

# Guidance

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## PCFM Guidance

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This document provides instructions and guidance to licenced network operators to enable them to complete the reporting requirements associated with updating various variable values and performance data in the Price Control Financial Model (PCFM) during the Annual Iteration Process (AIP).

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## Contents

<b>PCFM Guidance .....</b>	<b>1</b>
<b>1. Introduction .....</b>	<b>4</b>
Legal Framework .....	4
Purpose .....	4
<b>Related documents .....</b>	<b>4</b>
<b>2. Annual Iteration Process.....</b>	<b>5</b>
Submission of the ED2 PCFM .....	5
Interim submission process for August 2023 .....	5
Forecasting .....	6
Annual Inflation Updates.....	7
Dry Runs process.....	7
Publication of the RIIO-ED2 PCFM.....	9
<b>3. The ED2 Price Control Financial Model .....</b>	<b>9</b>
Background .....	9
Model structure .....	10
Supporting files .....	11
<b>4. Instructions for updating the PCFM Variable Values.....</b>	<b>12</b>
<b>5. PCFM Dry Run Commentary.....</b>	<b>23</b>
Structure of the commentary .....	23
Submission .....	24

## **1. Introduction**

- 1.1 The PCFM Guidance provides network operators (licensees) with guidance on how to fill out the PCFM Variable Values and any supporting workbooks, which they are required to submit to Ofgem for each dry run of the Annual Iteration Process (AIP).
- 1.2 The AIP is the process of agreeing the PCFM Variable Values used to calculate the licensee's Allowed Revenue ahead of the publication of the ED2 PCFM and the setting of network charges, as described in Chapter 2 of the ED2 PCFH.
- 1.3 It also sets out the required information that should be submitted to Ofgem in the supporting narrative commentary.
- 1.4 This document should be read in conjunction with the ED2 Price Control Financial Handbook (PCFH). Where a term is capitalised, it has the same definition as the PCFH or Part B of Special Condition 1.1 (Interpretation and Definitions).

## **Legal Framework**

- 1.5 The modification and governance process for Price Control Financial Model (PCFM) and Price Control Financial Handbook (PCFH), collectively known as the Price Control Financial Instruments, is set out in Special Condition 8.1 (Governance of the ED2 Price Control Financial Instruments).
- 1.6 The modification and governance process for the PCFM Guidance is set out in Standard Licence Condition 46 (Regulatory Instructions and Guidance).

## **Purpose**

- 1.7 The purpose of this document is to provide:
  - instructions and guidance on how to populate the PCFM Variable Values for submission for an AIP dry run;
  - guidance on the process and timeframe for reporting, forecasting and submitting the required data; and,
  - any requirements that apply to supporting information, documentation or commentary to be submitted.

## **Related documents**

ED2 PCFH

ED2 PCFM

RIIO-ED2 Regulatory Instructions and Guidance (RIGs)

RIIO-ED2 Costs, Volumes and Revenue Regulatory Reporting Pack (CVR pack)

RIIO-2 Regulatory Financial Performance Reporting template and Guidance (RIIO-2 RFPR)

## **2. Annual Iteration Process**

### **Submission of the ED2 PCFM**

- 2.1 Prior to each Regulatory Year commencing on or after 1 April 2024, the licensee must submit to the Authority a first dry run of the ED2 PCFM with updated variable values (covering activity in the prior Regulatory Year and changes to forecast activity), which has been run to calculate  $AR_t$  by 31 August.
- 2.2 As well as this, the licensee must submit an updated copy of the accompanying RIIO-ED2 Costs, Volumes and Revenue (CVR) reporting pack that was used to populate the variable values and any other relevant supporting files used to derive the variable values and any relevant commentary, as set out in chapter 6 of this guidance, by 31 August and for any subsequent submissions of the ED2 PCFM, thereafter.
- 2.3 The variable values in the PCFM Interface sheet of the CVR reporting pack should match the licensee-specific input sheets of the ED2 PCFM, where applicable.

### **Interim submission process for August 2023**

- 2.4 In general, this guidance is applicable to the reporting period ending 31 March 2024, with the first full dry run submission of the ED2 PCFM and accompanying CVR reporting pack due on 31 August 2024.
- 2.5 For 2023, an interim process will take place allowing the licensee to update the forecasts within the ED2 PCFM from those that were set at Final Determinations. For this process, the licensee must submit to the Authority a first dry run of the ED2 PCFM with updated variable values containing updated forecast data by 31 August 2023.
- 2.6 As well as this, the licensee must submit accompanying supporting sheets from the CVR reporting pack (see list below) and any other relevant supporting files used to derive the forecast variable values in the ED2 PCFM. As there is no requirement to submit a full CVR reporting pack, we do not expect a full accompanying CVR reporting pack submission, nor would we expect a full DAG process to be undertaken.

- 2.7 For the submission due in 2023, we expect the following sheets of the CVR reporting pack to be populated at a minimum:
- PCFM Interface
  - T1 - PCFM Totex Inputs 20-21
  - T2 - PCFM Actual Totex
  - T3 – Forecast Totex
  - T4 – PCFM Cap Rate 2 Totex
  - T5 – Forecasts C1
  - R1 - PCDs
  - R2 - UIOLI
  - R3 - Reopeners
  - R4 - Volume Drivers
  - R5 - ODI
  - R6 - PT
  - R7 – ORA
  - I6 – Inflation
- 2.8 Where these sheets contain linking cells that link to other sheets within the CVR reporting pack that are not being updated for the forecast submission due in 2023, these cells may be overwritten by the licensee with hard-coded forecast values.
- 2.9 Debt and interest values on a regulatory basis should be taken from the latest submitted ED1 RFPR (in the absence of a completed RIIO-2 RFPR in 2023).

