

Development of a Risk Based Approach to Network Licensee Data Compliance Report to Ofgem

19 April 2011

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1 Executive Summary

1.1 Background

Ofgem is currently in the process of carrying out a price control review under its new regulatory framework in each of the Transmission and Gas Distribution sectors (RIIO-T1 and RIIO-GD1 respectively) which will result in Ofgem proposing an eight-year package of allowed revenue and associated output to be delivered, as well as targeted incentive arrangements. In the Electricity Distribution sector, a five year price control period commenced in April 2010 (DPCR5).

In parallel with the development of the new regulatory framework, Ofgem is revisiting its approach to compliance and is reviewing requirements placed on the regulated companies with regards to the verification and assurance processes to which regulatory data should be subjected before being submitted.

This report sets out recommendations on the verification and sign-off Ofgem should require for the different categories of data expected to be submitted by electricity and gas transmission companies and gas distribution companies during the next price control period (2013 to 2021) and for data currently submitted by the electricity distribution companies under DPCR5.

1.2 Approach for Risk Assessment

We have set out a recommended risk based approach to data compliance which considers both the likelihood and impact of data mis-reporting and the inherent risk associated with the party submitting the data. We have disaggregated the likelihood component into the ease of production of the information, ease of its verification and incentive for misreporting on the part of the network operator. Similarly we have separately considered the impact on the network licensee and the impact on the customer. Further detail on the approach is provided in Section 2.6.

We also recognise that the ability of network operators to provide reliable information is not uniform and can change over time, thus presenting different company risk profiles. Accordingly, it is important that all the network operators are individually risk assessed, and we have suggested a Company Risk Assessment mechanism detailed in Appendix 2 of this report as a basis for this risk assessment.

By combining the average risk associated with each data submission with the risk assessment for each network operator, the specific risk score for each data submission for each company can be derived, and this should be used to determine the most appropriate assurance approach from the following assurance options:

- Clear and Transparent Guidance from Ofgem
- Director Sign Off
- Network Licensee's Internal Audit function
- Key Compliance Indicators (KCIs)
- Annual Visits by Ofgem
- Benchmarking
- Spot Checks by Ofgem or its Consultants
- External Financial Auditor
- External Reporter or Examiner

The proposed minimum compliance approach for each risk combination is summarised in the table below:

Description of Risk	Minimum Assurance Approach
High risk associated with both network operator and data submission category	Additional Site Visits and Spot checks Reporter if technical Internal and External Audit Director Sign Off with internal audit support Benchmarking and evaluation using KCIs.
High risk associated with network operator. Low risk data submission category	Additional Site Visits and Spot checks Director Sign Off with internal audit support Benchmarking and evaluation using KCIs
Low risk associated with network operator. High risk data submission category	Reporter if technically complex Internal audit subject to satisfactory QA Director Sign Off with internal audit support Benchmarking and evaluation using KCIs
Low risk associated with both network operator and data submission category	Benchmarking and evaluation using KCIs

Ofgem currently has no overall compliance framework in place for regulatory data submissions. Assurance approaches vary across network sectors and are not explicitly linked to risk. We have proposed a layered approach to compliance based upon increasing risk and incorporating all of the compliance approaches evaluated in this report to a greater or lesser extent. We propose the use of benchmarking and KCIs for all data submissions upon receipt to identify significant errors in submissions or as an early indicator of differences in interpretation of data requirements. The KCIs will also further inform the company risk assessment. The proposed approach allows for Ofgem to supplement suggested assurance arrangements with spot checks or focused reviews in areas considered to be higher risk for Ofgem.

The risk assessment mechanism described in this report is intended to provide a basis for ongoing assessment of the risk for each data submission category as the RIIO framework (Revenue = Incentives + Innovation + Outputs) develops and data requirements are clarified.

1.3 Key Findings and Recommendations

The findings and recommendations arising from our analysis are given below:

- We believe that there may still be a requirement for the technical expertise offered by reporters or examiners to conduct focused reviews in high risk areas across all the network companies and our proposed compliance approach incorporates this requirement. Particular focus should be given to new or technically complex measures introduced as a result of the RIIO price control regime.
- Guidance on regulatory submissions has the potential to be extremely effective in increasing the reliability of information submissions and therefore regulatory compliance. We have suggested therefore that Ofgem runs a series of workshops to clarify understanding on aspects of regulatory data as appropriate across the Price Review reporting period.
- High risk financial data items will continue to be subject to review by external audit as part of their review of the main regulatory returns. Ofgem specify audit requirements and run an annual audit & compliance workshop to ensure that consistency around the terms of external audit engagements is achieved. However differences in materiality will drive differences in the audit approach between network operators. We would therefore recommend that audit approach guidelines additionally consider the risk associated with a particular category of data.

- The current audit approach adopted is a mixture of the traditional substantive approach to audit testing and reviews of the underlying processes and controls, depending upon the type of data being reviewed. We would recommend that the approach moves more towards reviews of the underlying processes and controls and governance procedures.
- There would also be benefit in site visits by Ofgem to perform independent scrutiny or benchmarking of adoption of aspects of guidance across the network companies, particularly where a new requirement has been introduced under RIIO.
- We have recommended that guidance around Director Sign off arrangements be enhanced to state clearly the implications of Director Sign off, the level of sign off and degree of independence required, and the expectations around the level of verification required to support the sign off. In addition, the requirement for sign off of re-submissions of data should also be clearly mandated in all of the RIGs (Regulatory Instructions and Guidance).
- The network licensee's internal audit team could be used to provide more support to the Director Sign off mechanism with Directors signing off on regulatory controls in a similar way that the Sarbanes–Oxley Act requires senior executives to sign off on the internal controls over financial reporting or the HMRC Senior Accounting Officer regime formalises responsibilities and requirements over tax accounting processes.
- The ability to place reliance on an organisation's internal audit team in terms of testing of regulatory processes and systems has the potential to reduce the need for more costly external audit resources. We would suggest that Ofgem and the network operators explore synergies in audit programmes and look to enhance existing internal audit programmes where gaps are identified.
- We would recommend that this activity be preceded by an independent quality assessment and benchmarking of internal audit and regulatory risk culture across the network companies in order to assess the quality and reliability of the network operators' internal audit functions.
- The risk landscape associated with each licensee changes over time. Therefore we recommend that the risk assessment for each network operator is revisited and refreshed annually using the model. The risk assessment may need to be updated between annual refreshes where additional information regarding the risk associated with the licensee comes to light.

1.4 Recommended Next Steps

The following areas of work would be beneficial in refining the data assurance processes for the new price controls and are listed in order of priority.

- Ofgem currently requires assurance over the reliability and accuracy of data at the level of the reporting packs. As reporting packs contain a variety of types of data with varying degrees of materiality and verifiability, we have divided the main data submissions into sub-categories for the purposes of our risk assessment. There is potentially some benefit in further refining the data submission categories, based upon discussions with a wider sample of network operators. There may also be a need to create more data submission categories as the metrics for RIIO outputs and Ofgem reporting requirements evolve.
- We have defined a mechanism for assessing the inherent risk associated with parties responsible for data submissions. Further work would be needed to develop mechanisms for measuring the criteria for company risk assessment in a consistent way across the network operators.
- We have recommended that KCIs be used to assess the performance of the network operator regarding regulatory submissions. Based upon the risk associated with the category of data, the KCIs and the Company Risk Assessment, data would be subject to increasing levels of scrutiny. We would suggest that suitable KCIs be developed based upon the existing regulatory compliance checklist.
- As our data risk assessment currently stands, a number of the RIIO data submission categories appear in the bottom half of the risk rankings simply because they were not able to be fully risk assessed at the time of our analysis. We would therefore recommend that the risk assessment be revisited as RIIO data

requirements develop.

- Our discussions with network operators and responses to our questionnaire indicate that there is clearly potential to identify areas for rationalisation and simplification in terms of existing reports, (e.g. the detailed connections report, cost reporting, transmission investment incentives, etc.).

2 Approach

2.1 Development of Information Submission Catalogues

Licensees in each network sector are required to prepare and submit a significant number of data submissions to Ofgem under the terms of the applicable licence as well as statutory requirements. We compiled a comprehensive catalogue of regulatory information submission requirements for each sector and recorded details of the current compliance assurance approach mandated by Ofgem for each submission. The catalogues are provided as Appendix 3 of this report.

Documentation sourced in the compilation of the catalogues included Ofgem's compliance tracking spreadsheets (where available), relevant operating licences, copies of regulatory submissions, RIGs, RIIO strategy papers, RIIO documentation of outputs and incentives and documentation on incentives and revenue allowances relating to the current price review periods.

2.2 Categorisation of Information Submissions

Ofgem assurance requirements are generally consistent across the sectors and as a result there is significant overlap in the type and nature of information submissions. For example all licensees are required to report on availability of resources and losses. Therefore, for the purposes of our analysis, we compiled a Consolidated Information Submissions catalogue, grouping together similar information submission requirements across the sectors. The Consolidated Catalogue is provided in Appendix 3.

Assurance activities currently required by Ofgem are largely at the level of the regulatory submission itself (e.g. Price Control Review Reporting Pack, Regulatory Accounts, Revenue Return), even though some regulatory submissions encompass multiple licence reporting requirements. We therefore grouped the data submission requirements into 18 broad categories based upon the main regulatory submissions (e.g. Revenue Return).

The 18 data categories were used in a pilot of our risk assessment methodology at a workshop with the Network Companies on 7 March 2011. The exercise highlighted that there are significant differences in the degree of risk associated with different elements of a regulatory submission (e.g. operational data versus financial data). Recognising the range of data items within some submissions, we further sub-divided the main data submissions so that a more meaningful risk assessment could be performed.

Our list of 29 data categories, which has been discussed with Ofgem, is shown in Figure 2.1 below:

Fig 2.1: Data Categories for Risk Analysis

Data Categories for Risk Analysis		
Data Submission Category	Explanation	Licensee
Availability of Resources	Submit certificate stating whether licensee has sufficient resources to carry out licensable activities for next 12 months	All
Business Separation/ Cross Subsidy	Restriction of information, preferential or discriminatory behaviour and cross subsidies	All
Losses Distribution	Although covered in PCRPP/ RRP, analysed separately for risk purposes. Includes shrinkage	Distribution
Losses Transmission	Although covered in PCRPP/ RRP, analysed separately for risk purposes	Transmission
Annual reporting PCRPP/ RRP - Capex	e.g. asset replacement, reinforcement of the network	All
Annual reporting PCRPP/ RRP - Financial	Includes Assets, RAV, Tax, Pensions	All
Annual reporting PCRPP/ RRP - Opex	For Example, controllable opex, logged up and operational costs, cost mapping, Related Party, Maintenance Costs, Logged Up costs, Disaggregated Costs, excluded Services, DUOS	All
Annual reporting PCRPP/ RRP - Operational Data	For Example, Capacity & Storage, Governors, Mains replacement (repex), Gas Escapes, Demand & Supply, Activity Indicators, System Characteristics. Not losses as separately analysed. Not shrinkage	All
Price Control Review Business Plan Submission - Capex	e.g. asset replacement, reinforcement of the network	All
Price Control Review Business Plan Submission - Financial	Includes Assets, RAV, Tax, Pensions	All
Price Control Review Business Plan Submission - Operational Data	For Example, Capacity & Storage, Governors, Gas Escapes, Demand & Supply, Activity Indicators, System Characteristics. Not losses as separately analysed. Not shrinkage	All
Price Control Review Business Plan Submission - Opex	For Example, controllable opex, logged up and operational costs, cost mapping, Related Party, Maintenance Costs, Logged Up costs, Disaggregated Costs, excluded Services, DUOS	All
Regulatory Accounts	Annual regulatory accounts	All
Revenue Return - Base Revenue and Other	As reported in Revenue Return	All
Revenue Return - Entry and Exit Capacity	As reported in Gas Revenue Returns	Gas
Revenue Return - Other Incentives Distribution	i.e. Not QOS, Losses, Low Carbon or Repex, e.g. New transmission capacity charges, DGI and workforce renewal	Distribution
Revenue Return - Other Incentives Transmission	e.g. TNRI, SF6, Pre construction. Not IFI as covered by RIIO	Transmission
Revenue Return - Pass through Items	As reported in Revenue Return	All
Revenue Return - System Owner Incentive	As reported in Transmission Revenue Returns	Transmission
Revenue Return - TIRG	Adjustment to Transmission Charges due to Transmission Investment for Renewable Generation	Transmission
Revenue Return Transportation Owner Incentive	As reported in Transmission Revenue Returns	Transmission
RIIO Asset Health Matrices/ ED Output Measures	Information on the condition of assets, the importance or criticality of assets and the resulting risk associated within them. Includes ED output measures, data collected under D9 on performance and new RIIO requirements. Over and under-delivery also relevant.	All
RIIO Conditions for Connections/ ED Connections	e.g. Pre-connections performance time, overall time for delivery	All
RIIO Customers Satisfaction/ ED and GD Guaranteed Standards	e.g. Surveys, Complaints Handling	All
RIIO Environmental Impact/ ED business carbon footprint	Shrinkage already covered in losses. Residual carbon footprint, methane venting	All
RIIO Low Carbon Networks & Innovation Stimulus	Innovation projects and projects that bring particular value to the challenge of preparing networks for the low carbon economy	All
RIIO Network Safety	Mains replacement. Emergency response, repair, major accident, hazard prevention	All
RIIO Social Obligations	Promoting gas safety, connecting fuel poor	All
RIIO Supply Interruptions/ED QOS Interruptions	Reliability and availability: promoting a reliable network, such as by minimising the number and duration of interruptions and optimising costs associated with network unavailability. Includes interruptions, MTP data	Distribution and Electricity Transmission

2.3 Review of Compliance Assurance Approaches Currently Adopted

Ofgem currently employs a variety of methods to satisfy itself as to the accuracy of regulatory data submissions, including company assertion, company or independent verification, and assessment by Ofgem or its consultants. The assurance methods are mapped to the data submission categories in the Consolidated Catalogue in Appendix 3. We performed a detailed analysis of these assurance methods together with a comparison to methods that we have encountered in other organisations. This analysis is summarised in Section 3 of this report. Our analysis was based upon our existing knowledge and experience, meetings with network operators and other regulators, and completion of a questionnaire by the network operators.

