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# Accounting separation: Consultation on allocation of activities between business units

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## About this consultation

This document sets out the first part of our proposed approach to implementing accounting separation. As part of a pilot project, we have been working with some companies to develop a proposed new disaggregation of the value chain, splitting activities between potential business units.

The purpose of this paper is to consult on our proposed split of business units.

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## Responding to this consultation

We invite comments on the proposals in this document by 14 November 2008.

You can e-mail your responses to [hayley.purcell@ofwat.gsi.gov.uk](mailto:hayley.purcell@ofwat.gsi.gov.uk) or post them to:

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If you wish to discuss any aspect of this document, please direct your enquiry to Hayley Purcell on 0121 625 1481 in the first instance.

We will publish responses to this consultation on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk), unless you indicate that you would like your response to remain unpublished.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 and the Environmental Information Regulations 2004.

If you would like the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory ‘Code of Practice’ which deals, amongst other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.

An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

## Executive summary

In our methodology for the 2009 price review (PR09), '[Setting price limits for 2010-15: Framework and approach](#)', and in previous consultation papers on competition ([July 2007](#) and [December 2007](#)), we signalled our intention to pursue vertical accounting separation.

We held an industry workshop in January 2008 to explore the accounting separation process with appointed water companies and other, relevant stakeholders. At that session we proposed to establish a small group of appointed water companies to help us identify issues and pilot our interim ideas.

In May 2008, we published '[Ofwat's review of competition in the water and sewerage industries: part II](#)'. This set out for consultation our view that the water and sewerage value chains include a number of potentially contestable activities. As a first step to opening contestable markets, we confirmed that we would take forward accounting separation of the water and sewerage value chains.

Our objective is for all companies to report their accounts on a consistent vertically-disaggregated basis, which enables the development of competition in contestable parts of the value chain and provides greater transparency of costs in general for all stakeholders. This aligns with our strategy of introducing competition progressively where it benefits consumers.

In this consultation, we propose a set of vertically separated business units for accounting purposes and have proposed an allocation of activities to the business units.

We recommended in our [May consultation paper](#) that appointed companies' should legally separate their water and sewerage retail services businesses from the remainder of the business. Although legal separation may require government legislation to achieve, following our recommendation we propose to focus the most detailed financial reporting requirements on the retail business unit. As part of this we propose a retail business model that gives the retailer responsibility for all customer-facing activities. We are seeking views on this retail business model and on our preliminary split of activities between retail services and the upstream business units.

In the upstream water supply value chain we are proposing separate water resources, treatment and raw water distribution business units. We are also proposing separate sludge disposal and sludge treatment business units.

The responses to this consultation and our ongoing work with pilot companies will inform the development of detailed reporting requirements for 2009-10, including appropriate cost drivers and allocation methods. The plan is for all companies to report costs against revised reporting requirements (initially for 2009-10), with subsequent review and refinement to improve compliance for 2010-11.

All of our proposals are informed by the principle of separating potentially contestable activities from natural monopoly activities. In chapter 2, we have included questions on the proposed upstream and distribution business unit boundaries.

## 1. Introduction

As part of [‘Ofwat’s strategy – taking a forward look’](#), we set as one of our key priorities the progressive introduction of competition where it benefits consumers. Our strategy also made clear the need to maintain effective regulation where competition cannot, or does not yet, protect consumers.

In the water and sewerage sectors in England and Wales, appointed water companies typically operate vertically-integrated monopoly businesses, involving a number of different business activities that interact with each other. Costs and revenues associated with individual business activities are not always fully clear or visible, because the costs tend to be reported at a high level.

In May 2008, we published [‘Ofwat’s review of competition in the water and sewerage industries: part II’](#). This set out, for consultation, our view that the water and sewerage value chains include a number of potentially contestable activities.

Learning from experiences in other network utility sectors, we set out our view that vertical separation of contestable markets from natural monopoly activities would be important in developing effective competition in contestable activities.

As a first step we said we would take forward accounting separation. This involves identifying discrete activities and grouping these into separate business units. Companies will be required to prepare separate accounts for their different businesses and some parts of businesses, so that the costs and ultimately revenues associated with each business (and transfers between them) can be identified separately.

For accounting separation to be beneficial, it must yield information derived from financial records to reflect, as closely as possible, the performance and actual costs of separate business activities.

