

Published: January 12, 2026, 7:50 pm

---

*I was asked yesterday by a friend who is an accountant what I thought about the problems in water companies. This was my reply:*

---

What most accountants, let alone non-accountants, do not really understand about the accounts of any private sector entity that they look at is that there is, implicit within them, what is called a 'capital maintenance concept'. An accounting system is used to determine whether, over the course of the period, the relative worth of an enterprise has increased as a result of the transactions that it has undertaken, or reduced, ignoring for these purposes additional contributions received from its shareholders, and returns paid to them.

Before 2005 we used historic cost accounting in the UK. What this accounting framework emphasised was the ability of the enterprise to maintain its physical capacity intact. In other words, whether or not the entity was to be considered a going concern was determined on the basis of whether it could command the physical resources that it required to deliver the goods and services that it sought to sell to willing customers. The care emphasis was, as a consequence, upon the delivery of service and the profit and loss account was considered the primary accounting statement.

Since 2005 we have had International Financial Reporting Standards in use in the UK, and right across Europe as well as in about 80 other countries. The capital maintenance concept within this type of accounting differs from that within historic cost accounting. IFRS seeks to preserve the financial capital of the entity. As a consequence the focus is on the worth of those financial resources and the balance sheet is predominant, but not with regard to what is actually owned, or to which purpose it is put, but rather with regard to its financial worth to third parties. This is 'mark to market' accounting. There is actually some considerable indifference within IFRS accounting as to what the organisation actually does: in principle one pound earned from bank interest is exactly the same as one pound earned from the supply of essential drugs to the NHS or, come to that, one pound earned from the illicit supply of drugs to those using them in night

clubs.

The IFRS approach is supposed to maximise shareholder value, where the shareholder is only concerned about the receipt of a financial return on the share that they own. What is not explicitly stated within this framework, and which has only relatively recently been appreciated by academic accountants, is that implicit in this is the fact that what is being said is that the shareholders do not, as such, care in the slightest bit about the organisation in that case because they do not in fact own it: all that they actually own is the share that it issues, which gives them a right to a return if the company decides to pay it to them. However, because it has become commonplace in the last fifteen or so years for directors of companies to be heavily rewarded by bonuses that are usually linked to the value of company shares there is a considerable incentive upon the directors to increase the value of those shares because they personally gain as a consequence even though the company might not. There is implicit in this process a significant degree of moral hazard. Because shareholders only receive the upside of transactions with the company, with the cost of its failure being very largely imposed upon society at large, the inclination for companies to both overstate their earnings and over distribute their profits is very high. The result is that there is significant financial engineering rather than real product engineering to deliver financial rewards rather than returns that benefit society as a whole. With colleagues with whom I have worked on this issue we have described this as the process of hollowing out firms.

All this preamble is very relevant in the context of water companies. When these companies were privatised there was an implicit contract made with them that they would continue to supply essential water and sewage services to all consumers within the geographic area that they served. Again, implicit within this contract is the assumption that they will maintain the necessary infrastructure to do so. Unless they do so they cannot be a going concern. However, what is readily apparent is that the financial worth of that infrastructure is actually very low: no one can really use it for anything but the supply of water services, and given that only one company can have a contract for the supply of water in one area the likely financial value of any particular asset on the balance sheet of a water company is quite low even if that same asset is absolutely fundamental to the supply of water or sewage services in an area. The focus of emphasis within IFRS accounts is, then, wholly inappropriate in the case of water companies, but they are used nonetheless. Historic cost accounting, with its focus upon the supply of services would obviously be considerably more appropriate in this case because what it would highlight is the fact that, as is now very obviously apparent, these companies are not maintaining the physical capital that is required to supply their services into the future. It is very likely that they are financial engineering instead.

Three questions follow. The first is whether these companies can in that case be truly considered to be going concerns when it is apparent that at some point their systematic failings will cumulatively indicate a systemic failure to supply water and sewage

services within this country.

Second, in that case, and given that one of the reasons why these companies have failed to maintain water and surge systems is because they have mist likely over distributed profit to their shareholders, in my opinion, would be whether those shareholders should be due any compensation if the companies in question were to be taken back into national ownership? My answer would be that they are not. I think a review into this issue now would be of public benefit.

Third, who should then pick up the cost of those essential water and sewage services on which we all rely?

My suggestion is that in the long term there may be an inevitable cost to consumers from increasing the quality of the supply made to them by water companies. However, to be offset against this are savings from the payment of dividends and the removal of the entire corporate infrastructure which currently surrounds this industry. In addition, if, as is very likely, that replacement infrastructure is considerably more efficient than the Victorian system that it will replace, including with regard to leakages, processing of sewage, and the reduction in waste, then there may be considerable savings to in fact pass on to the consumer, which no shareholder would then partake in.

How to realise money for investment for this purpose? That appears obvious to me. As I suggested on my blog recently, there is what is called a savings glut in both the UK and the world at large at present. It is estimated by the Resolution Foundation that the net worth of UK savers went up by approximately£ 900 billion during the course of the Covid crisis, for example. I'm not pretending that all this money is available for reinvestment because some is implicit in the values of houses and shares, both of which might tumble if there was significant disinvestment from them. But, there are also considerably increased cash balances saved in UK banks and building societies at present, running to hundreds of billions of pounds, most of which are earning incredibly low rates of interest. If only the government was willing to reorganise the tax reliefs that it provides on both ISA and pension accounts so that those reliefs were only provided in exchange for the use of the contributions made in socially desirable projects, leaving the market to fend for itself with regard to other activities, then some of the £70 billion a year that goes into ISA accounts and the more than £100 billion a year that goes into pension savings could undoubtedly be redirected to provide the capital required to reinvigorate our water and sewage systems.

What would the return be? There are three. The first is a secure future, with health not being at risk. That seems to me to be pretty significant. The second would, of course, be a fair rate of return to those who have lent the money. That seems fair. The third would be essential environmental protection which is necessary to save the biodiversity of the society we live in and so becomes part of the whole process of tackling the degradation of our environment.

Why should shareholders get a share of this? I really do not know. But more than that, if we took all these factors into account, and managed water and sewage in the integrated way that I suggest I suspect that we could have all these savings and in the long run water and sewage at a lower cost than we do now, providing benefits to the consumer. We do, unfortunately, have a government that does not think that way because anything but short-term electoral gain does not seem to matter to it. That is a cost that we have to live with.

I hope that this helps.