2.4 Network Operators Questionnaire and Meetings

A questionnaire was devised and sent to all network operators in order to more widely understand the processes deployed and challenges faced in terms of assurance activities. The questionnaire required the network companies to rate each of the nine assurance options in our analysis in terms of cost and usefulness. The results of this rating exercise are illustrated in Figures 3.1 and 3.2 in Section 3 of this report.

In addition, meetings were held with the following network companies to gain an insight into the compliance assurance procedures used by these companies:

- Electricity North West (electricity distribution)
- Northern Gas Networks (gas distribution)
- Scottish Power (electricity distribution and transmission)
- National Grid (gas distribution and transmission)

2.5 Discussions with Other Regulators

We met with Ofwat and the Office of Rail Regulation to discuss their approaches to obtaining assurance over data submissions and any relevant lessons learned. We also discussed their ideas and proposals around obtaining assurance in the future. (See Appendices 6 and 7).

2.6 Development of Risk Assessment Model

The approach we have developed for the risk assessment of regulatory data submissions is multidimensional and includes:

1. A risk assessment of each data submission category based upon probability and impact of data mis-reporting (split across the risk factors shown in Figure 2.2);
2. An assessment of the inherent risk associated with the party submitting the data; and
3. An assessment of the impact of misreporting critical data to Ofgem, in terms of incorrect decisions, legal challenge and reputational damage.

2.6.1 Risk assessment of data submission categories.

The table below (Figure 2.2) shows the factors that we used to assess the risk associated with the different categories of data submitted to Ofgem by the network companies. Our initial risk rankings were informed by the following:

- A risk workshop attended by all of the network operators. The attendees rated each of the data submission categories against each of the risk factors.
- Meetings with the network companies listed in Section 2.4 above.

- Review of data submissions, information on RIIO-T1 and GD1 incentives and information on levels of materiality provided by Ofgem.

Fig 2.2: Risk factors for assessing data submissions

	Factor	Explanation	Measurement Criteria	Max Risk Score	Min Risk Score
Likelihood	Ease of producing	Complexity of data, manual vs. automated, use of assumptions or estimation, propensity for self checking	Difficult to produce = 5 Moderately so = 3 Easy = 1	5	1
	Ease of verification	Some of the data, e.g. Financial data may be easily reconcilable to the statutory accounts. Operational data may be more tricky to verify	Difficult to verify = 5 Easy = 1	5	1
	Incentive for misreporting	Considering potential motivations at the company, departmental and individual level	High Incentive = 5 Moderate Incentive = 3 No Incentive = 1	5	1
Impact	Impact on Licensee	Impact of revenues, unearned incentives, avoided penalties on bottom line and on reputational damage.	High Impact = 5 Moderate Impact = 3 Low Impact = 1	5	1
	Impact on Customer	Impact on Customer may be immediate or longer term if insufficient investment in infrastructure	Immediate and Significant Impact = 5 Longer Term but significant impact = 3, Low Impact = 1	5	1

The scores for the risk factors defined in Figure 2.2 may vary between companies due to the underlying systems and processes. For example, one company may have detailed timesheets supporting the allocation of staff costs between different activities whereas another may use estimation techniques. In terms of the model, this factor will impact both the data and company risk assessments.

2.6.2 Risk assessment of Network Operator

The factors proposed for consideration in assessing the risk associated with the party submitting the data and the mechanism for calculating that risk are described in Appendix 2 of this document.

The ability of the network operator to produce reliable and accurate data affects the confidence placed in that data and is an important component in a risk-based approach. We therefore propose that the risk rating associated with each network company is considered alongside the risk associated with a given type of data when considering the most appropriate assurance approach for each data submission category as illustrated in the worked example below:

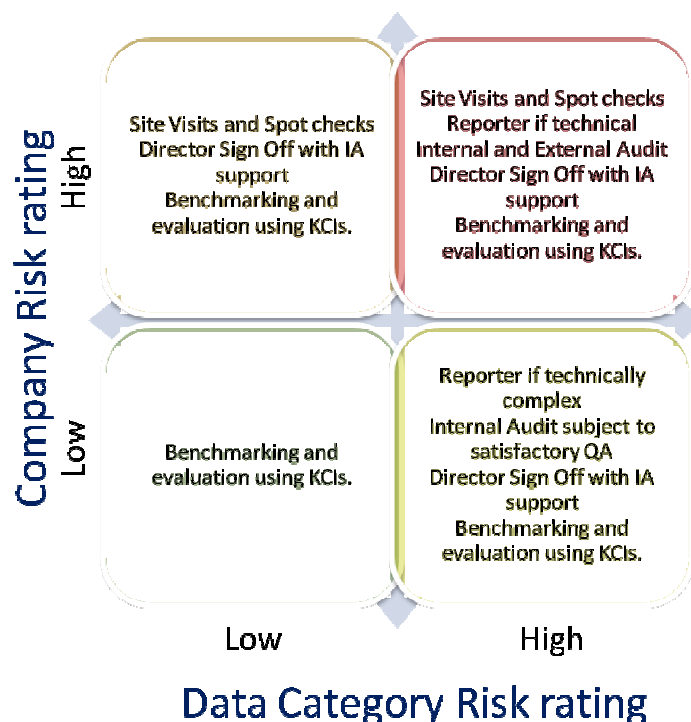
Fig 2.3: Interaction between Company Risk, Data Category Risk and required assurance



As illustrated above, data submission categories for Transmission Losses, Revenue Reporting and Regulatory Reporting submissions are allocated the average risk scores indicated by the markers. If these risk scores are considered in light of the perceived risk of the company submitting the data, the data submission for each company will fall into one of the quadrants above. Data submissions that fall into the top right quadrant in the matrix will require a larger degree of assurance than those in the bottom left, where a low risk data submission is produced by a lower risk company. Our proposed assurance approach depends upon whether the risk associated with the data submission category is largely due to company risk or the risk associated with the data itself.

See Figure 2.4 below for the proposed assurance approaches for each quadrant.

Fig 2.4: Proposed assurance approaches for categories of data



This mechanism is intended as a guide only and that the assurance options proposed are the minimum requirements. Ofgem may decide to do further checks on a case by case basis or based upon the perceived risk to the Regulator.

2.6.3 Risk to Ofgem

An important factor for consideration in assessing the risk associated with a regulatory submission is the impact of mis-reporting on the Regulator. We have agreed with Ofgem that this risk element is left to the judgement and discretion of the Regulator.

3 Analysis of Results

3.1 Analysis of Compliance Assurance Options

Nine compliance assurance options were identified and analysed in terms of benefits, limitations and cost/resource implications. Although each option was analysed in isolation, in practice a combination of these approaches would be adopted to gain assurance over regulatory data. While the first option, Guidance from Ofgem, does not in itself provide assurance, the provision of clear, detailed guidance supported by locked-down templates can increase confidence in the reliability of data submissions. The summary analysis below is supported by the detailed analysis in Appendix 4, the results of our survey of network operators in Appendix 5 and records of meetings with peer regulators (Appendix 6 and 7). The views of the network operators on the relative effectiveness and perceived cost of the nine assurance options are illustrated in Figures 3.1 and 3.2 below. These views have been considered in arriving at our conclusions and recommendations, together with Ofgem’s views, the experiences of the peer regulators interviewed and our views of good practice.

Fig 3.1 – Assurance Options Ranked in order of Usefulness

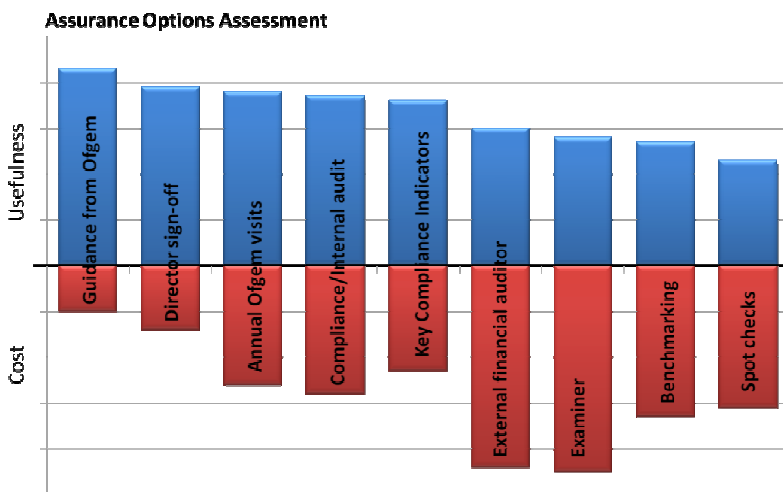
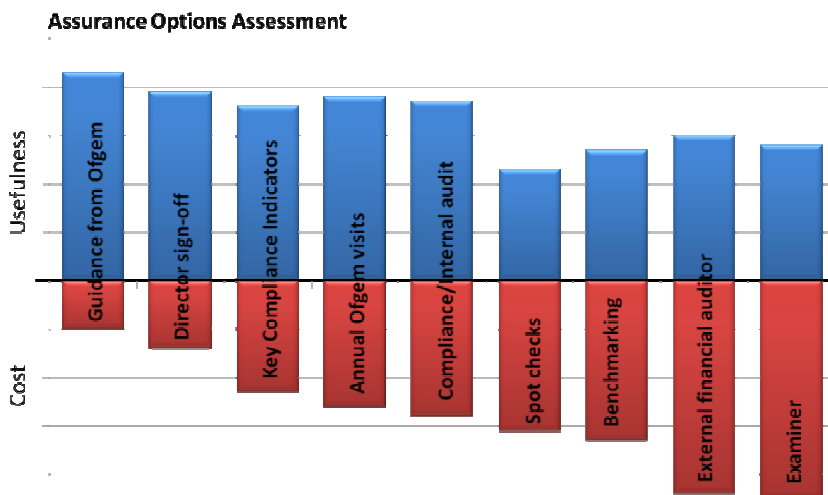


Fig 3.2 – Assurance Options Ranked in order of Increasing Cost



Clear and Transparent Guidance from Authority

The network operators rated guidance from Ofgem as the most effective and economic means of providing confidence in the reliability of data submissions. The RIGs are issued by Ofgem with the intention of ensuring consistent interpretation of definitions and reporting requirements and to provide a framework that enables Ofgem to collect accurate data in a consistent format. In addition, standard spreadsheets (with in-built validations, protected cells and other checks) are provided, e.g. the gas and electricity transmission Price Control Review Reporting Packs, the electricity distribution reporting packs, the gas distribution Regulatory Reporting Pack.

The network operators find this guidance helpful, but six of nine network operators surveyed felt that there were areas which would benefit from more detailed guidance on data collation and presentation. Areas specifically highlighted as requiring additional guidance were D10 guaranteed standards, A40 cost reporting and environmental/incentive reporting for GDNs, and utilisation and condition (health) data for DNOs.

The development of the RIGs is intended to be an iterative process and Ofgem welcomes feedback on the guidance. We would suggest that Ofgem enhances engagement by all network operators by running workshops to clarify understanding on aspects of regulatory data. The workshops should be prioritised on the basis of risk and the network operators' understanding of requirements. There may be value in running the workshops after a round of submissions and across the Price Review reporting period. In addition, there may also be benefit in site visits by Ofgem to perform independent scrutiny or benchmarking of adoption of aspects of guidance across the network companies, particularly where a new requirement has been introduced.