## **Forecasting**

- 2.10 This submitted version of the ED2 PCFM may contain provisional values for variable values that are unknown at the time of submission. An example of a variable values which will not be known by 31 August is a re-opener term which is subject to an outstanding decision by the Authority.
- 2.11 Where a variable value is unknown at the time of submission, the licensee must calculate a provisional value using the approach specified within the ED2 PCFH or this guidance document, as applicable, and otherwise provide its best estimate with the information available at the time. This will be deemed to be compliant with the best endeavours requirement in paragraph 2.1.3 of the Special Licence Conditions.
- 2.12 It is acknowledged that forecasts will not be as accurate as actual reported data and that all forecasts will be made with a view to truing-up in a subsequent

submission when actual data is available, however we expect that the inclusion of forecasts will reduce the magnitude of any subsequent true-ups and reduce revenue volatility.

- 2.13 All forecast values should be stated in 20-21 prices unless otherwise stated.

## **Annual Inflation Updates**

- 2.14 Ofgem will update and circulate the inflation data contained in the “Inflation” tab of the CVR reporting pack by the end of April in each Regulatory Year, reflecting actual RPI and CPIH data until the end of March as well as data from the March OBR forecast. This inflation data must be used by the licensee in its CVR reporting pack submission due on 31 July. This will ensure the latest inflation data are feeding into the CVR reporting pack and PCFM.
- 2.15 Ofgem will perform a further inflation update in July in each Regulatory Year, reflecting actual RPI and CPIH data until the end of June. This will be published in the version of the PCFM to be used for the next AIP. This inflation data must be used by the licensee in the CVR reporting pack and the PCFM that it submits as part of its first AIP dry run by 31 August.
- 2.16 Ofgem will normally perform a final inflation update in November following the publication of the OBR’s autumn forecast, in line with the methodology prescribed the PCFH.

## **Dry Runs process**

- 2.17 The process of confirming and amending values will normally take place over a number of months from 31 August to December and will be iterative to account for updates to the variable values as they become known.
- 2.18 There will be one or more dry runs of the ED2 PCFM between the licensee’s initial dry run submission on 31 August and the final run in December. The number of dry runs needed will depend on the number and timing of Variable Value updates required for the licensee in any particular Regulatory Year.
- 2.19 All of the documents submitted as part of a dry run of the AIP must be sent to the Authority either through email or a secure file-sharing application such as Huddle.
- 2.20 Ofgem will review the submitted ED2 PCFM and confirm whether this has been prepared in accordance with the PCFM Guidance. Where values have not been prepared in accordance with the PCFM Guidance, Ofgem will notify the licensee of any required amendments to such variable values, which the licensee must amend in a subsequent dry run. Where the Authority amends a Variable Value

from an earlier licensee submission, either due to a licensee error or to reflect updates to a provisional value, it will notify the licensee and request a resubmission of the ED2 PCFM at the next available dry run.

2.21 The dry runs process will normally take place with the following timeline:

- a) **1 June:** The Authority will normally direct and publish on its website modifications resulting from engagement with the PCFM Working Group for that year into the applicable Price Control Financial Instruments.
- b) **31 August:** The licensee must submit the ED2 PCFM with updated variable values and accompanying supporting files to the Authority (dry-run 1). Ofgem will then review and respond to this dry run, either confirming or amending the variable values, as appropriate.
- c) **31 October:** The licensee must submit a further ED2 PCFM with completed variable values table to the Authority (dry-run 2) to reflect any further updates since the first dry run. Ofgem will then review and respond to this dry run, either confirming or amending the variable values, as appropriate.
- d) **November:** By no later than 30 November, the Authority will provide an update to the Ofgem-provided variable values and the underlying models used to calculate them. These are the WACC allowance model, RPE model, and the grey inflation input values within the Annual Inflation and Monthly Inflation sheets of the ED2 PCFM. Following the provision of the Ofgem-determined variable values the licensee must, by the later of

(1) 30 November; and

(2) 7 working days after their receipt,

submit a further ED2 PCFM (dry-run 3) with an updated variable values table to the Authority, which should include the Ofgem-determined values.

- e) **Early December – Notice of publication of the ED2 PCFM:** In accordance with paragraph 2.28 of the ED2 PCFH, the licensee must give the Authority:
  - (i) a copy of the ED2 PCFM which the licensee intends to publish on its website; and
  - (ii) supporting files and a commentary describing any changes to the PCFM Variable Values and to the value of Allowed Revenue since the last submission of the ED2 PCFM. See Chapter 5 of this document for more on the PCFM dry run commentary.



The licensee must provide the above to the Authority with no less than 14 days' notice in advance of the publication of the ED2 PCFM. In addition, the commentary must also contain the value of Allowed Revenue (ARt) for the licensee for the Regulatory Year for which network charges will be set. In accordance with paragraph 2.28 of the ED2 PCFH the licensee will not be required to provide a further copy of the ED2 PCFM where the Authority requires the licensee to make a change to the ED2 PCFM Provided as part of this notification.

## **Publication of the RIIO-ED2 PCFM**

- 2.22 Following the minimum 14-day notice period, the licensee must publish on its website the version of the ED2 PCFM that it will use to set its tariffs for the relevant Regulatory Year.
- 2.23 The requirements for the publication of the ED2 PCFM are set out in paragraphs 2.29 to 2.31 of the ED2 PCFH.
- 2.24 The licensee is responsible for publishing a reduced version of the ED2 PCFM so that it contains the PCFM Variable Values and Allowed Revenues for each of its licensees, and should delete any data that relates to other licensees. To do this, the licensee must perform the following steps:
1. Navigate to cell A1 in a licensee input tabs that should be cleared. Holding down the "Ctrl" key, select all the relevant sheets from which the data should be cleared
  2. With these sheets selected, in the current sheet press "Ctrl+A" twice to select the entire contents of the sheet.
  3. In the Excel Ribbon, click on the Home tab and then select "Clear All" from the dropdown menu.
  4. Navigate to a different tab to de-select the current selected tabs. Data in the other licensee tabs has now been deleted.

