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## Ofwat's targeted review of sludge and water resources

Companies have been reporting separate accounting data across different business units, including costs for water resources and sludge, in their regulatory accounts for several years. We have recently consulted on our proposal to set separate price controls for water resources and sludge in [Water 2020: Regulatory framework for wholesale markets and the 2019 price review](#). Whether or not we do eventually set price controls for these areas, we have identified a need for greater consistency and comparability.

Accounting separation was a first step towards developing a better understanding of company activities and costs across the value chain. We now think we need to review and refine the definitions of the water resources and sludge business units.

The Water Act 2014 will allow for competition in upstream services including water resources and sludge. If we were to model costs and revenues in these areas – and particularly if we needed to set separate price controls – we would need good quality data in 2016-17 and 2017-18.

With this in mind, we engaged Cambridge Economic Policy Associates (CEPA) to lead [a targeted review into the accounting treatment of these business units and to produce a report setting out where changes needed to be made](#). As we explained in [Monitoring and Assuring Delivery](#), we use targeted reviews to carry out a much more detailed examination of the sector's approach to a particular topic. This is a proportionate response where:

- There are significant concerns identified by stakeholders;
- There is a high risk to customers or other stakeholders; or
- There is an opportunity for major benefits for stakeholders.

We identified a number of areas to look at in more detail: These were:

- Sludge revenues and non-appointed income;
- Sludge related activities outside the price control;
- Reporting of costs – sludge and water resources;
- Interaction with non-appointed businesses; and
- MEAV revaluation in 2009.

CEPA issued a standard questionnaire to all 10 water and sewerage companies (WaSCs) and followed this up with a one day visit to each WaSC. Following these meetings, CEPA revised the questionnaire responses to reflect its understanding of the discussions and then shared these with the WaSC to confirm the responses and make further additions.

We are [consulting on changes to our Regulatory Accounting Guidelines](#) following CEPA's report.