 interest receivable

	notes	2006 £'000	2005* £'000
bank interest		223	233
other interest		–	1
other finance income	10(d)	35	10
		258	**244**

*(as restated – note 10)

6 interest payable and similar charges

	2006 £'000	2005 £'000
bank loan and overdraft	269	214
other interest	1	–
	270	**214**

7 deficit on ordinary activities before taxation

	notes	2006 £'000	2005* £'000
this is stated after charging:			
staff costs	9	39,008	31,919
depreciation	13	2,926	2,706
operating lease rentals: premises		1,918	1,861
other operating lease rentals		44	41
bad debts written off		636	508
auditors' remuneration	12	217	54

*(as restated – note 10)

8 tax charge on deficit on ordinary activities

analysis of tax charge on ordinary activities

	2006 £'000	2005 £'000
United Kingdom corporation tax at 19% (2005: 19%) for the year	(10)	(10)
adjustment in respect of prior years	1	(1)
current tax charge for the current year	(9)	(11)

8. tax charge on deficit on ordinary activities (continued)

factors affecting tax charge for the current year

The tax assessed for the year is lower than that resulting from applying the standard rate of corporation tax in the UK: 19% (2005: 19%). The differences are explained below:

	2006 £'000	2005* £'000
deficit on ordinary activities before taxation	(316)	(791)
tax at 19% (2005: 19%) thereon	60	150
effects of:		
non taxable income	(70)	(160)
prior period adjustments	1	(1)
current tax charge for year	**(9)**	**(11)**

*(as restated – note 10)

Corporation tax is only payable on the surplus generated from the company's activities not directly related to its statutory obligations.

9 staff costs

	notes	2006 £'000	2005* £'000
salary costs		30,726	25,321
social security costs		3,460	2,835
employer's pension costs included in administrative costs:			
■ current service costs of final salary scheme	10 (c)	1,027	830
■ money purchase scheme		2,199	1,735
flexible benefit costs		1,596	1,198
	7	**39,008**	**31,919**
employer's pension costs			
■ included in other finance income	10 (d)	(35)	(10)
■ included in statement of total recognised gains and losses	10 (e)	247	1,270
total employment costs		**39,220**	**33,179**

*(as restated – note 10)

The average number of employees during the year in the United Kingdom was as follows:

	2006	2005
adjudicators	510	397
other	477	429
	987	**826**

10 pension costs

The Financial Ombudsman Service is part of the Financial Services Authority's (FSA) tax-approved pension plan open to permanent employees. The pension plan was established on 1 April 1998 and operates on both a defined benefit (final salary) and a defined contribution (money purchase) basis. Since 1 April 2000, all employees joining the Financial Ombudsman Service have been eligible only for the defined contribution section of the plan. The defined benefit section of the plan 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 plan.

Up to the year ended 31 March 2005, the Financial Ombudsman Service accounted for its defined benefit pension scheme in accordance with SSAP 24 ("Accounting for pension costs") and followed the transitional arrangements permitted by FRS 17 ("Retirement benefits") under which disclosure on retirement benefits was given in the notes to the financial statements. For the year ended 31 March 2006, the costs for the defined benefit scheme are accounted for in accordance with FRS 17, which has now been adopted in full. The impact of fully adopting FRS 17, and the restatement of prior year results, is further explained below.

defined benefit scheme

The latest full actuarial valuation of the FSA pension plan was carried out as at 1 April 2002 by an independent actuary using the projected unit method. Independent actuarial advice has been obtained in order to calculate the share of the assets and liabilities of the FSA scheme relating to those present and past employees of the Financial Ombudsman Service.

The figures below relate solely to the obligations of the Financial Ombudsman Service in respect of the defined benefit section of the FSA pension plan.

The principal assumptions used by the independent qualified actuaries in updating this valuation for FRS 17 purposes are shown below:

(a) main financial assumptions

	31 March 2006 %pa	31 March 2005 %pa	31 March 2004 %pa
inflation	3.0	2.9	2.9
rate of general long-term increase in salaries	4.5	4.4	4.4
rate of increase to pensions in payment	2.9	2.8	2.8
discount rate for plan liabilities	4.9	5.4	5.5

10. pension costs (continued)

(b) expected return on assets

	at 31 March 2006 long-term rate of return expected %pa	value £'000	at 31 March 2005 long-term rate of return expected %pa	value £'000	at 31 March 2004 long-term rate of return expected %pa	value £'000
equities	7.7	8,775	7.7	5,810	7.7	4,010
government bonds	4.3	–	4.7	–	4.7	960
corporate bonds	4.7	1,962	5.2	1,480	5.2	50
other	4.5	–	4.8	70	4.2	40
total market value of assets		**10,737**		**7,360**		**5,060**

(c) analysis of amount charged to operating deficit

	for the year ending 31 March 2006 £'000	for the year ending 31 March 2005 £'000
current service cost	1,027	830
total operating charge	**1,027**	**830**