## **3. The ED2 Price Control Financial Model**

### **Background**

- 3.1 The PCFM is used by licensees to calculate Allowed Revenue in accordance with the licence conditions.

- 3.2 Throughout the price control, we use the AIP to update the variable values in the PCFM by updating inputs for actual expenditure and performance as well as updating forecasts for the latest view.
- 3.3 The purple calculation sheets in the model then capture this new information and calculate an updated Allowed Revenue ( $AR_t$ ) value.
- 3.4 Accompanying its Use of System Charging Statement prepared in accordance with Standard Condition 14 (Charges for Use of System and connection), the licensee must publish on its Website, a copy of the ED2 Price Control Financial Model containing the value of Allowed Revenue it used when setting Use of System Charges for the Regulatory Year to which the relevant Use of System Charging Statement relates.

## Model structure

- 3.5 The table below sets out the structure and contents of the sheets in the ED2 PCFM:

Sheet	Contents
<i>Cover</i>	Content directory and model key
<i>UserInterface</i>	<p>This sheet contains licensee selector switch allowing the user to switch between licensees.</p> <p>It also contains the price base year, which determines the price base for the values in the model and applies unless otherwise specified.</p>
<p>Input sheets:</p> <p><i>SelectedInputs</i> <i>InputSummary</i> <i>Legacy</i></p>	<p>The <i>SelectedInputs</i> sheet picks up data from the fourteen identically structured licensee-specific input sheets at the end of the model, using a choose function, depending on which licensee is selected. It too is structured identically to the licensee-specific input sheets.</p> <p>The <i>InputSummary</i> sheet is the starting point for the calculations in the PCFM and categorises the raw inputs from the <i>SelectedInputs</i> to allow the PCFM to calculate Allowed Revenue.</p> <p>The Legacy sheet picks up Legacy related variable values from the <i>SelectedInputs</i> sheet and uses these to calculate the legacy adjustments required to ED2 allowances. This performs a similar function to the <i>InputSummary</i> sheet but for Legacy values, only.</p>
<p>Calculation sheets:</p> <p><i>Totex</i> <i>TIM</i> <i>Depn</i> <i>Return&amp;RAV</i></p>	<p>The calculation sheets are purple sheets and will be auto-populated by the model when the inputs are updated for each AIP. The calculations within the majority of these sheets follow the algebra set out in the special licence conditions for each licensee.</p>

<i>TaxPools</i> <i>Finance&amp;Tax</i> <i>ReturnAdj</i> <i>Revenue</i> <i>AR</i>	
Inflation:  <i>Monthly Inflation</i> <i>Annual Inflation</i>	<p>The <i>Monthly Inflation</i> sheet shows the values for monthly outturn and forecast price indices relating to the Retail Price Index (RPI), Consumer Price Inflation including owner-occupiers' housing costs (CPIH) and Price index (PI), as described in chapter 2 of the ED2 PCFH.</p> <p>The <i>Annual Inflation</i> sheet aggregates the data in the <i>Monthly Inflation</i> sheet to derive annual indices and inflation rates. The inflation rates in this sheet are used to derive "real to nominal" conversion factors used throughout the PCFM in relation to the 2020/21 price base.</p>
<i>Checks</i>	This sheet pulls together the results of the various check functions used throughout the model.
Licensee-specific input sheets:  <i>ENWL</i> <i>NPgN</i> <i>NPgY</i> <i>WMID</i> <i>EMID</i> <i>SWALES</i> <i>SWEST</i> <i>LPN</i> <i>SPN</i> <i>EPN</i> <i>SPD</i> <i>SPMW</i> <i>SSEH</i> <i>SSES</i>	<p>These are the sheets into which the relevant licensee must input its updated variable values (the blue and grey shaded input cells) as part of an AIP.</p> <p>These are the values that this guidance document pertains to, unless otherwise specified.</p>

## Supporting files

- 3.6 As well as the ED2 PCFM itself, licensees must submit other files, the values from which will feed into the PCFM Variable Values. These include but are not limited to:
- a) Costs, Volumes and Revenue Regulatory Reporting Pack (RRP)
  - b) ED1 legacy PCFM and ED1 legacy RRP template (if revisions to the legacy adjustments are proposed)
  - c) Any other relevant underlying files, eg a Tax Trigger Event model

Where data in supporting files which will feed into the PCFM Variable Values is unchanged from the previous PCFM dry run or final submission, the file is not required to be resubmitted, but a statement should be included in the commentary to this effect.

## 4. Instructions for updating the PCFM Variable Values

- 4.1 The PCFM Variable Values are listed in Table 3.1 of the PCFH.
- 4.2 For each variable value, table 3.1 provides a description, cross-references to the relevant Special Condition(s) (where appropriate) and details of Associated Documents (where relevant).
- 4.3 The remainder of this section contains requirements for licensees on how to populate different types of PCFM Variable Values for submission to the Authority at each dry run of an AIP.
- 4.4 Unless otherwise specified, all references relate to the sheets of the CVR reporting pack.