Director Sign off

Conditions in the network operator licences stipulate that a number of the data submissions are required to be accompanied by a statement or letter signed by a Director. In the case of the Revenue Reporting Pack or the ED Cost and Revenue reporting pack, the Director's statement provides confirmation that the data has been provided in accordance with the RIGs. For the certificate of Availability of Resources, the Director is required to provide a statement on whether the licensee is able to carry out its duties as a business for the next 12 months. This assurance mechanism was evaluated by the network companies as the second most effective and economic means of providing assurance around regulatory data. A network operator commented that the focused approach based on risk/materiality gives high benefit for relatively little cost.

We noted that Ofgem has no visibility of the degree of scrutiny of data required by Directors and the associated effort directed towards validating Directors' assertions. We would contrast this with the requirements placed on Directors under HMRC's Senior Accounting Officer (SAO) regime introduced in 2009 which placed responsibility on a Board level director to sign off that the company's tax accounting arrangements were fit for purpose.

Furthermore, unlike the Office of Rail Regulation which requires the Annual Return to be signed off by a Board Director and the Regulatory Accounts to be signed off by the Finance Director, Ofgem does not give any guidance on the level or degree of independence of the Director signing off the data submissions.

We would therefore recommend that guidance around Director Sign off arrangements is enhanced to include the implications of Director Sign off, the level of Sign off and degree of independence required and the expectations around the level of verification required to support the Sign off. In addition, the requirement for Sign off of re-submissions of data should also be clearly mandated in all of the RIGS.

Annual Visits by Ofgem

The network operators ranked the annual Ofgem visits as the third most effective means of providing assurance around regulatory data. Ofgem follows up the submission of the Regulatory Reporting Pack with an annual visit to each network operator to understand the data contained in the submissions (trends, movements, spend against allowance, etc.), to identify inconsistencies between companies and to challenge those companies' actions and assumptions where necessary. Ofgem finds site visits useful in that they get closer to the companies and increase its understanding of the issues faced by the organisation in compiling data. All the network operators interviewed stated that they found Ofgem site visits beneficial and a good opportunity for productive discussion. We were informed that the effort required from Ofgem amounts to around three days per site visit per area covered and that

the effort on the part of the network operator to support site visits can be up to two man weeks per visit. The site visits provide an opportunity for direct observation of processes across the network operators; the opportunity to clarify data requirements and potentially reduce the scope for mis-interpretation; and the opportunity to gather subjective as well as objective feedback.

Internal Audit and Regulatory Risk Culture

Internal auditing is an independent, objective assurance and consulting function designed to add value and improve an organisation's operations. Internal Audit provides a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. Management is responsible for internal control and for establishing policies and processes to support the various categories of internal controls and internal auditors evaluate whether the policies and processes are designed and operating effectively and provide recommendations for improvement. Internal auditing professional standards also require the function to monitor and evaluate the effectiveness of the organisation's risk management processes. Based on a risk assessment of the organisation, internal auditors, management and the Audit Committee determine where to focus internal auditing efforts.

A number of the network companies interviewed informed us that regulatory processes form a significant part of their organisation's risk management processes, with clear ownership of risks associated with regulatory reporting, accountability for regulatory reports and tables and a clear internal audit focus in this area. There may be scope for Ofgem to place more reliance upon this aspect of assurance. The ability to place reliance on an organisation's internal audit team in terms of testing of regulatory processes and systems may have the potential to reduce the need for more costly external audit resources. In fact the Institute of Internal Auditors recommends that the work of internal and external auditors should be coordinated for optimal effectiveness, economy and efficiency.

The Internal Audit team could also be used to give more weight to the Director Sign off mechanism, with Directors signing off on regulatory controls in the same way that the Sarbanes–Oxley Act requires senior executives to sign off on the internal controls over financial reporting.

The Authority currently has no process of assessing the quality and reliability of the network operators' internal audit functions. Therefore we would recommend an independent quality assessment and benchmarking of Internal Audit and regulatory risk culture across the network companies. Typical factors for assessing the shape of an organisation's internal audit function are described in Appendix 8. Examples of some typical Internal Audit KPIs used to assess the effectiveness of an internal audit function may include:

- Number of days that reported audit issues remain open after their agreed-upon closure date
- Percentage of staff with professional certifications, graduate degrees
- Overall years of experience of the audit team
- Staff utilisation rate (% of time spent on projects, as opposed to administrative time including training or annual leave).

Reporting on Key Compliance Indicators (KCIs)

The Office of Rail Regulation utilise Key Performance Indicators to measure Network Rail's delivery against its key regulatory obligations. Key Compliance Indicators could similarly be used by Ofgem during the annual reporting processes to track network operator performance in terms of data submissions. Ofgem could identify 12 to 20 key indicators and produce traffic light type or balanced scorecard reports and trend reporting.

Ofgem currently maintains a Regulatory reporting compliance checklist which logs the receipt of and completeness of key financial regulatory returns and audit reports from the network companies. Some of the items in the checklist would be suitable as a starting point for the development of Key Compliance Indicators. Some suggested KCIs are given below. These could be weighted according to their degree of subjectivity.

- Number of items omitted from cross subsidy checklist
- Number of omissions of items in regulatory accounts
- Whether audit opinion is unqualified

- Percentage of errors identified in submissions received to date
- Number of re-submissions of data received to date
- Level of Director Sign off
- Degree of independence of Director Sign off
- Status and independence of compliance officer
- Effectiveness of Internal Audit function.

The KCIs above may then be used to inform the company risk assessment mechanism as outlined in Appendix 2.

Report by External Financial Auditor

External audit are required by statute to perform an audit in accordance with specific laws or rules on the financial statements of a company in order to present an unbiased and independent opinion on the financial statements. They also have a limited duty to review other information issued alongside the audited financial statements. For example, the auditor must consider whether the information in any reports published with the financial statements is consistent with the information in the income statement and balance sheet. A number of the network operator licence conditions also require financial data in regulatory submissions to be reconciled to the statutory and regulatory accounts (e.g. opex and capex reported in the PCRRP for gas and electricity transmission; revenue reporting for gas distribution). The licences also stipulate that external audit are to be additionally engaged to report upon items of a financial nature such as the regulatory accounts, availability of resources, cross subsidy and revenue returns.

External audit are therefore used by all of the network companies to provide assurance around regulatory data submissions. However, the questionnaire responses revealed that the network operators consider external audit to be one of the most costly and one of the least effective of the assurance options. Our experience is that regulatory submissions and the underlying systems and processes are complex to understand from first principles and the members of an external audit team will typically change from year to year. Time constraints and costs also limit the amount of additional work that external audit are able to do and external audit's typical skill set will lead them to focus on financial rather than technical data. However, external audit provide professional and independent verification of regulatory data and auditing standards and frameworks give assurance around the consistency of the audit approach. External audit are used by other regulators such as ORR and Ofwat. ORR uses external audit to sign off regulatory financial statements and adequacy of resources. Ofwat uses external audit to sign off the regulatory accounts, transfer pricing and principle statements for charging.

Reports produced by external financial auditors may take one of the following forms:

- Financial statements opinion, produced under the UK Companies Acts and International Statements on Auditing issued by the International Auditing and Assurance Standards Board.
- Assurance reports, produced under International Standard for Assurance Engagements (ISAE) 3000 (Assurance Engagements other than Audits or Reviews of Historical Financial Information) issued by the International Auditing and Assurance Standards Board. This standard is particularly suitable for audits of environmental, social and sustainability reports; auditing of information systems, internal control, and corporate governance processes; and compliance audits for grant conditions, contracts and regulations. The ISAE 3000 framework includes both reasonable assurance or limited assurance reports and can provide a flexible approach to be adopted whereby Ofgem would specify the subject matter and measurement criteria, leaving the auditor to design and execute a programme of work to deliver the required assurance.
- Agreed Upon Procedures report, produced under the International Standard for Related Services (ISRS) 4400 (Engagements to Perform Agreed-Upon Procedures Regarding Financial Information) issued by the International Auditing and Assurance Standards Board. While directed at engagements involving financial information, the ISRS it may provide useful guidance for engagements regarding nonfinancial information, provided the auditor has adequate knowledge of the subject matter in question and reasonable criteria exist on which to base findings. An Agreed Upon Procedures engagement does not lead to an opinion but a report of factual findings. Ofgem already makes use of this approach in a number of areas (e.g. revenue returns and cross subsidies).

Independent review by Examiner or Reporter

An assurance option currently being considered by Ofgem is to require the companies to appoint an independent reporter to quality assure the integrity of regulatory returns, similar to the approach currently adopted in the Water Industry. Water companies typically appoint a firm of consulting engineers (approved by Ofwat) for terms of four to five years. The reporters scrutinise water companies' regulatory returns and record their opinion in a report to Ofwat. The Office of Rail Regulation also makes use of reporters.

Network operators' views on the use of reporters were sought by Ofgem in December as part of the consultation on the strategy for the next price control review and the questionnaire asked the network companies whether they felt that the use of an independent examiner or reporter would be appropriate for verification of submissions and data in some areas. The use of an independent examiner or reporter appointed by Ofgem was perceived by the network operators to be among the most expensive (e.g. upwards of £0.5m per network company) and one of the least useful assurance options. Network operators documented concerns around high costs, subjectivity and the risk of reporters becoming part of the assurance process. However, one network operator commented that the use of an examiner is felt to work effectively in the areas where such an approach is currently employed (electricity distribution quality of service and innovation funding / distributed generation incentive schemes). Another network operator suggested specific technical areas which would benefit from review by an examiner (such as Asset Health and Load Indices) and two of the network operators felt that this approach could help ensure consistent processes and interpretation of reporting requirements.

Ofwat and ORR have used reporters to give assurance on regulatory submissions for some time. Therefore we sought their views on and experience of this compliance approach. ORR uses an independent Reporter to operate a rolling programme of data assurance audits, agreed by ORR to measure Network Rail's delivery against its key obligations (e.g. safety, performance, asset condition, quality of service) (See Appendix 6). ORR is satisfied with this approach for its sole network operator. Ofwat on the other hand feels that the imperfections of reporters outweigh the benefits. Ofwat's experience has been that reporters have tended to become part of the process, there has been information mis-reporting despite the regime and that there are large inconsistencies across reporters and hence no comparability across companies. Ofwat also found that consulting engineers were not always best placed to comment on processes and systems. Ofwat is now proposing to move away from the use of the reporter and to place the onus on companies to provide assurance themselves. However, it feels that there is still a role for third party technical expertise to support targeted reviews by Ofwat itself and it can see the value of reporters to assist with comparative analysis of compliance issues across the whole sector.

Cost was not raised as a concern by either regulator. Ofwat estimates that the reporter costs no more than £1.5M per annum across the 21 companies in the industry and ORR estimates that the effort required from their reporter equates to 1 FTE per annum. This is clearly significantly less than the perceptions of the network operators regarding the cost of an independent examiner.

The RIIO Framework focuses very much on the delivery of outputs, which will require technical expertise to define and measure, and therefore independently verify. Therefore, whilst we would not recommend the adoption of an Ofwat reporter type regime, we believe that there will still be a requirement for the technical expertise offered by reporters or examiners to conduct focused reviews in high risk areas across all the network companies. Particular focus should be given to new or technically complex measures introduced as a result of the RIIO price control regime at the start, mid and end of the price control period. Ofgem's professional engineering staff could be utilised for this purpose, but limited resources in this area would potentially need to be supplemented by technical consultants.

Benchmarking

Ofgem currently performs some benchmarking of data submissions, either in-house or via the use of independent consultants (e.g. IT Costs, Property Costs). Ofgem also uses the Regulatory reporting compliance checklist to log the results of completeness checks on the content of audit engagement letters, the regulatory accounts, availability of resources certificates, dividend certificates and cross subsidy reports. A record of exceptions and late submissions is also maintained by network sector. No other formal benchmarking is performed around data

compliance. Benchmarking was perceived by the network operators to be both ineffective and costly in terms of the assurance it provides around data submissions and cost. However, benchmarking could be useful in identifying significant errors in submissions or as an early indicator of differences in interpretation of data requirements. Initial benchmarking analysis should be followed up by workshops or site visits in order to get the full benefit from such comparisons.

Spot Checks by Ofgem or its Consultants

The use of ad-hoc, irregular checks of data as a method for achieving compliance assurance was ranked as the least useful from the point of view of the network operators. This is probably due to the potentially disruptive and unplanned nature of such an approach. The scope of the assurance given by spot checks can only ever be limited. However, this type of approach may be useful to Ofgem where non-compliance or difficulties around interpretation of regulatory guidance are suspected.

3.2 Risk Assessment Results

The 29 data submission categories were evaluated using our risk factors and scoring mechanism and the results of this assessment are given in Appendix 1 and summarised here.