(d) analysis of amount credited to other finance income

	for the year ending 31 March 2006 £'000	for the year ending 31 March 2005 £'000
expected return on pension plan assets	583	420
interest on pension plan liabilities	(548)	(410)
net return	**35**	**10**

notes to the accounts for the year ended 31 March 2006 (continued)

10. pension costs (continued)

(e) analysis of amount recognised in statement of total recognised gains and losses (STRGL)

	for the year ending 31 March 2006 £'000	for the year ending 31 March 2005 £'000
actual return less expected return on pension plan assets	1,563	70
experience gains and losses arising on the plan liabilities	(31)	(200)
changes in assumptions underlying the present value of the plan liabilities	(1,779)	(1,140)
actuarial loss recognised in STRGL	**(247)**	**(1,270)**

(f) reconciliation to balance sheet

	value at 31 March 2006 £'000	value at 31 March 2005 £'000	value at 31 March 2004 £'000
total market value of assets	10,737	7,360	5,060
present value of plan liabilities	(13,009)	(9,640)	(7,060)
net pensions liabilities	**(2,272)**	**(2,280)**	**(2,000)**

(g) analysis of movement in deficit during the year

	for the year ending 31 March 2006 £'000	for the year ending 31 March 2005 £'000
deficit in plan at beginning of the year	(2,280)	(2,000)
current service cost	(1,027)	(830)
contributions and expenses	1,247	1,810
past service costs	–	–
other finance income	35	10
actuarial loss	(247)	(1,270)
deficit in plan at end of the year	**(2,272)**	**(2,280)**

The Financial Ombudsman Service made regular contributions totalling £870,000 (2005: £810,000) at the agreed rate of 23.0 % (2005: 21.3%) of pensionable salaries for final salary section benefits and, in addition, contributed towards the insurance cost of death benefits payable from the plan and the expenses of administering the plan. The Financial Ombudsman Service also made lump sum contributions totalling £377,000 (2005: £1,000,000) to the plan towards funding the deficit.

10. pension costs (continued)

(h) history of experience gains and losses

	for the year ending 31 March 2006	for the year ending 31 March 2005	for the year ending 31 March 2004	for the year ending 31 March 2003
difference between expected and actual return on plan assets:				
■ amount (£'000)	1,563	70	600	(1,120)
■ percentage of plan assets	15%	1%	12%	(36%)
experience gains/(losses) on plan liabilities:				
■ amount (£'000)	(31)	(200)	(470)	120
■ percentage of the present value of the plan liabilities	(0.2%)	(2%)	(7%)	2%
total amount recognised in STRGL:				
■ amount (£'000)	(247)	(1,270)	(410)	(1,200)
■ percentage of the present value of the plan liabilities	(2%)	(13%)	(6%)	(23%)

(i) impact of change in accounting policy

The full adoption of FRS 17 in the current year is a change in accounting policy. The table below shows the impact of this change, firstly, due to the restatement of the prior year's results and, secondly, on the current year's results:

1. restatement of comparative figures

	income and expenditure account			balance sheet	
	administrative costs £'000	interest receivable £'000	deficit on ordinary activities £'000	net pensions liabilities £'000	reserves £'000
as previously reported at 31 March 2005	(45,593)	–	(1,781)	–	6,769
adoption of FRS 17	980	10	990	(2,280)	(2,280)
31 March 2005 – restated	(44,613)	10	(791)	(2,280)	4,489

10. pension costs (continued)

2. impact of change of accounting policy on the current year's results

	FRS 17 basis 2006 £'000	SSAP 24 basis 2006 £'000
income and expenditure account		
administrative costs	(1,027)	(1,247)
interest receivable	35	–
statement of total recognised gains and losses		
actuarial losses for the year in respect of the pension scheme	(247)	–
balance sheet		
net pensions liabilities	(2,272)	–
accumulated surplus	3,917	6,189

defined contribution scheme

The Financial Ombudsman Service made regular contributions totalling £2,199,335 (2005: £1,734,855) to the defined contribution scheme.

11 directors' remuneration

Directors' remuneration payable during the year amounted to £213,000 (2005: £157,603). The chairman, who is also the highest paid director, was paid £65,000 (2005: £45,000 per annum from 1 April 2004 to 31 January 2005 and £65,000 per annum from 1 February 2005 to 31 March 2005). The audit committee chairman was paid £22,000 (2005: £18,000 per annum from 1 April 2004 to 30 September 2004 and £21,000 per annum from 1 October 2004 to 28 February 2005) and the other directors £18,000 (2005: £12,000 per annum from 1 April 2004 to 30 September 2004 and £14,000 per annum from 1 October 2004 to 31 March 2005).

12 auditors' remuneration

	2006 £'000	2005 £'000
audit fee	45	42
other non-audit services	172	12
	217	**54**

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

A breakdown of the fees between the former auditors (Deloitte & Touche LLP) and the current auditors (Baker Tilly) is on the following page.