Variable Value category	Guidance for Completion
<b><u>Variant Totex Allowances – Price Control Deliverables</u></b> <ul style="list-style-type: none"> <li>• Network Asset Risk Metric Expenditure</li> <li>• Cyber Resilience OT baseline and non baseline</li> <li>• Cyber Resilience IT baseline and non baseline</li> <li>• Strategic Investment</li> <li>• New Control Room (SSES and SSEH only)</li> <li>• New Depot (EMID, SWALES, SWEST and WMID only)</li> <li>• Smart Street Mechanistic Price Control Deliverable (ENWL only)</li> <li>• Off-gas Grid Mechanistic Price Control Deliverable</li> <li>• LineSIGHT Mechanistic Price Control Deliverable (ENWL only)</li> <li>• Shetland Link Contribution (SSEH only)</li> </ul>	<p>In general, the value of the Price Control Deliverable is an ex-ante allowance, subtracting any reductions that have been directed by the Authority.</p> <p>The ex-ante allowances are given in the appendix for the relevant Special Condition, and the reductions are provided by directions from the Authority.</p> <p>For these Variable Values, the actual adjustments directed by Ofgem should be input into the yellow adjustment cells in the "R1 PCDs" sheet of the ED2 RRP. This data will then be picked up in the PCDs sheet and subsequently the allowance values on the "PCFM Interface" sheet, which should be used to populate the licensee input sheets in the PCFM.</p> <p>Where required, further detailed guidance for updating their variable values is provided in the RIIO-ED2 RIGs.</p> <p><b>Forecasting</b></p> <p>Where Ofgem has yet to issue any directions, but a licensee expects not to deliver an output identified in the relevant Special Condition appendices, it should use best endeavours to forecast the expected adjustment into the yellow adjustment cells in the "R1 PCDs" sheet. Details of the assumptions made should be provided in the supplementary commentary.</p>

<p><b><u>Variant Totex Allowances – UIOLI</u></b></p> <ul style="list-style-type: none"> <li>• Worst Served Customers</li> <li>• Visual Amenity Projects</li> <li>• EV Optioneering Projects (SPEN)</li> </ul>	<p>These variable values are automatically populated within the “R2 – UIOLI” sheet using the total expenditure incurred on the relevant projects and the expenditure cap as set out in Appendix 1 and Appendix 2 to Special Condition 3.4.</p> <p>These values will then feed into the PCFM Interface sheet and should be input into the PCFM.</p> <p><b>Forecasting</b></p> <p>For forecast periods relating to future Regulatory Years, data should be input directly into the the “R2 UIOLI ” sheet of the CVR pack. This data will then be picked up in the allowance values on the “PCFM Interface” sheet, which should be used to populate the licensee input sheets in the PCFM. To forecast values in any blue cells linked to other sheets of the CVR, which do not themselves contain forecast data, data should be input directly into the blue cells to overwrite the linking formulae. Where this applies, this should be made clear in the submitted CVR and commentary. This data will then be picked up in the allowance values on the “PCFM Interface” sheet, which should be used to populate the licensee input sheets in the PCFM.</p>
<p><b><u>Variant Totex Allowances – Volume Drivers and Other</u></b></p> <ul style="list-style-type: none"> <li>• PCB Interventions</li> <li>• Carry-over Green Recovery Scheme</li> <li>• Load Related Expenditure: Secondary Reinforcement</li> <li>• Load Related Expenditure: Low Voltage Services</li> <li>• 1-in-20 Severe Weather Event</li> <li>• Net to Gross Load Related Expenditure</li> <li>• Indirects Scalar</li> </ul>	<p>For actual periods, data should be input directly into the yellow input cells of the “R4 Volume Drivers” sheet of the CVR pack. This data is then picked up in the allowance values on the “PCFM Interface” sheet, which should be used to populate the licensee input sheets in the PCFM.</p> <p><b>Forecasting</b></p> <p>For forecast periods relating to future Regulatory Years, data should be input directly into the yellow input cells of the “R4 Volume Drivers” sheet of the ED2 CVR pack. This data will then be picked up in the allowance values on the PCFM Interface” sheet, which should be used to populate the licensee input sheets in the PCFM. To forecast values in any blue cells linked to other sheets of the CVR, which do not themselves contain forecast data, data should be input directly into the blue cells to overwrite the linking formulae. Where this applies, this should be made clear in the submitted CVR and commentary. This data will then be picked up in the allowance values on the “PCFM Interface” sheet, which should be used to populate the licensee input sheets in the PCFM.</p>
<p><b><u>Variant Totex Allowances – Re-openers</u></b></p> <ul style="list-style-type: none"> <li>• Storm Arwen Re-opener</li> <li>• High Value Projects Re-opener</li> </ul>	<p>A re-opener is a type of uncertainty mechanism, which allows the Authority to adjust a licensee’s allowances (either up or down) based on an application by the licensee, in response to</p>

<ul style="list-style-type: none"> <li>• Wayleaves and Diversions Re-opener</li> <li>• West Coast of Cumbria Re-opener (ENWL only)</li> <li>• Shetland Enduring Solution Re-opener (SSEH only)</li> <li>• Shetland Extension Fixed Energy Costs Re-opener (SSEH only)</li> <li>• Hebrides and Orkney Re-opener (SSEH only)</li> <li>• Cyber Resilience OT Re-opener</li> <li>• Cyber Resilience IT Re-opener</li> <li>• Load Related Expenditure Re-opener</li> <li>• Digitalisation Re-opener</li> <li>• Physical Security Re-opener</li> <li>• Specified Street Works Costs Re-opener</li> <li>• Rail Electrification Costs Re-opener</li> <li>• Net Zero Re-opener</li> <li>• Coordinated Adjustment Mechanism Re-opener</li> <li>• Electricity System Restoration Re-opener</li> <li>• Environmental Re-opener</li> </ul>	<p>changing circumstances during the price control period.</p> <p>The ex-ante allowances are given in the appendix for the relevant Special Condition, and the adjustments are provided by directions from the Authority.</p> <p><b>Within the application window</b></p> <p>For these Variable Values, where actual amounts are known at the time of the dry run, ie where a decision has already been made on a reopener application, the licensee must use the adjustment values as published by the Authority to update the relevant re-opener's allowance and adjustment yellow input cells in the "R3 Re-openers" sheet. This data will then be picked up in the allowance values on the "PCFM Interface" sheet, which should be used to populate the licensee input sheets in the PCFM.</p> <p>Where an application has been submitted but no decision has been made, the licensee must use the adjustment values as published in any minded-to position by the Authority. Where no minded-to position has been published, the licensee may use the same values included in its application or the actual costs incurred in the Regulatory Year, whichever is lower.</p> <p>This is with a view to updating these values at a later dry run (or AIP) to correspond to a subsequent Ofgem decision.</p> <p><b>Outside of the application window</b></p> <p>The licensee may choose to update its re-opener allowance Variable Values using forecast data ahead of any relevant re-opener window, at any dry run. This should be done by updating the yellow allowance cells in the "R3 Re-openers" sheet.</p> <p>The values to use are the actual costs incurred or forecast costs expected to be incurred in each Regulatory Year and applied for through the relevant re-opener and the adjusted allowance should be based on the information that the licensee has provided in the "R3-Re-openers" commentary. Where the values submitted in the tab are out of date and need to be changed, the licensee should update the Re-opener tab as part of any subsequent dry run submissions for the purpose of AIP.</p> <p>Any supporting justification should be provided in addition to the R3-Re-openers tab as per the re-opener guidance specified in the Annex B of the RIGs.</p>
<p><b>Actual Totex</b></p>	<p>Totex is reported in one of two buckets, capitalisation rate 1 and capitalisation rate 2.</p>