- The RIIO Network Safety category was ranked the highest in terms of risk with an average score of 4.4. This is because this data submission category includes mains replacement costs (repex) which are very high in terms of materiality. Therefore the impact on licensee risk factor was allocated the maximum possible score at the workshop.
- Repex costs are difficult to verify and therefore a high risk rating was also awarded for ease of verification.
- Business Plan Submissions were allocated a high score as they are complex to produce and errors and omissions would have a high impact on the Licensee.
- Data categories concerning operational data (PCRRP Operational Data, RIIO Asset Health Matrices, RIIO Supply Interruptions, Distribution Losses) were all allocated scores in the top half of the risk table, reflecting the difficulty in producing and verifying non-financial data.
- Submission categories associated with numerous material incentives also ranked highly (e.g. Revenue Return Other Incentives Distribution and Other Incentives Transmission).
- Losses Transmission received the lowest risk score as it is currently not a major risk area for the transmission network operators. However, this assessment would change if transmission losses were to become incentivised as part of the RIIO environmental emissions incentive.

A number of other RIIO data submission categories appear in the bottom half of the table simply because they were not able to be fully risk assessed at the time of our analysis (RIIO Conditions for Connections, RIIO Low carbon Networks & Innovation Stimulus, RIIO Customers Satisfaction, RIIO Social Obligations). There is therefore clearly a need to re-visit the risk assessment as RIIO data requirements develop.

3.3 Mapping of Current Compliance Assurance Approaches to Risk Level

There is currently no overall compliance framework in place for regulatory data submissions. Assurance approaches vary across network sectors and are not linked to risk. External audit are used for all the main returns, but the areas of focus and level of detail of their review is not specified. In mapping the data submission categories to the existing assurance approaches currently adopted by Ofgem, we identified that the Regulatory Accounts, Revenue Reporting Packs, Availability of Resources and Cross Subsidy Submissions all require Director Sign off on behalf of the Board and an external auditor's report. The average risk scores allocated to these submissions by the licensees cover a broad range (2.5 to 3.5) yet the same assurance approach is adopted for all. In some cases external statutory requirements or legislation drive the degree of sign off required (e.g. the Regulatory Accounts are subject to the same sign off requirements as the statutory accounts and for Cross Subsidy Submissions, external audit sign-off is an EC second & third package requirement) and are therefore outwith Ofgem's control. However, for other submissions there is clearly some scope to vary the required level of assurance commensurate with the degree of risk involved.

As identified in our analysis, the revenue return is sub-divided into eight data submission categories with different levels of risk. There is clearly potential to vary the compliance approach based upon the type of data and the perceived risk.

A large focus is given to assurance in the area of electricity interruptions including site visits and sample testing by Ofgem and the appointment of an external Examiner. This would appear to be appropriate given that this data falls into one of the higher risk rated categories in our initial assessment. However, Asset Health Matrices and ED Outputs have the same risk rating and are not subject to the same level of scrutiny. Nor is the Operational Data which forms part of the Regulatory Reporting Pack. This is more highly rated in terms of risk and receives only the Director sign off which is accorded to the whole pack.

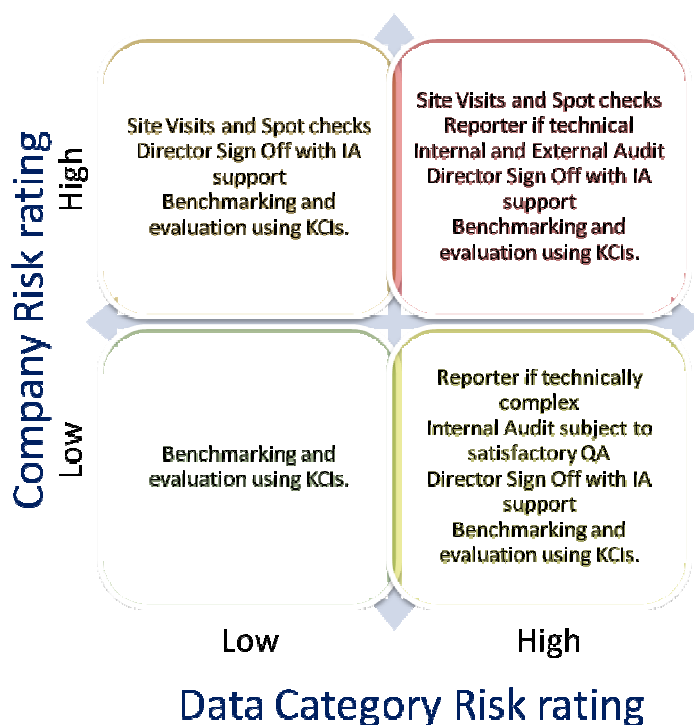
3.4 Future Compliance Framework

We propose a layered approach to compliance based upon the degree of risk associated with the data and the network operator.

- All network operators would be subject to annual assessment based upon the company assessment criteria in Appendix 2.
- All data submissions would be subject to benchmarking in terms of data accuracy, and Key Compliance Indicators would be used to assess the performance of the network operator regarding regulatory submissions. Based upon the risk associated with the category of data, the KCIs and the Company Risk Assessment, the data would be subject to increasing levels of scrutiny.
- Higher risk data items may be subject to guidance workshops, subject to Ofgem's judgement.
- High risk data items should also continue to be subject to review by external audit as part of their review of the main regulatory returns.
- Director Sign off should be required for high risk data categories and for all data categories for high risk organisations. Director Sign off should be at main board level, on behalf of the board and backed up by internal audit review.
- Where complex data requires further scrutiny and testing, this would also be performed by internal audit. (The use of internal audit may however be restricted if independent assessment of the internal audit team is not satisfactory).
- Reporter reviews for technically complex data items should be arranged at the discretion of Ofgem.
- High risk network operators should be subject to additional Ofgem site visits and spot checks.

3.5 Mapping of Risk Model to Future Compliance Approach

The diagram of the risk model described in Section 2.6 is provided below for ease of reference:



Bottom Left Quartile

In the risk matrix shown above, the data submission categories rated with a risk rating of less than 2.5 (i.e. those below the risk rating level of the regulatory accounts) would fall into the bottom left quartile and would be subject to only basic monitoring checks (benchmarking and KCI indicators). These submission categories are Transmission Losses, RIIO Social Obligations and Entry and Exit Capacity. If initial benchmarking or KCIs indicate errors in submissions or a lack of understanding by the network operator, then the risk associated with the network operator would increase and the data submission could potentially move up into the top left quartile and require more scrutiny.

Bottom Right Quartile

Most data submissions currently fall into the high risk data category. These submissions would also be subject to high level benchmarking and KCIs in the first instance. The results of these checks and the company risk assessment may then move the data submissions into the top right quartile for some network operators. Items in the bottom right quartile because the data is difficult to produce and verify (e.g. PCRRP Operational Data, RIIO Asset Health Matrices, RIIO Supply Interruptions, Distribution Losses) would be candidates for inclusion in Ofgem guidance workshops. However, a further degree of judgement should be applied by Ofgem in terms of risk and the network operators' understanding of requirements. Items in the bottom right quartile would also be subject to Director Sign off, external and internal audit and Reporter reviews (potentially across all network operators) where a data item is technically complex and new.

Top Left Quartile

Low risk data items in the top left quartile would be subject to additional checks reflecting a lack of confidence in the network operator. Such checks would include Director Sign off, site visits and spot checks by Ofgem.

Top Right Quartile

High risk data items in the top right quartile would be subject to the same checks as those in the bottom right quartile. However these data items would be subject to additional site visits and spot checks by Ofgem reflecting a lack of confidence in the network operator.

4 Conclusions and Next Steps

Our risk assessment model is based upon the adoption of differing and proportionate assurance approaches according to the risk associated with both data submissions and the party providing the data. There is therefore a need to evaluate all network operators using the company assessment criteria we have defined. Further work is also needed to develop mechanisms for measuring the criteria for company risk assessment in a consistent way across the network operators. Additionally, since the risk landscape associated with each licensee will evolve and change over time, we recommend that the risk assessment for each network operator is revisited and refreshed at least annually using the model.

As our data risk assessment currently stands, a number of the RIIO data submission categories appear in the bottom half of the risk rankings simply because they were not able to be fully risk assessed at the time of our analysis. There is therefore clearly a need to re-visit the risk assessment as RIIO data requirements develop.

There is currently no overall compliance framework in place for regulatory data submissions. Assurance approaches vary across network sectors and are not linked to risk. We have proposed a layered approach to compliance based upon increasing risk and incorporating all of the compliance approaches evaluated in this report to a greater or lesser extent. We propose the use of benchmarking and KCIs for all data submissions to identify significant errors in submissions or as an early indicator of differences in interpretation of data requirements. The KCIs will also further inform the company risk assessment. Our compliance framework also incorporates the use of spot checks and site visits to gain additional assurance around the systems and processes adopted by high risk network operators. High risk data items will also continue to be subject to review by external audit as part of their review of the main regulatory returns.

We believe that there will still be a requirement for the technical expertise offered by reporters to conduct focused reviews in high risk areas across all the network companies and our proposed compliance approach incorporates this requirement. Particular focus should be given to new or technically complex measures introduced as a result of the RIIO price control regime. Ofgem's professional engineering staff could be utilised for this purpose, but limited resources in this area would potentially need to be supplemented by technical consultants.

Guidance on regulatory submissions has the potential to be effective in increasing regulatory compliance, particularly where supported by clearly designed templates for data submission, with in-built checks and validations. The role of the network operators in clarifying requirements for guidance is invaluable. We have suggested that Ofgem enforce this engagement by running a series of workshops to clarify understanding on aspects of regulatory data. The workshops should be prioritised on the basis of risk and the network operators' understanding of requirements. The workshops should be run on alternate months across the Price Review reporting period. In addition, there would also be benefit in site visits by Ofgem to perform independent scrutiny or benchmarking of adoption of aspects of guidance across the network companies, particularly where a new requirement has been introduced following the adoption of RIIO.

We have recommended that guidance around Director Sign off arrangements is enhanced to include the implications of Director Sign off, the level of Sign off and degree of independence required and the expectations around the level of verification required to support the Sign off. In addition, the requirement for Sign off of re-submissions of data should also be clearly mandated in all of the RIGS. The network licensee's internal audit team could be used to give more support to the Director Sign off mechanism with Directors signing off on regulatory controls in the same way that the Sarbanes–Oxley Act requires senior executives to sign off on the internal controls over financial reporting.

The ability to place reliance on an organisation's internal audit team in terms of testing of regulatory processes and systems may have the potential to reduce the need for more costly external audit resources. We would suggest that Ofgem and the network operators explore synergies in audit programmes and look to enhance existing internal audit programmes where gaps are identified. However we would recommend that this activity is preceded by an independent quality assessment and benchmarking of internal audit and regulatory risk culture across the network companies in order to assess the quality and reliability of the network operators' internal audit functions.

Ofgem currently obtains assurance at the regulatory reporting level, despite the fact that reporting packs contain a variety of types of data with varying degrees of materiality, incentivisation and verifiability. In order to perform a meaningful risk assessment we divided the main data submissions into sub-categories. We believe that there is scope to further refine our data submission categories, based upon discussions with a wider sample of network operators and as the metrics for RIIO outputs and Ofgem reporting requirements evolve.

Appendix 1: Data Categories Risk Ranking

Below are average risk scores for each data submission category ranked in order of risk. The risk assessment was based upon a combination of factors contributing to the overall likelihood and impact of data mis-reporting (see explanation of risk factors in Fig 2.2 above). The risk assessment was informed by a risk workshop attended by all of the Network Operators, meetings with individual network companies and review of data submissions and information provided by Ofgem. Details of the rationale behind each risk assessment are also given.

It is important to understand that the risk assessment exercise was intended merely to be a straw poll to give an indication of overall risk. It should also be noted that each attendee had a vote and no adjustment was made to the results of the risk assessment for the number of attendees from a particular organisation or sector. Furthermore the judgement applied by the workshop attendees will inevitably have been influenced by the discussions that took place at the workshop.

Category	Ease of producing	Ease of verification	Incentive for misreporting	Impact on Licensee	Impact on Customer	Average Score	Data Informing Risk Assessment
RIIO Network Safety	4.3	4.5	4.0	5.0	4.0	4.4	Evaluated at Workshop as 4.6 for RIIO Safety including Repex (for GDNs 09/10 £0.8bn). Have reduced score allocated for Customer Impact
Price Control Review Business Plan Submission - Capex	4.9	4.5	3.4	4.4	3.6	4.2	Based upon score allocated at the workshop
Price Control Review Business Plan Submission - Financial	4.9	4.5	3.4	4.4	3.6	4.2	Based upon score allocated at the workshop
Price Control Review Business Plan Submission - Operational Data	4.9	4.5	3.4	4.4	3.6	4.2	Based upon score allocated at the workshop
Price Control Review Business Plan Submission – Opex	4.9	4.5	3.4	4.4	3.6	4.2	Based upon score allocated at the workshop
Price Control Review Annual Reporting/ RRP – Operational Data	5.0	5.0	3.4	3.9	2.6	4.0	Have increased ratings for verification & producing based upon workshop comments that this data is significantly more difficult to produce & verify than financial data.
Price Control Review Annual Reporting/ RRP - Opex	4.6	4.4	3.4	4.2	2.6	3.8	Have increased ratings for verification and producing as this data is more difficult to produce and verify than financial data. GDNs Opex 09/10 £0.7bn
RIIO Asset Health Matrices/ ED Output Measures	4.1	4.1	3.7	4.3	3.3	3.8	Rating based upon scores from workshop for RIIO Reliability & Availability/ ED interruptions & Network Output Measures. This is a sub-set of that category.