### 1.1 Accounting separation project

The accounting separation project will put in place robust reporting requirements to allow companies to report their accounts on a consistent vertically-disaggregated basis. This is a necessary enabler to the development of competition in contestable parts of the value chain and provides greater transparency of costs in general.

The project is part of an overall programme aiming to introduce formally vertically separated price controls by the time we begin to set any price limits for the period after 2015.

This project involves identifying distinct business units along the value chain and identifying the activities, assets and costs associated with each unit. We will then look to review the risks and returns, and determine the revenue for each business unit.

The project started in January 2008 with industry and stakeholder workshops. Our initial priorities over the next two years are:

- the allocation of activities and the development of detailed reporting requirements for companies' retail services business units, based on an appropriate assumed retail business model. This would support delivery of our recommendation for legal separation of retail services businesses;
- revised business units and updated requirements for cost reporting across the rest of the value chains, which support ongoing work to develop upstream business models and disaggregated indicative price caps;
- for all companies to report costs against revised reporting requirements (initially for 2009-10); and
- to review and evaluate the project, with engagement from auditors and reporters.

Subsequent priorities are likely to include:

- developing detailed business models for upstream business units. This is part of our wider competition reform programme and would be informed by the Cave review's recommendations, and use these models to define more detailed reporting requirements for upstream business units;
- refining initial reporting requirements and improving companies' compliance for 2010-11 accounting separation reports;
- disaggregating the PR09 price cap into indicative revenue caps for each business unit (leading to formal price control separation); and
- separating retail services business units into separate legal entities, subject to consultation and legislation.

It is important that we make as much progress as possible in 2009-10 but we recognise that costs and the reporting requirements will be improved over time, and that the data for the initial year (2009-10) will not be as refined as for subsequent years.

We can learn from successful approaches to introducing accounting separation both in the water industry in Scotland and in other utility sectors where it has been used as a first step in helping competition to develop.

## 1.2 Costs and benefits

The rationale for pursuing accounting separation was set out in previous consultations and includes the following benefits.

- It can improve transparency of costs with benefits for customers, the company, entrants and help the economic regulator better target its regulatory interventions.
- It may help identify areas for efficiency improvements (for example, redundant services were revealed when this process was carried out in Scotland).
- It should help to ensure parity of treatment, including in relation to access prices, for competing providers of contestable activities.
- In particular, it is also a necessary first step towards any development of a legally-separated competitive retail services market and establishing vertically-disaggregated price controls across the value chain.

We recognise that the companies may incur implementation costs associated with introducing accounting separation. For example, they may need to adapt their existing cost accounting systems, so that they are capable of reporting separated accounts (although some companies' systems architecture may already be capable of producing separated accounts).

In general, these costs would be short term and are unlikely to outweigh the long-term benefits set out above. The [May paper](#) included a draft impact assessment for overall competition reform. This is relevant here since, accounting separation as noted above, is an important initial step in the development of competition.

As the pilot progresses and we develop detailed reporting requirements, we will be better able to understand the costs of the different implementation options. We will use this knowledge to inform decisions about how accounting separation is rolled out.

## 2. Taking forward accounting separation

### 2.1 Principles for activity allocation

Accounting separation does not dictate how activities should actually be organised and carried out within companies, but how financial accounting information should be collected and reported.

We already collect some vertically-disaggregated data on operating costs of each regulated business through the regulatory accounts (and replicated in tables 21 and 22 of the June return). The current tables disaggregate the water value chain into two categories:

- water treatment and resources; and
- water distribution.

The sewerage value chain is disaggregated into:

- sewerage;
- sewage treatment; and
- sludge treatment and disposal.

Customer services (including retail costs), scientific services and other business activities are not allocated to specific business units at the moment. The primary purpose of this analysis has historically been to drive our econometric models for comparative efficiency purposes.

The nature of the reporting requirements under the accounting separation project, including grouping activities into business units, needs to be informed by the purpose of the project. One of the main objectives of accounting separation is to help facilitate the development of competition in contestable parts of the value chain. So, identifying the separate business units and reporting requirements needs to be shaped by views about the potential for, and likely shape of, future competing businesses.

Our approach to allocating activities to business units has been to test and discuss ideas with a small group of volunteer companies (the pilot companies) ahead of a wider consultation. We have now reached an initial view on allocating activities between business units. The rationale for deciding the grouping has included:

- separating all potentially contestable activities from those which are not contestable;
- giving consideration to potential business models; and
- including all customer-facing activities in the retail services business unit.