	<p>Any expenditure relating to ex-ante, or baseline funded activities including PCDs is subject to capitalisation rate 1.</p> <p>Any expenditure relating to activities that have been funded under Uncertainty Mechanisms (as labelled in the PCFM) is subject to capitalisation rate 2.</p> <p>For Totex values, actual and forecast data for the reporting period in question will be automatically linked from the "T1 - PCFM Totex 20-21" sheet to the "PCFM Interface" sheet of the ED2 RRP. These values should be used to populate the licensee input sheets in the PCFM.</p>
<p><b><u>Pass-through costs - other</u></b></p> <ul style="list-style-type: none"> <li>• Licence Fee Payments</li> <li>• Prescribed Rates</li> <li>• Pass-through Transmission Connection Point Charges</li> <li>• Smart Meter Communication Licensee Costs</li> <li>• Smart Meter Information Technology Costs</li> <li>• Ring Fence Costs</li> <li>• Supplier of Last Resort Net Costs</li> <li>• Valid Bad Debt Claims</li> <li>• Pension Scheme Established Deficit repair expenditure</li> <li>• Failed Supplier Recovered Costs</li> </ul>	<p>Pass-through costs are specified costs that are predominantly outside of a licensee's control and may be passed through to consumers. These costs are defined in SpC 6.1 (Pass-through items).</p> <p>For pass-through Variable Values, actual cost data for the reporting period in question will be linked to the "C22 – Pass Through" sheet. Where this is not the case, actual cost data should be input directly into the yellow input cells of the "R6 PT" sheet of the ED2 RRP. This data will then be picked up in the allowance values on the "PCFM Interface" sheet, which should be used to populate the licensee input sheets in the PCFM.</p> <p>For Licence fees: where a rebate is given by Ofgem in relation to Licence fee costs for the previous regulatory year, that rebate should be netted off against the Licence Fee costs, when reported in the PCFM.</p> <p>Eg if Ofgem provides a rebate to networks in the 22/23 year, relating to the 21/22 year, the licensee may either restate its Licence fee variable value for the regulatory year 21/22 or it may net off the rebate from the licence fee variable value for the 2022/23 regulatory year.</p> <p>Where required, further detailed guidance for updating the pass-through variable values is provided in the Annex B of the RIIO-ED2 RIGs.</p> <p><b>Forecasting</b></p> <p>Forecasts for future regulatory periods should be input directly into the yellow input cells of the "R6 PT" sheet.</p> <p>To forecast values in any blue cells linked to other parts of the CVR, data should be input directly into the blue cells to overwrite the linking formulae. Where this applies, this should be made clear in the submitted CVR and commentary. This data will then be picked up in the allowance values on the "PCFM Interface" sheet, which should be used to populate the licensee input sheets in the PCFM.</p>
<p><b><u>Incentive revenue (Output Delivery Incentives)</u></b></p> <ul style="list-style-type: none"> <li>• Time to connect ODI</li> </ul>	<p>Incentive revenue or output delivery incentives (ODI) are used to reward or penalise licensees for their performance.</p>