Category	Ease of producing	Ease of verification	Incentive for misreporting	Impact on Licensee	Impact on Customer	Average Score	Data Informing Risk Assessment
RIIO Supply Interruptions/ ED QOS Interruptions	3.8	4.1	4.0	4.3	3.3	3.8	Based upon score allocated at the workshop
Price Control Review Annual Reporting/ RRP – Capex	4.3	4.1	4.0	3.9	2.6	3.8	Have increased incentive score from workshop as now capex only Capex for GDNs 09/10 £0.4bn. Capex for transmission pa £0.9b.
Losses Distribution	3.3	4.2	3.9	4.0	3.1	3.7	Based upon score allocated at the workshop
Revenue Return - Other Incentives Distribution	2.9	3.0	4.5	4.4	2.6	3.5	Evaluated at Workshop as 4.6 for RIIO Safety including Repex. Have modified max score allocated for Customer Impact and reduced rating
Price Control Review Annual Reporting/ RRP – Financial	4.3	3.0	3.4	3.9	2.6	3.4	More easily reconcilable than other aspects of return. Workshop Score for ease of verification subsequently reduced to reflect this.
Revenue Return - Other Incentives Transmission	2.9	3.0	3.5	4.4	2.6	3.4	Score from workshop increased to reflect that there are incentives on this submission
RIIO Conditions for Connections/ ED Connections	3.3	3.3	3.2	3.7	3.1	3.3	Based upon score allocated at the workshop. Score may increase with RIIO requirements.
Revenue Return - Base Revenue and Other	2.9	3.0	3.5	4.4	2.6	2.9	Based upon score allocated at the workshop
Revenue Return - Pass through Items	2.9	3.0	3.5	4.4	2.6	2.9	Based upon score allocated at the workshop
Revenue Return - System Owner Incentive	2.9	3.0	3.5	4.4	2.6	2.9	Based upon score allocated at the workshop
Revenue Return Transportation Owner Incentive	2.9	3.0	3.7	4.4	2.6	2.9	Based upon score for transportation charges from workshop. Rating increased to reflect the fact that this is incentivised.
Revenue Return - TIRG	2.9	3.0	3.5	2.5	2.6	2.9	Based upon interview with licensee is a lower risk area so have reduced impact on licensee score on this basis.
Availability of Resources	2.6	2.7	1.8	4.1	2.8	2.6	Based upon score allocated at the workshop

Category	Ease of producing	Ease of verification	Incentive for misreporting	Impact on Licensee	Impact on Customer	Average Score	Data Informing Risk Assessment
RIIO Low Carbon Networks & Innovation Stimulus	2.5	2.5	4.0	2.5	2.5	2.8	Not evaluated at workshop as requirement still being developed. Have given average scores and added incentive scores based upon the fact that there are incentives for this.
RIIO Customers Satisfaction/ ED and GD Guaranteed Standards	2.4	2.9	2.9	3.3	2.3	2.8	Based upon score allocated at the workshop. Score may increase with RIIO requirements. RIIO incentive +/-1% of total revenues
Business Separation/ Cross Subsidy	2.7	2.7	2.6	3.2	2.3	2.7	Based upon score allocated at the workshop
RIIO Environmental Impact/ ED Business Carbon	3.3	3.7	2.5	2.2	1.4	2.6	Based upon score allocated at the workshop
Regulatory Accounts	2.8	2.3	2.1	3.7	1.6	2.5	Based upon score allocated at the workshop
Revenue Return - Entry and Exit Capacity	2.5	1.9	2.1	2.0	2.7	2.2	Based upon score for Exit Capacity at the workshop. Now re-categorised as part of revenue return
RIIO Social Obligations	2.3	2.3	1.7	3.0	1.3	2.1	Based upon scores from workshop. Only three attendees voted as RIIO requirements still being developed.
Losses Transmission	2.5	2.5	1.0	1.0	1.0	1.6	In licensee interview stated that not major or verified in any way. Incentive rating may change as transmission losses become incentivised for GT as part of RIIO environmental emissions incentive.

Appendix 2: Company Risk Assessment

The following table lists the factors that should be considered in assessing the risk associated with the parties submitting data and a potential mechanism for calculating that risk.

 Network Company Risk Assessment				
	Description	Measurement Criteria	Max Risk Score	Min Risk Score
FINANCIAL	Accounts qualified in past 5 years	Yes = 3, No = 0	3	0
	Credit Rating of the Licensee	Range, 3 = Poor, 1 = Good	3	1
PREVIOUS EXPERIENCE	High level of errors in previous submissions	Range, 10 = High Error Rate, 5 = Moderate Error Rate, 0 = Low or No Error Rate	10	0
	Extent of modifications to and re-submission of data already submitted	Range, 5 = High degree, 3 = Moderate degree, 0 = Minimal	5	0
	Ofgem fines or enforcement actions in last 12 months?	Range, Fine of > £0.5M = 5, Fine of <£0.5M = 3, No Fine = 0	5	0
	Quality of business plan	Range, 5 = poor quality business plan, 0 = high quality, well-justified business plan	10	0
SYSTEMS AND PROCESSES	New financial accounting and reporting systems implemented in the last 18 months	Yes = 5, No = 0	5	0
	New operational, asset management or call handling implemented in the last 18 months	Yes = 5, No = 0	5	0
	Level and quality of documentation of underlying systems and processes	Range, 5 = Little or no documentation, 3 = Some documentation, 0 = High quality, extensive updated documentation	5	0
	Complexity of underlying systems and processes	Range, 5 = Complex, 0 = simple	5	0
	Degree of understanding of regulatory systems and processes	Range, 5 = Good up to date level of understanding, 3 = Moderate Level of understanding, 1 = Low level of understanding	5	1
GOVERNANCE AND COMPLIANCE	Perceived quality of network company's governance framework	Range, 5 = Poor, 1 = Good	5	1
	Degree of scrutiny by in-house internal audit team and size and competency of team	Range, 5 = Little scrutiny, 1 = Large degree of scrutiny by large, competent in-house team	5	1
	Degree of staff turnover in regulatory area	Range, 5 = High, 0 = Low	5	0
	Reliability of personnel	Range, 3 = Poor, 1 = Reliable	3	1
	Remuneration packages tied into quality targets v short term maximisation of profits	Range, 5 = Reward and Bonuses are linked to profitability, 1 = Reward and bonuses are tied into quality targets	5	1
	Benchmarking of performance against peers	Range, 5 = Low Range Performer, 3 = Medium Range Performer, 1 = Top Range Performer	5	1
ENGAGEMENT WITH REGULATORY PROCESS	Responsiveness to new requests for data from the regulator	Range, 3 = Least Responsive, 2 = Average Responsiveness, 1 = Most responsive	3	1
	Degree of Participation in development of new regulatory reporting requirements	Range, 5 = Active participation, 3 = Some participation, 1 = Little or no participation	5	1
	Good communication channels with Ofgem	Range, 3 = Poor, 1 = Good	3	1
Overall risk score			100	10

Appendix 3: Catalogues

Consolidated Catalogue, detailed risk assessment and mapping of risk ratings to assurance approaches



Consolidated
Catalogue Deliverable

Gas Distribution Information Submissions Catalogue



Gas Distribution
Information Submissic

Electricity Distribution Information Submissions Catalogue



Electricity
Distribution Informati

Gas Transmission Information Submissions Catalogue



Gas Transmission
Information Submissic

Electricity Transmission Information Submissions Catalogue



Electricity
Transmission Informa

Appendix 4: Analysis of Compliance Assurance Options

This Appendix provides an analysis of data reliability and compliance assurance options.

1. Provision of clear and transparent guidance from Authority

RIGs issued by Ofgem to ensure consistent interpretation of definitions and reporting requirements and to provide a framework. Standard spreadsheets (with in-built validations, protected cells and other checks) also provided (e.g. gas and electricity transmission Price Control Review Reporting Packs, six electricity distribution reporting packs, gas distribution Regulatory Reporting Pack).

Benefits	Limitations	Cost/Resource Implications				
<ul style="list-style-type: none"> Requirement to structure data in a consistent manner Less scope for mis-interpretation (deliberate or otherwise) of regulatory requirements Increased consistency facilitates comparison / benchmarking against other licensees Ability to specify granularity of data required Can build cross checks into the data capture process 	<ul style="list-style-type: none"> No independent verification No visibility of underlying systems and processes Too much narrative may make key information difficult to extract. Guidance may be incomplete or subject to variable interpretation. 	<table border="1"> <thead> <tr> <th data-bbox="1034 790 1485 828">Ofgem</th> </tr> </thead> <tbody> <tr> <td data-bbox="1034 828 1485 981"> <ul style="list-style-type: none"> Potentially significant resource requirement required to compile data reporting requirements </td> </tr> <tr> <th data-bbox="1034 981 1485 1019">Network Company</th> </tr> <tr> <td data-bbox="1034 1019 1485 1229"> <ul style="list-style-type: none"> Moderate </td> </tr> </tbody> </table>	Ofgem	<ul style="list-style-type: none"> Potentially significant resource requirement required to compile data reporting requirements 	Network Company	<ul style="list-style-type: none"> Moderate
Ofgem						
<ul style="list-style-type: none"> Potentially significant resource requirement required to compile data reporting requirements 						
Network Company						
<ul style="list-style-type: none"> Moderate 						
Potential Improvements						
<ul style="list-style-type: none"> Request commentary from Network Company explaining the data and what has been happening from their point of view, e.g. explain reasons for outperforming or under-performing. Insisting on a commentary up from could remove the need for Ofgem to ask questions later. Narrative included within the tables but Ofgem will need to specify on which areas of the pack commentary is required. Commentary will need to explain how data has been built up, trends and any unusual results. Ofgem could include more data validation in reporting spreadsheets. 						

2. Director Sign Off

A number of the data submissions are required to be accompanied by a statement or letter signed by a Director, e.g. the ED Cost and Revenue reporting pack. The Director's statement provides confirmation that data has been provided in accordance with the RIGs. For the certificate of Availability of Resources, the Director is required to provide a statement on whether the licensee is able to carry out its duties as a business for the next 12 months. This statement is required to be submitted and approved by the Board as are the regulatory accounts.

Benefits	Limitations	Cost/Resource Implications
<ul style="list-style-type: none"> Gives accountability and ownership Can be a powerful driver 	<ul style="list-style-type: none"> No independent verification No specific requirement to structure data in a consistent manner No means of comparison/benchmarking with other licensees No visibility of underlying systems and processes No visibility of data or testing supporting assertions Variability of quality of data supporting assertions 	<p>Ofgem</p> <ul style="list-style-type: none"> Low cost and resource requirement
		<p>Network Company</p> <ul style="list-style-type: none"> Variable depending upon degree of scrutiny by Directors and associated effort directed towards validating assertions Potentially significant resource implications
Potential Improvements		
<ul style="list-style-type: none"> Potential for Ofgem to give more specific guidance on what Directors are signing off and to make it clearer what they expect from them. Director sign off needs formalising and re-structuring. There should be Director sign off for all re-submissions of data. 		

3. Review by Internal Audit

Internal auditing is an independent, objective assurance and consulting function designed to add value and improve an organisation's operations. Internal Audit provides a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. Management is responsible for internal control and for establishing policies and processes to support the various categories of internal controls and internal auditors evaluate whether the policies and processes are designed and operating effectively and provide recommendations for improvement. The Agreed Upon Procedures require that external audit review any reports by internal audit and report findings

Benefits	Limitations	Cost/Resource Implications
<ul style="list-style-type: none"> Degree of independent verification Gives accountability and ownership Potential to examine supporting evidence and test results Ability to track progress towards compliance via audit actions Visibility of underlying systems and processes In-house team have understanding of internal systems and processes and knowledge of key contacts within network company 	<ul style="list-style-type: none"> Variability in audit approaches and quality of audit staff No means of comparison/ benchmarking with other licensees No requirement to structure data in a consistent manner Could become part of the process Could lead to less accountability as individuals believe any errors will be picked up later therefore do not need to exercise as much care 	Ofgem <ul style="list-style-type: none"> Low cost and resource requirement
		Network Company <ul style="list-style-type: none"> Significant cost implication, e.g. one licensee quoted 44 man days to review 3 tables Significant network company resource requirement

Potential Improvements
<ul style="list-style-type: none"> Need some means of assessing the quality and reliability of the internal audit function. Ofgem could issue a self-assessment questionnaire to Heads of Internal Audit, with questions around size of team, qualifications and methodologies employed, e.g. do they follow IIA Guidelines; are they ISO 27001 compliant? Information could also feed into Company Risk Assessment. Can Ofgem be more specific about expectations from internal audit?