Certain activities, such as meter installation and maintenance, may be accounted for in a business unit (retail) that is different to the unit in which integrated companies may operationally include them. At this stage, that is before any other form of separation, this does not require operational changes within the integrated company, but only makes a financial reporting requirement.

The initially-agreed allocation of activities is not intended to pre-empt how future markets will operate. More work may be needed as the framework for competition develops and as markets themselves develop. We have tried to identify activities for which, at a later stage, it may be decided that they fit better in a different business unit. We propose that companies should report such activities separately within business units.

## 2.2 Issues for consultation

### Questions

1. Do you agree with the activities allocated to the retail services business unit?
2. Do you agree with the proposal that activities listed in chapter 3 should be reported separately within the retail services business unit?
3. Do you agree with the inclusion of costs associated with resolving operational calls within a retail business unit?
4. Do you have other comments, including on the retail services business model?
5. We are interested in understanding broadly what a raw water distribution network would look like in each water company region.
6. We are seeking views on whether or not to separate out some defined category of small, co-located water treatment works plus resources business unit. What objective criteria could define this business unit?
7. Is it sensible to have sludge disposal as a separate business unit?
8. Do you agree with the proposed split of business units and allocation of activities?

### **2.2.1 Retail services business unit**

We have said we will require companies to account separately for relevant business units across the entire value chain.

In our [May paper](#) we also put forward our recommendation for consultation that appointed companies' water and sewerage retail services businesses should be divided into legal entities separate from the remainder of the business. As a result, we are placing greatest priority on specifying the allocation of activities and detailed reporting requirements for companies' retail services business units. We recognise that legal separation is likely to require government legislation to achieve, but consider that the information revealed by accounting separation can assist policy development.

To achieve this, we first need to differentiate the activities associated with retail services activities from the rest of the business. Companies will need to identify both operating costs and assets associated with these activities. Chapter 3 discusses our views on the overall shape of the retail business unit. It also identifies proposed activities within the retail business unit which we think should be reported separately. We also propose that the retail costs of servicing households should be separately reported from the retail costs of reporting non-household services.

A description of the activities which we propose including within the retail services business unit is in appendix 1.

### **2.2.2 Allocation of activities between distribution and upstream business units**

We are proposing business units and allocation of activities across the rest of the value chains, which support ongoing work to develop upstream business models and disaggregated indicative price caps.

These are:

- water resources;
- raw water distribution;
- water treatment;
- treated water distribution;
- sewage collection;
- sewage treatment;
- sludge treatment; and
- sludge disposal.

Chapter 4 discusses the proposed upstream business units and appendix 3 describes examples of activities to be reported in each unit.

### **2.2.3 Reporting templates**

Appendix 3 suggests a pro forma to report retail services costs and appendix 4 sets out a suggested pro forma for reporting separated costs for activities (excluding retail) for use in the pilot. These are based on tables 21 and 22 of the June return. Pilot companies will be asked to complete returns in the requested layout at agreed timescales. We have included these pro formas for information only, and for discussion with pilot companies. We are not seeking views on them at this time.

The responses to this consultation and our ongoing work with pilot companies will inform the development of detailed reporting requirements for 2009-10, including appropriate cost drivers and allocation methods. The reporting requirements will be more detailed for the retail services business unit than for other units for 2009-10.

We will develop, consult on and issue revised regulatory accounting guidelines by next spring and amend condition F of companies' licences where appropriate. A high-level timetable for the project's overall work is set out in chapter 5.

## **2.3 Principles governing allocation of costs**

Having defined the activities to be included in each business unit, companies will need to consider how they allocate their costs between activities and, as a result, business units.

The processes of cost accounting and accounting separation can be complex, covering issues such as:

- cost attribution methodologies;
- accounting standards;
- audit;
- transparency;
- disaggregation;
- reconciliation; and
- publication of information.

We will consult on the detailed guidance in early 2009 and then publish detailed guidance with updated regulatory accounting guidance and reporting requirements in spring 2009.

Ahead of that, in particular to inform the project, we consider in this paper general principles that water companies should follow when developing their cost allocation policies.

The main aim is that companies' accounts are transparent with the overriding principle that costs should be recorded by the activity that incurred or consumed them.

In general, there are two main types of costs: direct and indirect.