<ul style="list-style-type: none"> <li>• Broad Measure of Customer Service ODI</li> <li>• Interruptions incentive scheme ODI</li> <li>• Major connections ODI</li> <li>• Consumer Vulnerability ODI</li> <li>• Distribution System Operator ODI</li> <li>• Dig, Fix and Go ODI (ENWL only)</li> <li>• Collaborative Streetworks ODI (EPN, LPN and SPN only)</li> </ul>	<p>For ODI values, actual data for the reporting period in question should be input directly into the yellow input cells of the "R5 ODI" sheet of the ED2 RRP. This data will then be picked up in the allowance values on the "PCFM Interface" sheet, which should be used to populate the licensee input sheets in the PCFM.</p> <p><b>Forecasting</b> Forecasts for year t or future regulatory periods if available should be input directly into the yellow input cells of the "R5 ODI" sheet of the ED2 CVR. This data will then be picked up in the allowance values on the "PCFM Interface" sheet, which should be used to populate the licensee input sheets in the PCFM.</p>
<p><b><u>Other Revenue allowances</u></b></p> <ul style="list-style-type: none"> <li>• Network Innovation Allowance</li> <li>• Carry-over Network Innovation Allowance</li> <li>• Revenue adjustments in respect of connection performance failures</li> <li>• Aggregate amount notified</li> </ul>	<p>For ORA Variable Values, actual data for the reporting period in question should be input directly into the yellow input cells of the "R7 ORA" sheet of the ED2 RRP. This data will then be picked up in the allowance values on the "PCFM Interface" sheet, which should be used to populate the licensee input sheets in the PCFM. With respect to Total NIA Expenditure, this value will be linked to the "CV36 – NIA &amp; ED2 Innovation" sheet and should exclude any expenditure which is deemed to be 'Unrecoverable NIA Expenditure' as it does not satisfy the requirements of the RIIO-2 NIA Governance Document.</p> <p><b>Forecasting</b> Forecasts for future regulatory periods should be input directly into the yellow input cells of the "R7 ORA" sheet of the ED2 RRP. To forecast values in any blue cells linked to other parts of the CVR reporting pack, data should be input directly into the blue cells to overwrite the linking formulae. Where this applies, this should be made clear in the submitted CVR reporting pack and commentary. This data will then be picked up in the allowance values on the "PCFM Interface" sheet, which should be used to populate the licensee input sheets in the PCFM.</p>
<ul style="list-style-type: none"> <li>• <b>Directly remunerated services (DRS)</b></li> <li>• DRS1 cost</li> <li>• DRS2 revenue</li> <li>• DRS2. Diversionary works under obligation revenue</li> <li>• DRS2. Diversionary works under obligation costs</li> <li>• DRS3. Works required by any alteration of premises revenue</li> <li>• DRS3. Works required by any alteration of premises costs</li> </ul>	<p>DRS Variable Values, comprise costs and revenues.</p> <p>For both these variable values, actual data for the reporting period in question should be input directly into the yellow input cells of the "CV39 - DRS" sheet of the ED2 RRP. This data will then be picked up in the DRS allowance values on the "PCFM Interface" sheet, which should be used to populate the licensee input sheets in the PCFM.</p> <p><b>Forecasting</b> Forecasts for future regulatory periods (optional) should be input directly into the PCFM interface sheet (which should be used to populate the licensee input sheets in the PCFM) by overwriting</p>



<ul style="list-style-type: none"> <li>• DRS11. Top-up, standby and enhanced system security revenue</li> <li>• DRS11. Top-up, standby and enhanced system security costs</li> <li>• DRS12. Revenue protection services revenue</li> <li>• DRS12. Revenue protection services costs</li> <li>• DRS13. Metering Services revenue</li> <li>• DRS13. Metering Services costs</li> <li>• DRS14. Smart Meter Roll-out rechargeable services revenue</li> <li>• DRS14. Smart Meter Roll-out rechargeable services costs</li> <li>• DRS15. Miscellaneous revenue</li> <li>• DRS15. Miscellaneous costs</li> </ul>	<p>the blue cells and making this clear in the commentary.</p>
<p><b><u>Legacy adjustments</u></b></p> <ul style="list-style-type: none"> <li>• RIIO-1 MOD</li> <li>• Legacy net RAV additions</li> <li>• General pool RIIO-2 opening balance brought forward</li> <li>• Special rates pool RIIO-2 opening balance brought forward</li> <li>• Deferred revenue expenditure pool RIIO-2 opening balance brought forward</li> <li>• Deferred revenue expenditure pool capex additions pre-RIIO-2</li> <li>• Structures and buildings pool RIIO-2 opening balance brought forward</li> <li>• Tax losses brought forwards</li> <li>• Relevant revenue adjustments</li> <li>• ED1 Price index adjustment factor</li> <li>• Legacy correction factor</li> <li>• Regulated Distribution Network Revenue</li> <li>• Allowed Distribution Network Revenue</li> <li>• Average Specified Rate</li> </ul>	<p>Legacy values will be directed by Ofgem following the formal close-out of the RIIO-ED1 price control.</p> <p>In the interim period between the beginning of ED2 and the direction of these values and the establishment of a close-out methodology, the licensee must calculate its provisional legacy values in accordance with the close-out methodologies and processes set out in chapter 8 of the ED2 PCFH.</p> <p>Revisions to the Legacy ED1 PCFM must be accompanied with a description of the specific modifications along with a copy of the ED1 Legacy PCFM and any relevant underlying calculation files used to populate the ED1 Legacy PCFM eg the tax clawback model for the calculation of the TGIE term, and a justification for the revisions in its PCFM Dry Run Commentary (see section 5 of this Guidance).</p>

<ul style="list-style-type: none"> <li>• Value of PRt (interest rate adjustment) set in a direction</li> <li>• Connections GS Failure Payments Adjustment</li> <li>• Connection Guaranteed Standards Payments made</li> <li>• Total connection guaranteed standards revenue exposure</li> <li>• Broader Measure of Customer Service (£m real 2012/13 prices)</li> <li>• Customer Satisfaction Survey term</li> <li>• Complaints metric term</li> <li>• Stakeholder engagement reward term</li> <li>• Interruptions-Related Quality of Service (£m real 2012/13 prices)</li> <li>• Performance on the number of supply interruptions and the duration of supply interruptions</li> <li>• Performance on severe weather supply restoration</li> <li>• Performance on normal weather supply restoration</li> <li>• Incentive on Connections Engagement (£m real 2012/13 prices)</li> <li>• Incentive on Connections Engagement negative performance adjustment</li> <li>• Time To Connect (£m real 2012/13 prices)</li> <li>• LVSSA Time to Quote term</li> <li>• LVSSB Time to Quote term</li> <li>• LVSSA Time to Connect term</li> <li>• LVSSB Time to Connect term</li> <li>• Licence fee payments</li> <li>• Licence fee allowance</li> <li>• Business rates payments</li> <li>• Business rates allowance</li> <li>• Pass-through Transmission Connection Point Charges incurred</li> <li>• Pass-through Transmission Connection Point Charges allowance</li> <li>• Smart Meter Communication Licensee Costs incurred</li> </ul>	
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<ul style="list-style-type: none"> <li>• Smart Meter Communication Licensee Costs allowance</li> <li>• Smart Meter Information Technology Costs incurred</li> <li>• Smart Meter Information Technology Costs allowance</li> <li>• Ring Fence Costs incurred</li> <li>• Ring Fence Costs allowance</li> <li>• Shetland variable Energy Costs Actual incurred (SSEH only)</li> <li>• Shetland variable Energy Costs allowance (SSEH only)</li> <li>• Shetland Extension Variable Energy Costs incurred (SSEH only)</li> <li>• Shetland Extension Variable Energy Costs allowance (SSEH only)</li> <li>• Shetland New Energy Solution Residual Costs incurred (SSEH only)</li> <li>• Shetland New Energy Solution Residual Costs allowance (SSEH only)</li> <li>• Supplier of Last Resort Net Costs incurred</li> <li>• Eligible Use of System Bad Debt Costs incurred</li> <li>• Recovered Bad Debt</li> <li>• Aggregate value of provisional COVID-19 Bad Debt incurred</li> <li>• Credited Amount by the Administrator or Liquidator</li> <li>• Aggregate value of COVID-19 Bad Debt incurred</li> <li>• Low Carbon Networks Fund Second Tier and Discretionary Funding Mechanism</li> <li>• Recovered Low Carbon Networks, determined to be unrecoverable</li> </ul>	
<p><b>Guidance for Finance and Tax inputs to be entered directly into the ED2 PCFM licensee input sheets</b></p>	
<ul style="list-style-type: none"> <li>• iBoxx trailing average (iBTA<sub>t</sub>)</li> <li>• Risk-free rate (RFR)</li> </ul>	<p>These finance inputs are calculated by the Authority using the WACC allowance model and feed into the licensee's allowed return on capital. These values are calculated and provided to the licensee by Ofgem during the AIP dry runs. This</p>