12. auditors' renumeration (continued)

	2006 £'000	2005 £'000
Deloitte & Touche LLP		
audit fee	–	42
other non-audit services	165	12
	165	**54**
Baker Tilly		
audit fee	45	–
other non-audit services	7	–
	52	**–**

13 tangible assets

	premises and leasehold improvements £'000	computer equipment and software £'000	furniture and equipment £'000	total £'000
cost				
at 1 April 2005	4,882	9,875	2,296	17,053
additions	19	642	93	754
disposals	–	(1,687)	–	(1,687)
at 31 March 2006	**4,901**	**8,830**	**2,389**	**16,120**
depreciation				
at 1 April 2005	2,268	6,114	1,289	9,671
charge for year	656	1,807	463	2,926
disposals	–	(1,687)	–	(1,687)
at 31 March 2006	**2,924**	**6,234**	**1,752**	**10,910**
net book value				
at 31 March 2006	**1,977**	**2,596**	**637**	**5,210**
at 31 March 2005	**2,614**	**3,761**	**1,007**	**7,382**

14 debtors

	2006 £'000	2005 £'000
trade debtors	6,261	5,876
other debtors	1,336	1,116
prepayments	1,018	1,072
	8,615	**8,064**

15 creditors: amounts falling due within one year

	2006 £'000	2005 £'000
trade creditors	461	797
UK corporation tax	10	10
other taxes and social security	922	832
other creditors	148	304
accruals and deferred income	3,269	3,014
	4,810	**4,957**

16 creditors: amounts falling due after one year

	2006 £'000	2005 £'000
bank loan	7,500	7,500
	7,500	**7,500**

The company took out a revolving loan facility of £15m dated 24 January 2003. The amount drawn-down at 31 March 2006 was £7.5m (2005: £7.5m). The interest rate payable is 0.15% per annum above London interbank offered rates. A commitment fee of 0.08% is charged on the outstanding sum on the revolving loan facility not yet drawn down. The Financial Services Authority has guaranteed the loan facility.

17 operating lease commitments

The company entered into a fifteen-year lease for four floors at South Quay Plaza in November 1999, with a rent review every five years. Under the lease the company was entitled to a one-year rent free period. The Financial Services Authority is a party to the lease agreement for the four floors as guarantor of performance of the lease in the sum of £1,089,798 per annum. On 6 July 2001, the company entered into a thirteen-year lease for the sixth floor, with a break clause and rent review in 2004 and a further rent review in 2009. For both leases, rent has been charged from the date at which the premises became available for occupation. On 23 December 2003, the company entered into a five-year lease for half of the seventh floor. Under the lease the company was entitled to a one-year rent free period. On 5 May 2004, the company exchanged contracts on the lease for the ninth floor of South Quay Plaza. The lease runs until July 2009, with a break clause in December 2006 and a rent review in September 2008. On 27 April 2005 the company entered into a lease for half of the eighth floor. The lease runs until 24 June 2010 with break clauses in March 2007 and in March 2008. As at 31 March 2006, the company was committed to making the following payments during the next year, in respect of operating leases:

	premises 2006 £'000	other 2006 £'000	premises 2005 £'000	other 2005 £'000
leases which expire:				
within one year	–	3	–	2
between two and five years	132	37	318	40
after five years	1,961	–	1,666	–

Details of the terms of the leases are as follows:

floor	start of lease	future break clauses	future rent reviews	end of lease
1–4	November 1999		November 2009	November 2014
6	July 2001		February 2009	February 2014
7 part	December 2003	December 2006		December 2008
8 part	April 2005	March 2007 & March 2008	December 2009	June 2010
9	May 2004	December 2006	September 2008	July 2009

18 related party transactions

The Financial Ombudsman Service, together with the Financial Services Authority, was created as part of the government's legislation for the financial services market and derives its statutory authority from the Financial Services and Markets Act 2000. The Financial Services Authority is regarded as a related party.

(a) The Financial Ombudsman Service has entered into an agency agreement with the Financial Services Authority whereby, with effect from 1 April 2004, the Financial Services Authority will collect tariff data, issue levy invoices and collect levy monies on behalf of the Financial Ombudsman Service, at a cost of £65,800 for the year ended 31 March 2006 (2005: £52,875).

(b) An amount of £1,027,563 was due from the Financial Services Authority at 31 March 2006 (2005: £820,281). This was the net balance due following the billing of levies to firms and is included in "other debtors" (see note 14).

(c) The Financial Services Authority is the guarantor of the loan facility in the sum of £7,500,000 at 31 March 2006 (see note 16), and also is a party to the lease agreement for four floors at South Quay Plaza as guarantor of performance of the lease in the sum of £1,089,798 per annum (see note 17).

Other than disclosed above, there were no related party transactions during the year (2005: none).