- Direct costs are those that can be clearly ascribed to and are caused by a particular activity or service.
- Indirect costs are those that cannot be readily ascribed to a particular activity or service.

Costs which can be assigned to a particular activity or business directly should be assigned appropriately. If this is not possible, companies should identify a suitable allocation method. It is important that companies state clearly the methodology that they have used and that they can support it with a clear rationale.

We are committed to keeping the cost of regulation to a minimum and will work with the companies and other stakeholders to make sure that this is achieved. We recognise that there will be a point beyond which allocating the costs outweighs potential benefits where the amounts are immaterial. In such instances, the remaining costs could be allocated or apportioned in a manner which does not reflect precisely the consumption of those costs.

The above principles are consistent with the existing regulatory accounting guidelines.

### 3. Retail services business model

In this chapter, we set out how we have developed the proposals for the activities that we propose to include in the retail services business unit for accounting separation purposes. The list of activities is in appendix 1.

In considering the potential business model for a competitive retail service business, **the first key principle is that retailers would ‘own’ the final consumers and each retailer would compete for market share.**

The retailer would compete:

- by offering different options for downstream services and tariffs;
- with the quality of customer service it offers;
- by offering lower prices as a result of its own operational efficiencies; and
- potentially, in the long term, in the way it contracts for upstream water (and wastewater) services.

Therefore, giving the retailer responsibility for all customer-facing activities is critical to the model.

**A second principle is that no potentially contestable activities downstream of treated water distribution are allocated to the natural monopoly distribution business.** Any activities which competing suppliers could carry out, should not be provided preferentially by a monopoly supplier.

Based on these principles, we have proposed a preliminary split of activities between a retail services business unit (consisting of all downstream contestable activities) and business units further upstream in the value chain. A proposed pro forma table for reporting retail costs in the pilot is set out in appendix 2. This requires companies to capture separately the costs for household and non-household customers for:

- billing;
- operational customer enquiries and complaints;
- non-operational customer enquiries and complaints;
- debt recovery;
- payment handling;
- disconnections;
- meter reading;
- meter maintenance and installation;
- demand-side water efficiency initiatives;
- developers’ services;

- support for trade effluent compliance;
- purchasing/contract management;
- customer-side leaks; and
- doubtful debts.

### Questions

- 1. Do you agree with the activities allocated to the retail services business unit?**
- 2. Do you agree with the proposal that the above activities should be reported separately within the business unit?**

It is important to note that whilst the responsibility and financial reporting for an activity may well lie with one business unit (which will, therefore, also bear the cost associated with it), it does not mean that they operationally have to perform that activity.

A list of the main activities included in the retail business model is listed in appendix 1. We set out below explanations for our proposal to include three particular activities in the retail services business unit.

#### **2.3.1 Customer operational enquiries**

We propose that the retail business unit includes all customer enquiries and customer relations activities, including operational enquiries. Our reasons for this are based on our view of how future competing retail services business could operate, which could include the following.

- Delivering operational enquiries is customer-facing and contestable.
- There is clarity for the customer, with the retailer being the single point of contact. (Whatever the formal arrangements, customers would be likely to hold their retailer accountable.)
- Potential efficiencies from all customer enquiries sitting with the retailer.
- The retailer has a competitive incentive to give a good call centre service to customer.
- The retailer also has incentives to help ensure as far as it can that the customer's problem is resolved effectively.
- The retailer might seek to negotiate differentiation of operational service, to provide customer service choices where that was feasible.
- The retailer is closest to the customer and has greater visibility than other business units as to the nature of the supply their customers are receiving.

We also envisage that retailers would be responsible for resolving customer calls about operational activities, for example low pressure. We propose that this activity should be included in the retail business unit alongside operational enquires.

### **2.3.2 Water meters**

We propose that the activities relating to the reading, installation and maintenance of meters are included in the retail business unit. Nevertheless, it might still be appropriate for the network business unit to continue to own and physically maintain meters, at least for a certain period of time. This would be consistent with retailers' overall responsibility for this activity, for example through retailers contracting with, and leasing meters, from the network business.

Our reasons for this proposal include the following.

- All metering activities are potentially contestable, and customer-facing.
- The costs of the meter itself (installation and operation) should sit with meter reading because of the trade-offs between choice of meter type (for example, smart meters), and costs of meter reading and availability of service options.
- Both the retailer and network operator business have incentives to ensure accurate meter reading.
- Relevant operational issues, such as meter interoperability with the network, can continue to be agreed with the network business.