4. Reporting on Key Compliance Indicators (KCIs)

KPIs are used by the Office of Rail Regulation to track performance and identify trends (e.g. in safety, performance, asset condition, QOS). Compliance Indicators would be useful to Ofgem for benchmarking purposes. Ofgem currently maintains a regulatory reporting compliance checklist which logs the receipt of and completeness of key financial regulatory returns and audit reports from the network companies. Some of the items in the checklist would be suitable as a starting point for the development of Key Compliance Indicators.

Benefits	Limitations	Cost/Resource Implications
<ul style="list-style-type: none"> Potential to compare/benchmark against other licensees Requirement to structure data in a consistent manner 	<ul style="list-style-type: none"> No independent verification No visibility of underlying systems and processes Scope for mis-interpretation (deliberate or otherwise) of regulatory requirements 	Ofgem
		<ul style="list-style-type: none"> Low ongoing cost implications Significant resource requirement initially to determine meaningful KCIs
		Network Company <ul style="list-style-type: none"> Low resource requirement from network company
Potential Improvements		
<ul style="list-style-type: none"> Could use existing compliance logs to identify KCIs around data submissions. Potential to use “knife edge” indicators. Could identify 12 to 20 key indicators and produce traffic light type/ balanced scorecard reports and trend reporting on a quarterly basis. Could also produce KCIs for annual data submissions process, i.e. Materiality of changes from initial submission to final. Quarterly assessment KCIs should also include some subjective and qualitative analysis of data submissions. 		

5. Annual Visits by Ofgem to Network Operators

Ofgem follows up the submission of the Regulatory Reporting Pack with an annual visit to each network operator to understand the data contained in the submissions (trends, movements, spend against allowance, etc.), to identify inconsistencies between companies and to challenge those companies' actions and assumptions where necessary. During the visit Ofgem performs informal sample testing of transactions.

Benefits	Limitations	Cost/Resource Implications				
<ul style="list-style-type: none"> Potential to compare/ benchmark against other licensees Opportunity to inform KCIs and KRIs Opportunity to gain subjective as well as objective feedback Independent assurance Can reduce risk of/ scope for mis-interpretation (deliberate or otherwise) of regulatory requirements Potential to clarify information requirements Licensees find beneficial 	<ul style="list-style-type: none"> Limited visibility of underlying systems and processes 	<table border="1"> <thead> <tr> <th data-bbox="1031 432 1484 465">Ofgem</th> </tr> </thead> <tbody> <tr> <td data-bbox="1031 465 1484 651"> <ul style="list-style-type: none"> If increase in this type of approach, increased cost, with each area typically taking 3 days to cover </td> </tr> <tr> <th data-bbox="1031 651 1484 685">Network Company</th> </tr> <tr> <td data-bbox="1031 685 1484 902"> <ul style="list-style-type: none"> Some additional cost/resource </td> </tr> </tbody> </table>	Ofgem	<ul style="list-style-type: none"> If increase in this type of approach, increased cost, with each area typically taking 3 days to cover 	Network Company	<ul style="list-style-type: none"> Some additional cost/resource
Ofgem						
<ul style="list-style-type: none"> If increase in this type of approach, increased cost, with each area typically taking 3 days to cover 						
Network Company						
<ul style="list-style-type: none"> Some additional cost/resource 						
Potential Improvements						
<ul style="list-style-type: none"> Opportunity for comparison/ benchmarking of interpretation of data requirements early on in the price review period. Opportunity to contribute to identification of "fast track" licensees. Need to focus on areas where most benefit can be derived, e.g. where a new information requirement has been introduced. 						

6. Verification to independent data / benchmarking

Ofgem may perform benchmarking of data submissions in-house or via the use of independent consultants. Ofgem uses a regulatory reporting compliance checklist to log results of completeness checks on the content of audit engagement letters, regulatory accounts, availability of resources certificates, dividend certificates and cross subsidy reports. A record of exceptions and late submissions is maintained by network sector. No other formal benchmarking is performed around data compliance

Benefits	Limitations	Cost/Resource Implications
<ul style="list-style-type: none"> Potential to compare/benchmark against other licensees Requirement to structure data in a consistent manner 	<ul style="list-style-type: none"> No independent verification No visibility of underlying systems and processes Scope for mis-interpretation (deliberate or otherwise) of regulatory requirements 	Ofgem
		<ul style="list-style-type: none"> Potentially significant cost Procurement and management of consultants
		Network Company
<ul style="list-style-type: none"> Low resource requirement from network company, depending on volume/granularity of data requests 		

Potential Improvements

- Could perform comparison with international competitors but would need to allow for regional variations in say labour costs.
- Could use independent sources of data to check data submitted in regulatory returns, e.g. could use settlements data from ELEXON to validate energy volumes sold to customers.
- Would be useful for Ofgem to publish some form of comparative analysis and key statistics after the annual visits to licensees.

7. Spot Checks by Ofgem or its Consultants

Ofgem performs ad-hoc irregular checks of data as a method for achieving compliance assurance. For example, Ofgem has in the past employed independent specialist consultants to assess and benchmark certain areas e.g. IT Costs, Property Costs, DNO Telephone performance.

Benefits	Limitations	Cost/Resource Implications
<ul style="list-style-type: none"> Potential to compare/ benchmark against other licensees Independent verification Visibility of underlying systems and processes Can reduce risk of/ scope for mis-interpretation (deliberate or otherwise) of regulatory requirements 	<ul style="list-style-type: none"> Potential for disruption 	Ofgem
		<ul style="list-style-type: none"> Potentially significant Ofgem resource requirement Procurement and management of consultants
		Network Company
<ul style="list-style-type: none"> Moderate cost Some resource requirement from network company 		
Potential Improvements		
<ul style="list-style-type: none"> Opportunity for comparison/ benchmarking of interpretation of data requirements early on in the price review period. Opportunity to contribute to identification of “fast track” licensees. 		

8. Report by External Financial Auditor

External audit are required by statute to perform an audit in accordance with specific laws or rules on the financial statements of a company in order to present an unbiased and independent opinion on the financial statements. They also have a limited duty to review other information issued alongside the audited financial statements. A number of the network operator licences require financial data in regulatory submissions to be reconciled to regulatory accounts (e.g. opex and capex reported in the PCRRP for gas and electricity transmission; revenue reporting for gas distribution). Licences also stipulate that external auditors are to be additionally engaged to report upon items of a financial nature such as the regulatory accounts, cross subsidy and revenue returns.

Benefits	Limitations	Cost/Resource Implications
<ul style="list-style-type: none"> Independent verification Potential to examine supporting evidence and test results Potential to structure data in a consistent manner Potential for comparison/ benchmarking with other licensees Ability to track progress towards compliance via audit actions Visibility of underlying systems and processes 	<ul style="list-style-type: none"> Very complex area to understand if not familiar and high learning curve Audit team change from year to year External audit have different drivers, i.e. financial materiality Different auditors may have different approach 	<p data-bbox="1038 562 1126 589">Ofgem</p> <ul style="list-style-type: none"> Moderate to significant, depending on nature of engagement <p data-bbox="1038 748 1267 775">Network Company</p> <ul style="list-style-type: none"> Potentially significant cost to network operator, (e.g. £1m to audit RRP tables was quoted by one network operator)

Potential Improvements

- Some regulatory data lends itself to scrutiny by external financial audit and can be reconciled with core financial data. Could use a variety of possible frameworks including ISRS4400, ISAE3000, etc. to standardise approach.
- Reports produced by external financial auditors may take one of the following forms:
 - Financial statements opinion, produced under the UK Companies Acts and International Statements on Auditing issued by the International Auditing and Assurance Standards Board.
 - Assurance reports, produced under International Standard for Assurance Engagements 3000 (Assurance Engagements other than Audits or Reviews of Historical Financial Information) issued by the International Auditing and Assurance Standards Board. This standard is particularly suitable for audits of environmental, social and sustainability reports; auditing of information systems, internal control, and corporate governance processes; and compliance audits for grant conditions, contracts and regulations. The ISAE 3000 framework includes both reasonable assurance or limited assurance reports and can provide a flexible approach to be adopted whereby Ofgem would specify the subject matter and measurement criteria, leaving the auditor to design and execute a programme of work to deliver the required assurance
 - Agreed Upon Procedures report, produced under the International Standard for Related Services 4400 (Engagements to Perform Agreed-Upon Procedures Regarding Financial Information) issued by the International Auditing and Assurance Standards Board. While directed at engagements involving financial information, the ISRS it may provide useful guidance for engagements regarding non-financial information, provided the auditor has adequate knowledge of the subject matter in question and reasonable criteria exist on which to base findings. An Agreed Upon Procedures engagement does not lead to an opinion but a report of factual findings. Ofgem already makes use of this approach in a number of areas (e.g. revenue returns and cross subsidies).

9. Independent review by technical auditor /examiner / reporter

May engage a specialist audit in a technical area. This occurs in other industries, e.g. ORR employ technical auditors to review enhancement projects, Ofwat reporter regime.

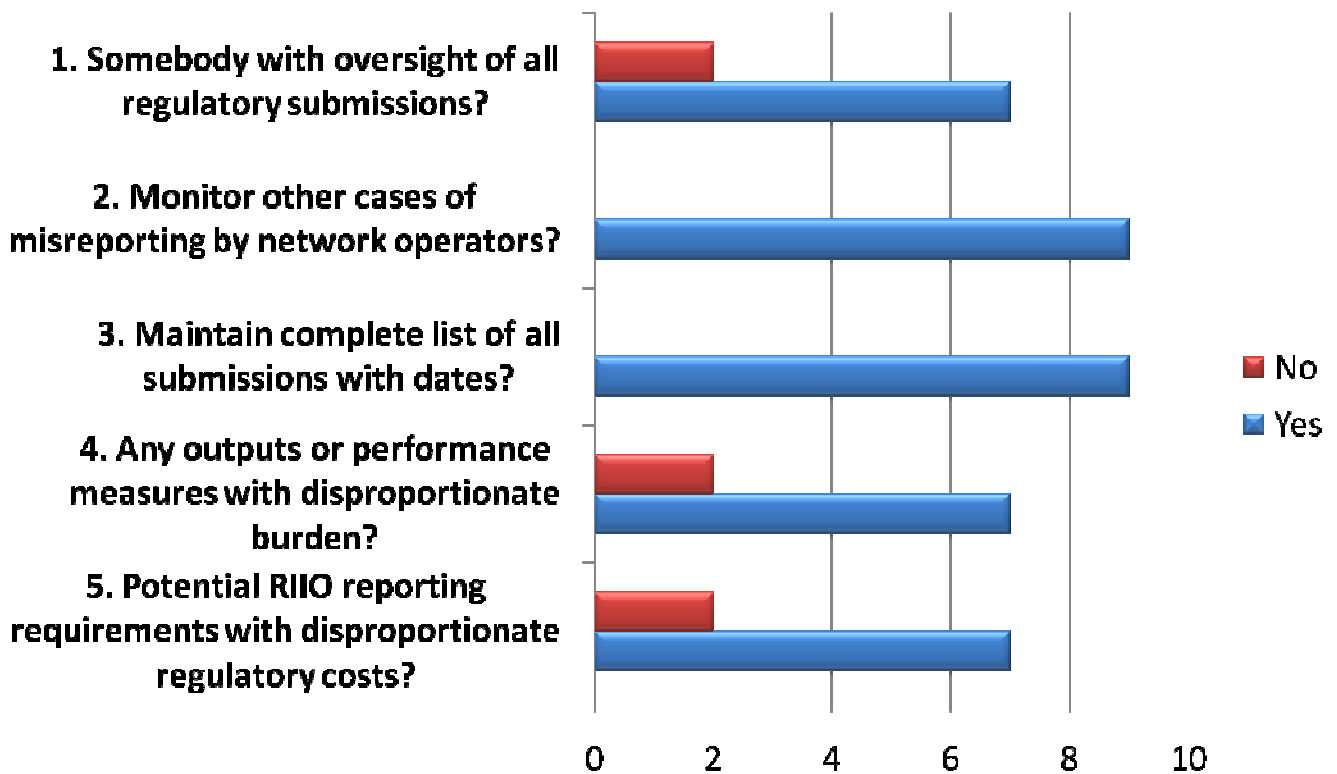
Benefits	Limitations	Cost/Resource Implications				
<ul style="list-style-type: none"> Independent verification Potential to examine supporting evidence and test results Potential to structure data in a consistent manner Potential for comparison/ benchmarking with other licensees Ability to track progress towards compliance via audit actions Visibility of underlying systems and processes 	<ul style="list-style-type: none"> Could become part of the process Could lead to less accountability in belief that any errors will be picked up later therefore do not need to exercise as much care In order to ensure that all companies have interpreted requirements in same way may need to ensure that same entity acts as reporter for all the companies in the sector Additional audit requirement? 	<table border="1"> <thead> <tr> <th data-bbox="1034 405 1485 439">Ofgem</th> </tr> </thead> <tbody> <tr> <td data-bbox="1034 439 1485 622"> <ul style="list-style-type: none"> Significant cost to Ofgem or network operator, (e.g. upwards of £0.5m per network company was quoted by one licensee). </td> </tr> <tr> <th data-bbox="1034 622 1485 656">Network Company</th> </tr> <tr> <td data-bbox="1034 656 1485 837"> <ul style="list-style-type: none"> Significant cost to Ofgem or network operator, (e.g. upwards of £0.5m per network company was quoted by one licensee). </td> </tr> </tbody> </table>	Ofgem	<ul style="list-style-type: none"> Significant cost to Ofgem or network operator, (e.g. upwards of £0.5m per network company was quoted by one licensee). 	Network Company	<ul style="list-style-type: none"> Significant cost to Ofgem or network operator, (e.g. upwards of £0.5m per network company was quoted by one licensee).
Ofgem						
<ul style="list-style-type: none"> Significant cost to Ofgem or network operator, (e.g. upwards of £0.5m per network company was quoted by one licensee). 						
Network Company						
<ul style="list-style-type: none"> Significant cost to Ofgem or network operator, (e.g. upwards of £0.5m per network company was quoted by one licensee). 						
Potential Improvements						
<ul style="list-style-type: none"> Could be engaged by Ofgem or Network Operator. Could use a variety of possible frameworks including ISRS4400, ISAE3000, etc to standardise approach. Is there a rationale to have someone who sits between Ofgem and network companies? Could focus efforts on high risk areas, e.g. Areas where new measures have been introduced, for example would need to look at outputs at the start, mid and end of the PCR. 						

