



Accountants &
business advisers

Office of Gas and Electricity Markets (Ofgem)
9 Millbank
London
SW1P 3GE
Attention: Andrew Stone

Our ref: BT/JDA/ABH

14 December 2012

Dear Andrew

Re: Audit of Licence Model– RIIO T1 & G1 Slow Track Final Proposals stage

In accordance with the terms of our agreed Variation Form Contract, dated 6 June 2012, and subsequent correspondence thereon, setting out the services to be provided, we have carried out an independent review of Ofgem's three Licence Models ('the Licence Models') in relation to the Electricity and Gas Transmission and Gas Distribution Final Proposals. The Licence Models have been designed to be used for the purposes of the RIIO T1 & G1 Slow Track Final Proposals Stage.

Our opinion is subject to the assumptions and comments, which we have summarised in Appendix A, and subject to the representations and responses from Ofgem in respect of our Base Case Findings Reports upon which we have relied. As a result of our review, we confirm that in our opinion, the Licence Models as reflected in Appendix B (to be published by Ofgem as part of the 'RIIO T1 & G1 Slow Track Final Proposals Stage):

- are logically constructed, internally consistent, and that the formulae, algorithms and calculations are arithmetically accurate, in all material respects.

Our work was limited to the matters set out above and accordingly did not include, for the avoidance of doubt, any form of review of the commercial merits, technical feasibility, or the factual accuracy of the input data; a review of the Model's consistency with UK Generally Accepted Accounting Principles or International Financial Reporting Standards; and a review of the Model's consistency with current corporate UK tax standards and legislation.

All comments and opinions above are given solely in respect of the Licence Models identified in Appendix B (to be published by Ofgem as part of the 'RIIO T1 & G1 Slow Track Final Proposals Stage) and cease to be valid if there are subsequent changes to the Licence Models.

This letter has been prepared for the information and benefit of the addressees subject to their agreement to the terms and conditions of our engagement and the aggregate limitation of liability set out therein and no other party may place reliance on any matters contained herein.

Yours sincerely

PKF (UK) LLP

Appendices: **A** **Assumptions and Comments on the Model**
 B **Model Versions**

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APPENDIX A

ASSUMPTIONS AND COMMENTS ON THE MODEL

Model Assumptions and Comments on the Model

- 1.1 Ofgem have developed the Licence Models to be used for the Gas Distribution Price Control Review (RIIO-G1) and the Transmission Price Control Review (RIIO-T1) as well as for ongoing monitoring purposes during the control period which will run from 1 April 2013 until 31 March 2021. The Licence Models reflect data and produce outcomes in relation to those companies considered for the RIIO T1 & G1 Slow Track Final Proposals stage which are the eight Gas Distribution Companies and four of the six Transmission Owners and System Operators. The Electricity Transmission Licence Model (the 'ET Licence Model') contains the functionality to reflect data and outcomes for the other two Transmission Owners, SP Transmission Limited (SPTL) and Scottish Hydro Electric Transmission Limited (SHETL), however these were covered by the RIIO Fast Track process and the ET Licence Model does not contain data for these companies.
- 1.2 The Licence Models are designed as tools to calculate allowed revenue for the RIIO period on the basis of the assumptions and input data contained on the company specific input worksheets. In accordance with our agreed scope of work we have accepted the hardcoded input assumptions reflected on these sheets as given and offer no further comment thereon.
- 1.3 The Model is also designed to be used during the control period to recalculate base revenues using actuals which will be applied within the Licence Models. These amounts are used as part of the calculation of MOD which is based on the difference between revenue under the Final Proposals and the recalculated base revenues.
- 1.4 The 'SavedResults' worksheet within each Licence Model has been designed to reflect the key outputs for each company. The results are macro generated on a company by company basis from the 'Live Results' worksheet and on this basis this worksheet may be considered to be a key output sheet of the Licence Models. It should be noted that the SHETL and SPTL tranches within the ET Licence Model contain #DIV/0! errors due to these companies not being covered within the Slow Track Proposals stage.
- 1.5 The Licence Models assume dividends are equal to 5% of the current period closing core nominal RAV balance multiplied by the assumed equity portion of RAV (which is assumed to vary between companies). We would usually expect the calculation of dividends to refer to cash available for dividends and retained profits and we note that for a number of the companies dividends paid during the RIIO periods will result in negative retained earnings for the period and that new external debt is assumed to be drawn to fund these dividends. We understand from the Model Author that 5% of the equity investment was the level of dividends proposed and accepted by Ofgem as part of the financial package during the previous price control reviews.
- 1.6 The 'LiveResults(SO)' worksheet of the Electricity and Gas Transmission Licence Models contains a minor error in the formula applied to cells G55:M55. This calculation has been designed to reflect Base Revenues for the applicable System Operator and in years prior to the year of MOD (Year t), these cells will not correctly reflect Base Revenues. We note that the issue does not affect the current outputs of these Licence Models as the year of MOD is assumed to be the first control period. We further understand that the Model Author is aware of the treatment applied and that the formula will be updated for the purposes of the annual iteration of MOD.



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- 1.7 The Licence Models contain a number of worksheets which we have agreed with the Model Author to exclude from the scope of our review. These comprise the following: 'RORE', 'RORE inputs', and 'Bill impact'. On this basis we have not undertaken a review of these worksheets and offer no opinion thereon.

APPENDIX B

MODEL VERSIONS

Licence Models

- Electricity Transmission Model version 'RIIO_ET1_FP_FinancialModel_dec12.xlsm' (as saved on 13 December 2012 at 18:57)
- Gas Transmission Model version 'RIIO_GT1_FP_FinancialModel_dec12.xlsm' (as saved on 14 December 2012 at 11:40)
- Gas Distribution Model version 'RIIO_GD1_FP_FinancialModel_dec12.xlsm' (as saved on 13 December 2012 at 19:22)