### **2.3.3 New connections**

We propose that new network connections should be included in the retail business unit because it is customer-facing and contestable.

Clearly, customers for this activity include developers, not just water consumers. Businesses would be able to compete to offer the best service to this group of customers. Including such a contestable activity within the network monopoly business would not be appropriate.

#### **Questions**

- 3. Do you agree with the inclusion of costs associated with resolving operational calls within a retail business unit?**
- 4. Do you have other comments, including on the retail services business model?**

## 4. Split of activities between upstream business units

For upstream water supply, we are proposing separate water resources, raw water distribution and water treatment business units. As we have already identified in our [May paper](#), both water resources and water treatment are potentially contestable markets.

Raw water transport has natural monopoly characteristics, so we are proposing that it should be in a separate business unit from the contestable resources activities (abstraction licences and abstraction). Any competing resources businesses may need to negotiate access to existing raw water transport in principle, and so should not be negotiating with a resources competitor. However, in physical terms, raw water transport may be separated from other transport assets by treatment works (which are contestable), this may increase complexity. Views are welcome on the scope and scale of raw water transport assets.

### **5. We are interested in understanding broadly what a raw water distribution network would look like in each water company region.**

We are seeking stakeholders' views on whether or not to separate out some defined category of small, co-located water treatment works plus resources business unit (for example, a small treatment works co-located with a borehole and without significant scope for other resources to gain access), whether to include such facilities within the resources business unit or whether to split the activity simply between resources and treatment.

#### **Question**

### **6. We are seeking views on whether or not to separate out some defined category of small, co-located water treatment works plus resources business unit. What objective criteria could define this business unit?**

Such category of water treatment works might be considered an integral part of the resources to which they are attached, and to only those resources. They might constitute a separate, readily contestable market.

We are also proposing that treated water distribution and sewage collection are reported as separate business units as both are considered to be natural monopoly.

In the sewerage service we are proposing separate reporting for sewage treatment, sludge treatment and sludge disposal business units as we believe that each market is potentially contestable. In particular, we are seeking views on whether sludge disposal is a potentially contestable market, separate from sludge treatment.

### Questions

- 7. Is it sensible to have sludge disposal as a separate business unit?**
- 8. Do you agree with the proposed split of business units and allocation of activities?**

As part of the project, we will be updating the regulatory accounting guidelines, where appropriate with new definitions of activities to reflect the new business boundaries. These will be drawn from responses to this consultation and the pilot exercise.

## 5. Next steps

Detailed timings of the following milestones will be agreed with the companies involved in the pilot project. We will issue updates on the progress of the cost allocation project as appropriate.

Consult on allocation of activities to business units and allocated cost templates	Summer 2008
Conclusions on business units and templates	Autumn 2008
Pilot companies report according to allocated costs templates	Autumn/winter 2008-09
Development of detailed reporting requirements, including indirect cost assessment methodology	Autumn/winter 2008-09
Consult on draft regulatory accounting guidelines	Winter/spring 2008-09
Issue updated regulatory accounting guidelines	Spring 2009
Pilot companies report second returns according to allocated costs templates	Spring/summer 2009
Develop and specify June 2010 requirements for presentation of reports and revised tables	Winter 2009-10
All companies report on revised basis (reporting year 2009-10)	June 2010
Issue refined regulatory accounting guidelines	Summer 2010
All companies report on revised basis (reporting year 2010-11)	June 2011

Before proceeding with proposals for formal price control separation we would need to review and consult on approaches to allocating revenue and the regulatory capital value (RCV) across the value chain. However, for the purpose of the initial implementation phase of the accounting separation project this is not necessary, as we are initially simply allocating accounting costs and not setting price controls or separating business operations.

Decisions about revenue are closely linked with decisions about the future shape of upstream competition and consequent business models. This will become clearer following the outputs from the Cave review and as our work on possible competition in upstream markets continues.

## **Appendix 1: Summary of key retail activities**

This appendix contains a description of the scope of activities that we propose should belong in the retail services business unit. The list is not exhaustive and is intended to help clarify the possible boundaries between retail and other business units.

Detailed definitions will be developed as part of the regulatory accounting guidelines. Not all activities listed need to be reported separately. Only those detailed in the tables in appendix 2 for retail services need to be reported separately.