Appendix 5: Analysis of Questionnaire Responses

A questionnaire was sent to the 11 companies who are Network Operators in order to more widely understand the processes deployed and challenges faced in terms of assurance activities. Responses were received from nine of the companies by the deadline date and are included in the metrics supporting this analysis. Responses were received from all of the network operators and all comments received have been considered in preparing this report.

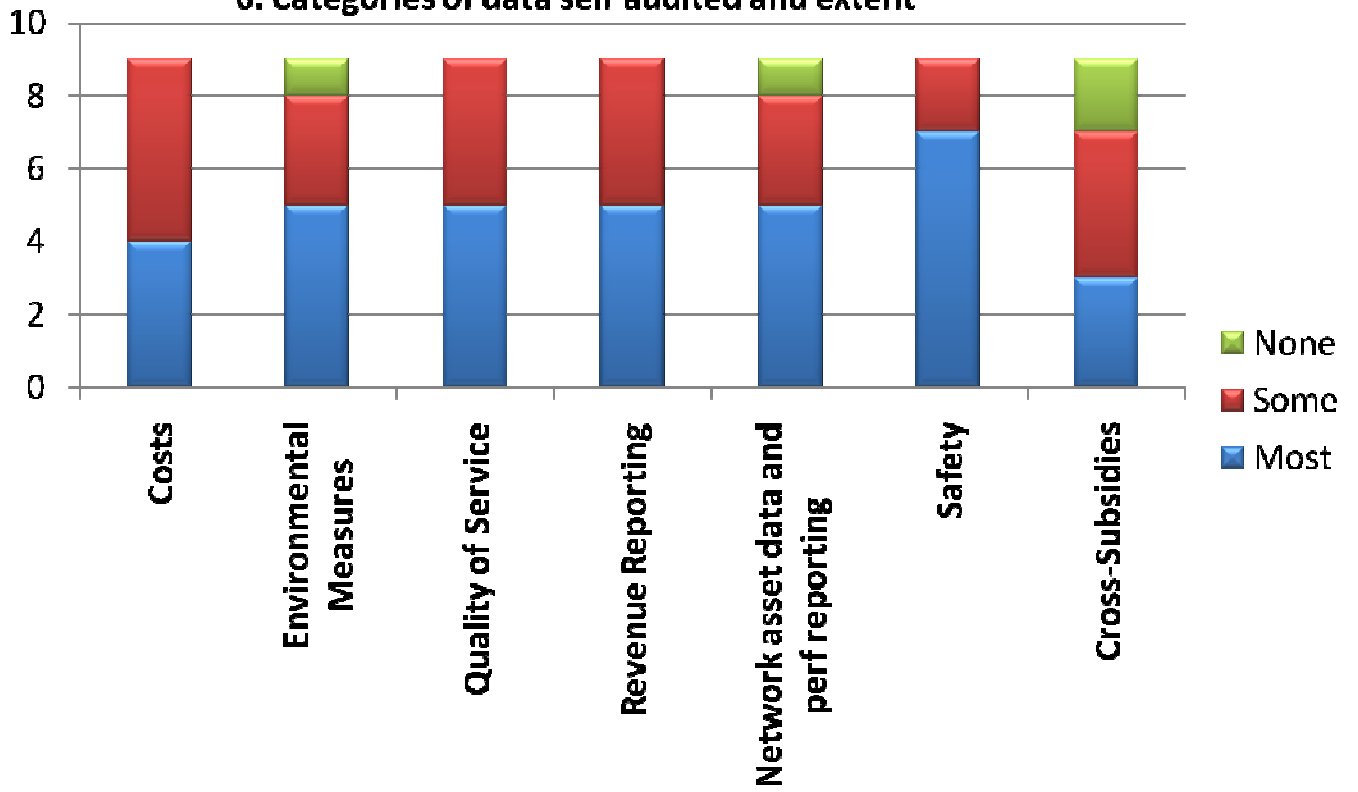
The questions are listed below and responses follow in the remainder of this Appendix:

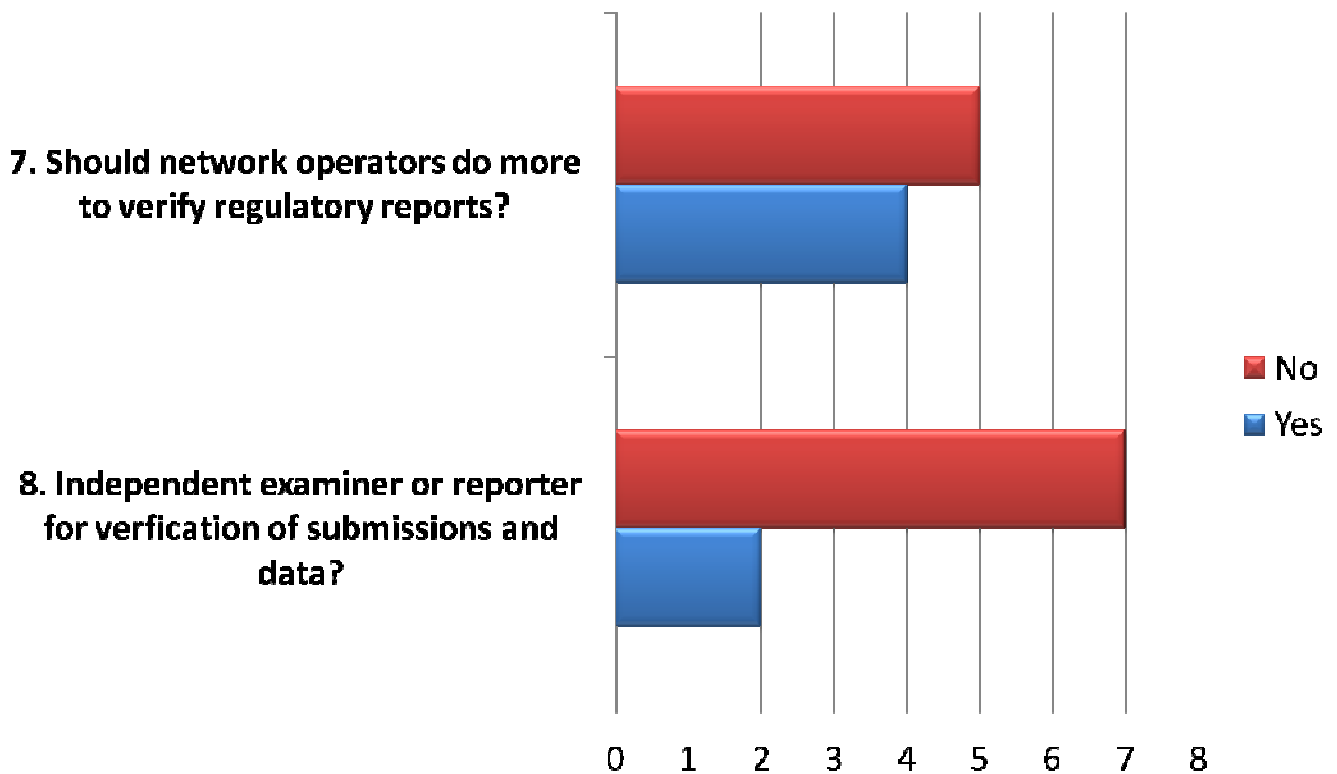
1a. Is there anyone who has responsibility/ oversight of all regulatory submissions in your organisation?
1b. If so, what is their position in the organisation?
2a. Do you monitor other cases of mis-reporting by network operators?
2b. What do you find is the best means of keeping in touch with regulatory developments?
3. Do you maintain a complete list of all the submissions you are required to make to Ofgem together with dates required?
4a. Are there any outputs and performance measures which you feel currently result in a disproportionate regulatory burden?
4b. If so, please Describe
5a. Are there any potential reporting requirements associated with RIIO which you feel could lead to disproportionate regulatory costs?
5b. If so, please Describe
6. Which of the following categories of data do you self-audit and to what extent?
a. Costs
b. Environmental Measures
c. Quality of Service
d. Revenue reporting
e. Network asset data and performance reporting
f. Safety
g. Cross-Subsidies
7. In principle, do you feel it would be appropriate to do more to verify your regulatory reports?
8a. Do you feel the use of an independent examiner or reporter would be appropriate for verification of submissions and data in some areas.
8b. Which areas in particular do you believe would benefit from such an approach?
9. How useful are your internal compliance function in giving assurance over regulatory data?
10. How useful are your internal audit team in giving assurance over regulatory data?
11a. Are there any areas of data which you feel should be subject to more scrutiny?
11b. If so, which areas and why?
12a. Do you currently prioritise your scrutiny processes?
12b. On which basis?
13. Are there any areas where you feel more detailed guidance on data collation and presentation should be given
13b. If so, please describe each area and why.
14. How frequently do you report regulatory performance and data to the Board?
15. When did you last review your regulatory systems and processes?
16. Please rate the assurance options below between 1 and 5 in terms of perceived cost and use, where: 5 represents a high cost and 1 is the least useful in terms of assurance provided
a. Provision of clear and transparent guidance from Authority
b. Director Sign Off
c. Review by compliance officer / internal audit
d. Reporting on Key Compliance Indicators
e. Annual Visits by Ofgem to Network Operators
f. Spot checks by Ofgem or its consultants
g. Verification to independent data / benchmarking against full submission population
h. Report by external financial auditor
i. Report by independent technical auditor/ examiner



Question Area	Selected responses
Oversight of Regulatory Submissions	<ul style="list-style-type: none"> • The Board • The Board and Audit Committee • Head of Regulation, etc.
Best means of keeping in touch with regulatory developments	<ul style="list-style-type: none"> • Ofgem Website, regular face-to-face contact • Press releases • Participate in regulatory expert groups
Outputs with Disproportionate Burden	<ul style="list-style-type: none"> • Requirement to report a cost type split for every asset replacement activity • The detailed connections report • Materiality levels along with the amount of detail asked for in the RIGs (asset, cost and financial reporting) has increased massively from DR4 to DR5. Whilst we acknowledge that DNOs have been involved in the development of the packs, Ofgem do not take a "risk based" approach to reporting, as an auditor would
RIIO requirement with disproportionate regulatory cost	<ul style="list-style-type: none"> • The new RIIO requirements provides the opportunity to review all the existing reporting requirements with a view to potential rationalisation • Process not yet developed and not possible to say with certainty • There are a number of output measures e.g. asset health and risk, capacity utilisation, etc. that will require changes to reporting systems and therefore could require material costs

6. Categories of data self audited and extent

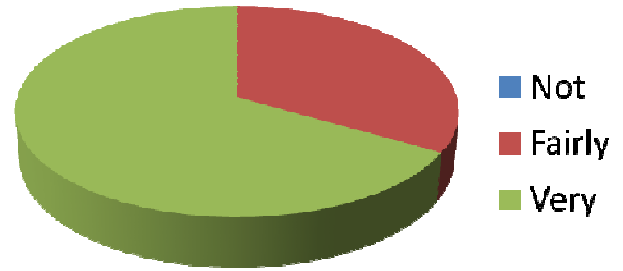
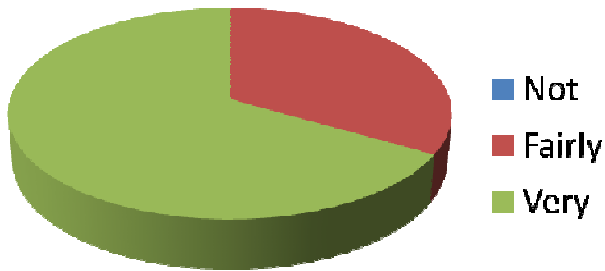