	<p>update usually takes place in the first half of November.</p> <p>These values are sourced from the updated WACC allowance model. The methodology for the derivation of iBTA and RFR is described in chapter 4 of the ED2 PCFH.</p>
Real Price Effects (RPEI <sub>t</sub> ) annual growth rate	<p>This value is calculated by the Authority and is sourced directly from the updated RPE model in accordance with the methodology and process set out in chapter 5 of the ED2 PCFH.</p> <p>Ofgem will share a redacted version of this workbook alongside the WACC Allowance Model no later than 30 November.</p>
Adjusted net debt	<p>For this variable value, actual data for the reporting period in question should be input directly into the licensee-specific input sheets of the ED2 PCFM. Licensees may also update forecast data for this variable value.</p> <p>The figures used to update this variable value should be those reported as "Net Debt as per the Regulatory (RIIO-2) definition" in the licensee's submitted RFPR.</p> <p>See the RIIO-2 RFPR Guidance for further detail on what this value comprises.</p>
Tax deductible net interest cost	<p>For this variable value, actual data for the reporting period in question should be input directly into the licensee-specific input sheets of the ED2 PCFM. Licensees may also update forecast data for this variable value.</p> <p>The figures used to update this variable value should be those reported as "Net Interest as per the Regulatory (RIIO-2) definition" in the licensee's submitted RFPR.</p> <p>See the RIIO-2 RFPR Guidance for further detail on what this value comprises.</p>
<p>Tax liability allowance adjustments – driven by tax trigger events</p> <p>General Pool Opening Balance Adjustment</p> <p>Special Pool Opening Balance Adjustment</p>	<p>These variable values will not be applicable unless the licensee has followed the notification process set out in Chapter 6 of the PCFH.</p> <p>Companies may include a forecast value in advance of the notification process and Ofgem confirmation being concluded.</p> <p>These values will be calculated according to the methodology that has been agreed to by Ofgem. Ofgem will provide confirmation of the final figures to be used for these variable values.</p>
Tax allowance adjustments	<p>This value will not be applicable unless the Authority has directed a value following a tax review under Special Condition 2.2.</p>
<ul style="list-style-type: none"> <li>• Corporation Tax rate</li> <li>• General pool capital allowance rate</li> <li>• Special Rates capital allowance rate</li> <li>• Structures and buildings capital allowance rate</li> </ul>	<p>Corporation tax and capital allowance rates should only be updated where a rate-change has been enacted, as set out in chapter 6 of the PCFH.</p>

<ul style="list-style-type: none"> <li>Deferred Revenue Expenditure capital allowance rate</li> </ul>	
Variant and non-variant allowances: tax pool allocations	Allocation percentages of Totex categories to tax pools should be input by the licensee based on their best estimate of the allocation rates at the time of updating the inputs. These rates will then be used to derive capital allowance allocation rates used by the PCFM.
Base revenue (last year of RIIO-1, per RIIO-1 definition) (for use in Correction term)	This variable value is defined in Part C of Charge Restriction Condition 2A (Restriction of Allowed Distribution Network Revenue) of the licence in force on 31 March 2023.
Revenue as billed (ignoring bad debt)	This variable value is defined in Part B of Special Condition 2.1 (Revenue Restriction) of the ED2 Licence and should be provided by licensees.
Allowed Revenue (as published) ( $AR_t^*$ )	This variable value is defined in Part G of Special Condition 2.1 (Revenue Restriction) of the ED2 Licence and should match the value of $AR_t$ contained in the corresponding PCFM published in advance of charge setting for year t. For example, if the Use of System Charging Statement is published in December 2024 for Regulatory Year 2026/27, then $AR_{2026/27}^*$ will be equal to the value of $AR_{2026/27}$ as it appears in the in row 53 in the "AR" tab of the PCFM published with the Use of System Charging Statement in December 2024.
Base Revenue (as published) ( $BR_t$ )	This variable value is defined in Part G of Special Condition 2.1 (Revenue Restriction) of the ED2 Licence and should match the value of $BR_t$ as at the time of publication of the PCFM by the licensee for tariff setting for Regulatory Year t in accordance with paragraph 2.1.5 of Special Condition 2.1. For example, if the Use of System Charging Statement is published in December 2024 for Regulatory Year 2026/27, then $BR_{2026/27}^*$ will be equal to the value of $BR_{2026/27}$ as it appears in the in row 75 in the "AR" tab of the PCFM published with the Use of System Charging Statement in December 2024.
Base Revenue Forecasting Penalty Adjustment (BRFPAt)	This variable value is defined in Part G of Special Condition 2.1 (Revenue Restriction) of the ED2 Licence and should have the value of 1 unless the Authority directs otherwise.
Recovered Revenue Forecasting Penalty Adjustment (RRFPAt)	This variable value is defined in Part G of Special Condition 2.1 (Revenue Restriction) of the ED2 Licence and should have the value of 1 unless the Authority directs otherwise.
Bad Debt (BDAt)	<p>Bad Debt costs relate to any amounts that are incurred (or forecast to be incurred) by the licensee due to network charges owed to it, which are considered unrecoverable.</p> <p>This variable value is defined in Part H of Special Condition 2.1 (Revenue Restriction) of the ED2</p>