### **Retail services business water and sewerage**

All direct costs linked to the following activities should be included.

#### **Billing**

- Customer accounting.
- Tariff setting and negotiation.
- Administering vulnerable groups scheme.
- Issuing bills.

#### **Customer enquiries and complaints**

- Enquiries in relation to operational matters,
- On-site investigations as a result of operational queries.
- Billing, payment and all other customer liaison on enquiries and complaints.

#### **Payment Handling/Remittance and cash processing**

#### **Debt management**

- Bad debt costs.
- Debt recovery.
- Costs of disconnecting non-household supplies for debt collection purposes.

#### **Meters**

- Meter reading.
- Meter maintenance and installation.

### **Demand-side water efficiency initiatives**

- Retro-fitting of water-saving devices.

### **Purchasing/contract management**

- Costs of purchasing upstream services, including negotiation and management of contracts.

### **Developer services**

- New connections.

### **Support for trade effluent compliance**

### **Customer-side leaks**

- Supply pipe repairs and replacements.
- Turning water supply on and off (including customer disconnection requests).

Relevant capital expenditure could include the cost of implementing or enhancing a billing system.

## **Appendix 2: Summary of key activities in upstream and distribution markets**

This appendix contains a description of the scope of activities that we propose should belong in the upstream and distribution business units. The list is not exhaustive and is intended to help clarify the possible boundaries between the various units.

### **A) Water resources**

All costs associated with water resources, including the following activities.

#### **Abstraction licences**

- Abstraction charges.
- Abstraction rights.

#### **Abstraction – boreholes, rivers and surface water**

- Operating, repairing and maintaining abstraction facilities.
- Low-lift raw water pumping into raw water reservoirs, holding tanks or treatment works.
- Pre-treatment of raw water.

#### **Collect and impound – raw water reservoirs**

- Operation and routine maintenance of reservoirs.

#### **Catchment management**

- Bulk supplies.

#### **Relevant capital expenditure, including:**

- Installing abstraction assets.
- Constructing raw water reservoirs.

## **B) Raw water distribution**

All costs associated with raw water distribution, including the following activities.

### **Operation of raw water transport**

- Operating, repairing and maintaining raw water networks.
- Raw water pumping and conveyance into treatment.
- Leakage detection and repair within raw water system.

### **Relevant capital expenditure including**

- Constructing raw water transport.

## **C) Water treatment**

All costs associated with water treatment, including the following activities.

### **Operation of water treatment**

- Discharge of treated water to distribution system.
- Operating, repairing and maintaining raw water treatment facilities.
- Waste disposal.
- Inter-process pumping.
- Process checks.
- Procuring bulk treated water.

### **Relevant capital expenditure, including:**

- Constructing new treatment facilities.
- Upgrading existing facilities

## **D) Treated water distribution**

All costs associated with treated water distribution, including the following activities.

### **Bulk and local transportation of treated water**

- Operating, maintaining and repairing mains, fittings, hydrants and water connection pipes.
- Mains flushing and scouring.

- Leakage detection and repair within treated water system.
- Secondary chlorination.
- High-lift pumping.

### **Distribution and storage of water**

- All activities associated with storage of treated water within the treated water distribution system.
- Cleaning and maintaining service reservoirs.
- Further treatment of stored treated water (such as treatment embedded in treated water distribution).

### **Relevant capital expenditure, including:**

- Constructing new infrastructure for the treated water network.

### **Monitoring and investigating treated water distribution system performance**

- Network modelling and water records.
- Investigating water quality, water pressure and other complaints.
- Replacing and calibrating district and zonal meters.

## **E) Sewage collection**

All costs associated with sewage collection and transport, including the following activities.

### **Sewage transport**

- Monitoring and controlling the sewer network.
- Operating, maintaining and repairing sewer network, service connections and street furniture.
- Sewer inspection.
- Sewer cleansing and removing blockages.
- Sewerage responses under the requirements of the New Roads and Street Works Act.
- Sewer records and models.

### **Pumping sewage**

- Monitoring, operating, maintaining, repairing and renewing pumping stations.
- Cleaning up sewer flooding.

## **Storm overflow and outfall**

### **Monitoring and investigating wastewater collection system performance**

- Investigating sewer flooding, odour and other complaints.
- Rodent control.
- Activities arising from enquiries and complaints to the sewerage system from customers, contractors, or other utilities, including site visits and any attendance on sites during excavations.