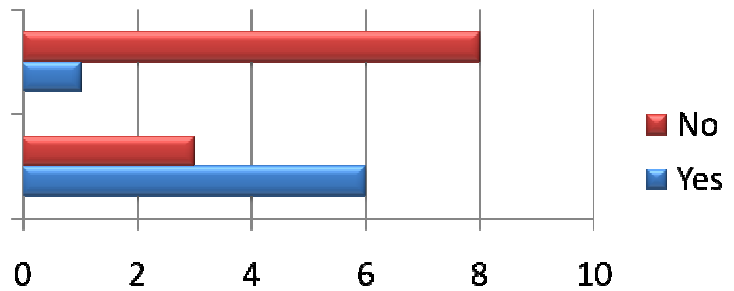
Question Area	Selected responses
Independent Reporter/ Examiner for verification of data	<ul style="list-style-type: none"> • We believe the existing process is satisfactory • We have a robust process in place that ensures that regulatory submissions such as the RRP and cross subsidy report are reviewed at senior management / director level and independently audited by our company auditors. Independent verification is useful in the correct areas and at a proportionate level; we consider this to already be in place • The best approach would be for Ofgem to reduce and simplify the reporting requirements and minimise opportunities for interpretation and mis-understanding. If an independent examiner/verifier were employed, it should be to ensure consistent processes and interpretation of reporting requirements • The onus should remain solely on licensees to provide accurate data and improve regulatory reporting. There is a risk with using an independent examiner that there is less accountability as checking and validation is deferred by staff to the examiner

9. Usefulness of your internal compliance function in providing assurance

10. Usefulness of your internal audit team in providing assurance

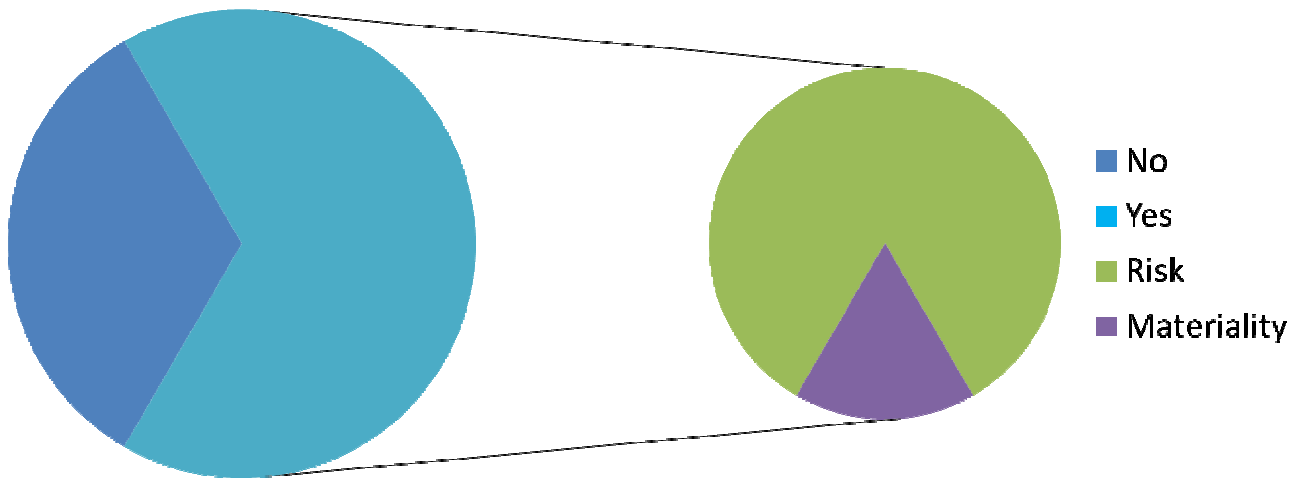


11a Areas of data which should be subject to more scrutiny
13 Areas for more detailed guidance on data collation and presentation

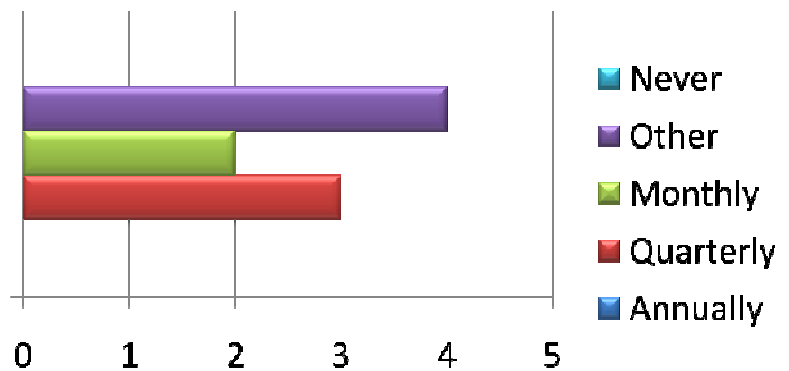


Question Area	Selected responses
11a Areas of data which would benefit from more scrutiny	<ul style="list-style-type: none"> Achievement reporting - to provide improved assurance of 'unit cost' benchmarking between DNOs Asset data - to provide improved assurance of quality of information More benefit could come from further scrutiny of consistency of adoption of guidance between companies and not from within the company.
13 Areas which would benefit from more detailed guidance	<ul style="list-style-type: none"> Utilisation data, to benchmark DNO risk-based Reinforcement Condition (Health) data, to benchmark DNO risk-based asset replacement Guidance needs to be sufficiently prescriptive to reduce opportunities for interpretation and therefore variations in accurate reporting. Guidance on D10/GSOPs is minimal and inconsistent with the statutory Instrument, guidance on A40 cost reporting (RRP) and environmental/incentive reporting is often patchy and inconsistent

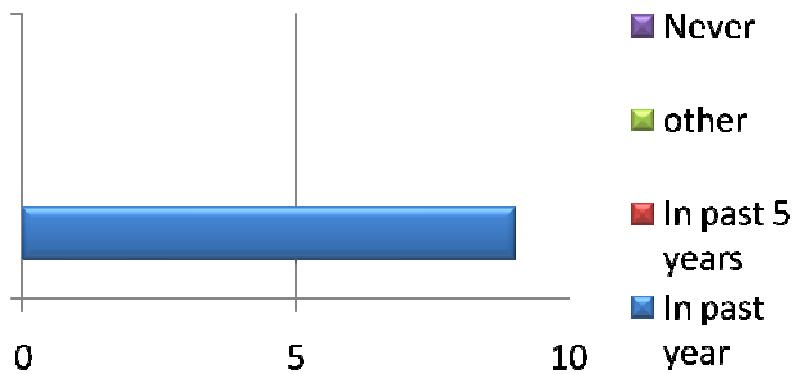
12. Do you currently prioritise your scrutiny processes?



14. Frequency of regulatory performance and data reporting to Board



15. Last review performed on regulatory systems and processes

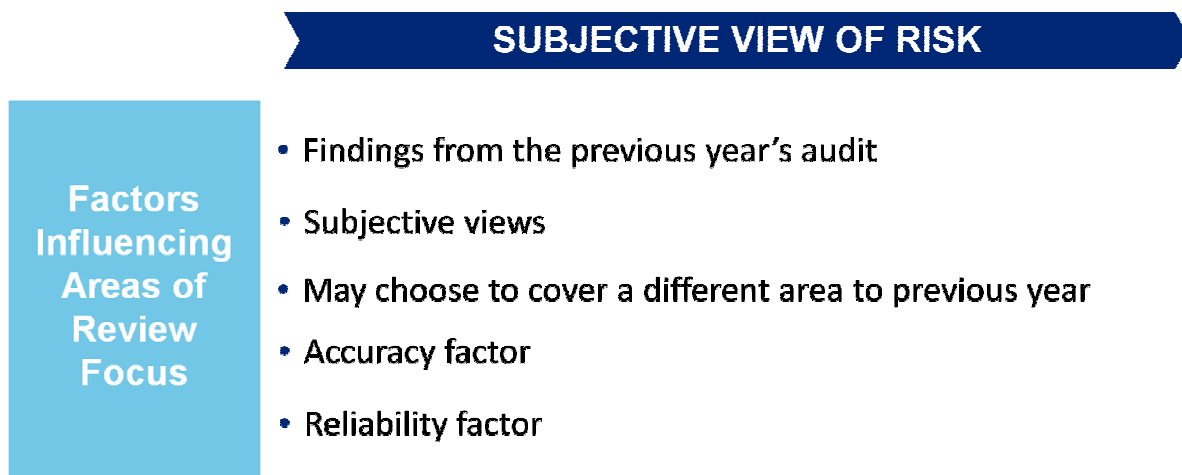


Appendix 6: Notes from Meeting with Office of Rail Regulation

The table below summarise the assurance methods adopted by the Office of Rail Regulation (ORR):

Assurance Method	Description
Guidance from Regulator and Verification/ Validation	<ul style="list-style-type: none"> • MOUs, the licence and Regulatory Accounting guidelines govern Networks Rail's data requirements • % tolerances for accuracy of data set based upon need, i.e. accuracy is more critical in areas such as technical/engineering • Data fed into sharepoint site and data warehouse which performs automated QA of data. High level manual sense checks also performed
Independent Reporter	<ul style="list-style-type: none"> • Three independent Reporters are appointed by ORR and Network Rail, and funded by Network Rail. Reporters owe duty of care to the Regulator and provide assurance on data, asset management and planning of enhancement projects • Data Reporter spends equivalent of 1 FTE per annum reviewing reliability, quality, consistency, completeness and accuracy of reported data
KPIs	<ul style="list-style-type: none"> • Reporter operates rolling programme of data assurance audits, agreed by ORR across range of KPIs designed to measure Network Rail's delivery against its key obligations (e.g. safety, performance, asset condition, QOS)
Director Sign Off	<ul style="list-style-type: none"> • Annual return is signed off by Board Director (Director of Planning & Regulation) • Regulatory Accounts are signed off by Finance Director and external audit
External Audit	<ul style="list-style-type: none"> • Review report on regulatory financial statements and adequacy of resources

The diagram below illustrates the Office of Rail Regulation's approach to risk assessment and selection of areas of review focus:



Appendix 7: Notes from Meeting with Ofwat

The table below summarises the current approaches to assurance adopted by Ofwat and the planned future approach:

As Is	To Be
Ofwat specify work that Reporters do. Reporter has duty of care to both Ofwat and Licensee. Licensee funds Reporter's work	Regulatory Compliance Project underway to reduce information burden and simplify reporting requirements
Regulatory accounts also audited against Ofwat Agreed Upon Procedures by external audit	Ofwat want companies to be more accountable going forward and to provide assurance themselves. It is up to them how they do this
Use of Reporter costs £1.5M per annum across whole sector	Ofwat are moving away from the use of the Reporter
Licensees have become Ofwat dependent and Reporters have tended to become part of the process. Independence is questionable	There is still a role for third party expertise to support targeted reviews by Ofwat themselves
There are large inconsistencies across Reporters and there is no comparability across companies	Ofwat would like to undertake planned horizontal reviews of specific issues across the whole sector and as the need arises
Imperfections of Reporter Approach outweigh imperfections	Propose to perform targeted, proportionate reviews of companies compliance, focussing on major risks
There has been information mis-reporting in the past despite the Reporter regime	

Appendix 7: Factors Influencing the Shape of the Internal Audit Function

Stakeholders' demands	Objectives for Internal Audit	Required skills	Effective delivery
Shareholders	Independent assurance	Strategic risk	Strong communication
The Executive	Change agent	Financial risk	Best practice methodology
Group management	Training ground for future leaders	Operational risk	High quality leadership
Divisional management	Trusted business adviser	Compliance risk (regulation i.e. HSE)	Effective quality control processes
Business unit management	Policeman/Fraud detector	Project risk	Clear and timely reporting

The structure and skills of the Internal Audit Department should be aligned to the strategic needs of the business. The key questions to consider in assessing the strategy and objectives of the Internal Audit function are shown in the top row of the table above. These questions could be asked in a regulatory context and are as follows:

- Who are the key stakeholders and what do they expect of Internal Audit?
- Taking into account these stakeholder expectations, what are the objectives of the Internal Audit Function?
- Given the objectives that have been set, what skills are required and what is the coverage of the Internal Audit Plan?
- Does the internal Audit team have all the elements needed to achieve effective delivery of the Function's objectives?

Source: "Internal Audit services, A hands-on approach", Deloitte LLP, 2009.

Appendix 9: Statement of Responsibility

Statement of Responsibility

We take responsibility for this report which is prepared on the basis of the limitations set out below. The matters raised in this report are only those which came to our attention during the course of our work and are not necessarily a comprehensive statement of all the weaknesses that may exist or all improvements that might be made. Any recommendations made for improvements should be assessed by you for their full impact before they are implemented.

Deloitte LLP
London
April 2011

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