	<p>Licence and should be input into the PCFM by licensees.</p> <p>These values should be exclusive of VAT.</p>
Recovered Bad Debt (RBDt)	<p>This variable value is defined in Part H of Special Condition 2.1 (Revenue Restriction) of the ED2 Licence and should be into the PCFM by licensees. The recovered Bad Debt value should be input as a negative value and should include the aggregate value of any Bad Debt recovered.</p> <p>These values should be exclusive of VAT.</p>
CPIH Outturn	<p>This value is shown in the "Monthly inflation" sheet of the PCFM and will be updated by the Authority in line with the methodology for the Price Index calculation set out in chapter 2 of the PCFH.</p> <p>Ofgem will update the CPIH outturn index prior to the first dry run of each AIP using data that is available as at 31 July.</p>
RPI Outturn	<p>This value is shown in the "Monthly inflation" sheet of the PCFM and will be updated by the Authority in line with the methodology for the Price Index calculation set out in chapter 2 of the PCFH.</p> <p>Ofgem will update the RPI outturn index prior to the first dry run of each AIP using data that is available as at 31 July.</p>
RPI inflation forecast (Calendar year) "CYRPIFt"	<p>This value is shown in the "Annual inflation" sheet of the PCFM and will be updated by the Authority in line with the methodology for the Price Index calculation set out in chapter 2 of the PCFH.</p> <p>Ofgem will update the RPI inflation forecast in November at each AIP using the most recent Office for Budget Responsibility (OBR) outlook available during November.</p>
CPI inflation forecast (Calendar year) "CYCPIHt"	<p>This value is shown in the "Annual inflation" sheet of the PCFM and will be updated by the Authority in line with the methodology for the Price Index calculation set out in chapter 2 of the PCFH.</p> <p>Ofgem will update the CPI inflation forecast in November at each AIP using the most recent OBR outlook available during November.</p>
Long term CPIH inflation forecast "LCPIHfT"	<p>This value is shown in the "Annual inflation" sheet of the PCFM and will be updated by the Authority in line with the methodology set out in chapter 4 of PCFH.</p> <p>Ofgem will update this inflation forecast in November at each AIP using OBR data that is available as at 31 October.</p>

## **5. PCFM Dry Run Commentary**

- 5.1 Submissions of the ED2 PCFM to the Authority must be accompanied by supporting commentary as well as any applicable subsidiary models and underlying workings
- 5.2 The purpose of the PCFM dry run commentary is to provide a useful summary of the updates that have been made to the PCFM variable values and the impact that these have had on the licensee's Allowed Revenue, in narrative form.

### **Structure of the commentary**

- 5.3 The outline structure of the commentary is as follows:
- a) Executive summary
  - b) Updates to the PCFM Variable Values
  - c) Impact on Allowed Revenue
  - d) Statement on forecast data
  - e) Data assurance statement
  - f) Other relevant information
- 5.4 The sections outlined above should contain sufficient detail such that the Authority would be able to re-perform the updates made since the last submitted version of the ED2 PCFM and arrive at the same value of Allowed Revenue.
- 5.5 The licensee must provide detail on the following areas at a minimum:
- a) a summary of the updates the licensee has made to the PCFM Variable Values in the input sheet(s) since the most recent version of the PCFM published by the Licensee.
  - b) the source of the data used to update the PCFM Variable Values (ie, Ofgem directions, ED2 RRP, Legacy ED1 PCFM or forecast data;
  - c) a description of the impact of the changes on Allowed Revenue and the key driver(s) of this impact ranked in order of materiality;
  - d) for any forecast data, the licensee should include a statement confirming that it has used its best estimate to ensure forecasts are reasonable in light of the information available at the time and that any significant changes to forecast values have suitable supporting statements;

- e) A data assurance statement briefly setting out the assurance processes that the information in the commentary, the PCFM inputs sheet and any underlying input files are subject to; and,
- f) any other information the licensee considers is appropriate to explain the ED2 PCFM submission.

## **Submission**

- 5.6 A dry run commentary is required from all licensees. Where a licensee is part of a company that has more than one licence within a sector it may submit a single commentary to cover all licensees.
- 5.7 The dry run commentary should reconcile with and refer to the ED2 PCFM(s) submitted. Any narrative, tables or descriptions of changes in PCFM Variable Values and Allowed Revenue in the commentary should be clearly disaggregated by licensee. A full dry run commentary is required for the first dry run submission, comparing the submitted ED2 PCFM and Allowed Revenue value against the previously published version of the ED2 PCFM, provided by Ofgem for use in the AIP.
- 5.8 For any subsequent dry runs, a detailed narrative will only be required for the PCFM Variable Values, which have been amended from the prior dry run.
- 5.9 Where appropriate, the licensee may cross-reference to other information that supports its submission. Any cross-referencing should clearly direct the Authority to the source data used eg, through hyperlinks.