### **Sewer adoption**

- Administering sewer adoption applications.
- Managing first-time sewerage applications.

### **Relevant capital expenditure, including:**

- Constructing new or enhanced infrastructure for collecting and transporting sewage.

## **F) Sewage treatment**

All costs associated with sewage treatment, including the following activities.

### **Preliminary, primary, secondary and tertiary treatment**

- Monitoring, operating, maintaining, repairing and renewing sewage treatment plants.
- Associated pumping plant and outfalls.
- Costs of sludge storage on satellite sites before transport to treatment sites.

### **Relevant capital expenditure, including:**

- Constructing new sewage treatment facilities.

## **G) Sludge treatment**

All costs associated with treatment of sewage sludge, including the following activities.

## **Sludge treatment**

- Sludge conditioning, drying and de-watering.
- Thickening (except where carried out alone ahead of transport from satellite sewage treatment plant).
- Digestion.

## **Sludge transfer by pumping, tankering or other means**

### **Relevant capital expenditure, including:**

- Constructing new sludge treatment facilities.

## **H) Sludge disposal**

All costs associated with disposal of sewage sludge, including the following activities.

### **Sludge disposal**

- Incinerating and disposing of ash and other waste streams.
- Disposal of sludge to land.
- Composting, landfill or other sludge disposal.

### **Relevant capital expenditure including**

- Constructing new sludge disposal facilities.

## Appendix 3: Pro forma for retail services for water supply and sewerage services

Description	Units	Field Type	Retail Household	Retail - Non household	Retail Service Total
<b>Service Analysis : Direct Costs</b>					
Billing	£m	I/C			
Meter reading	£m	I/C			
Meter maintenance/installation (non capex)	£m	I/C			
Payment handling	£m	I/C			
Operational customer enquiries	£m	I/C			
Non operational customer enquiries and complaints	£m	I/C			
Debt Recovery	£m	I/C			
Disconnections	£m	I/C			
Doubtful debts	£m	I/C			
Demand side water efficiency initiatives	£m	I/C			
Developer Services	£m	I/C			
Support for trade effluent compliance	£m	I/C			
Purchasing/contract management	£m	I/C			
Customer side leaks	£m	I/C			
Other Direct Costs	£m	I/C			
<b>Total direct costs</b>	£m	C			
General and support costs	£m	I/C			
Exceptional items	£m	I/C			
<b>Total operating expenditure</b>	£m	C			
<b>Capital Maintenance</b>					
Infrastructure renewals expenditure	£m	I/C			
Current cost depreciation	£m	I/C			
Amortisation of intangible assets	£m	I/C			
Amortisation of deferred credits	£m	I/C			
<b>Total capital maintenance</b>	£m	C			
<b>Total operating costs</b>	£m	C			

## Appendix 4: Pro forma for water supply and sewerage services

### Water supply

Description	Units	Field Type	Water Resources	Raw Water Distribution	Water Treatment	Treated Water Distribution	Water Service Total
<b>Total direct costs</b>	£m	C					
General and support costs	£m	I/C					
Other business activities	£m	I					
<b>Total business activities</b>	£m	C					
Exceptional items	£m	I/C					
<b>Total operating expenditure</b>	£m	C					
<b>Capital Maintenance</b>							
Infrastructure renewals charge	£m	I/C					
Current cost depreciation	£m	I/C					
Amortisation of deferred credits	£m	I/C					
Amortisation of intangible assets	£m	I/C					
<b>Total capital maintenance</b>	£m	C					
<b>Total operating costs</b>	£m	C					

### Sewerage services

Description	Units	Field Type	Sewage Collection	Sewage Treatment	Sludge Treatment	Sludge Disposal	Wastewater Service Total
<b>Total direct costs</b>	£m	C					
General and support costs	£m	I/C					
Other business activities	£m	I					
<b>Total business activities</b>	£m	C					
Exceptional items	£m	I/C					
<b>Total operating expenditure</b>	£m	C					
<b>Capital Maintenance</b>							
Infrastructure renewals expenditure	£m	I/C					
Current cost depreciation	£m	I/C					
Amortisation of deferred credits	£m	I/C					
Amortisation of intangible assets	£m	I/C					
<b>Total capital maintenance</b>	£m	C					
<b>Total operating costs</b>	£m	C					







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