Promoting choice and value
for all gas and electricity customers

Improving the Reporting Transparency of Large Energy Suppliers

Consultation

Reference:	64/12
Publication date:	1 May 2012
Response deadline:	30 May 2012

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Overview:

As part of the Retail Market Review (RMR) Ofgem appointed the accountancy firm BDO to review the way that companies provide information about the profitability of different parts of their vertically integrated businesses. As a result of this work we put forward proposals in January which would change the way that companies provide this information. Following consultation we have amended our proposals and seek views on these revised proposals.

Our aim is to make it easier for stakeholders to understand the profitability of the different components of the Great Britain energy market. We believe that this information will provide greater transparency for independent market participants and other stakeholders leading to increased confidence in the market and thereby greater and more effective competition. We believe our proposals strike the right balance between increasing transparency and allowing companies to determine how best to run their businesses.

Subject to views on our proposals received during consultation, we intend for the 2011 Consolidated Segmental Statements to be prepared under the new requirements. Our deadline for responses to this consultation is 30 May 2012.

Context

Ofgem's principal objective is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition. The Retail Market Review (RMR) represents Ofgem's attempt to enhance competition in the retail energy markets and make it work more effectively so that the benefits can be realised by more consumers than at present.

The proposals presented in this document are the results of one of the five workstreams initiated in the March RMR consultation. These proposals aim to improve the quality of information available to stakeholders about the profitability of different parts of the large, vertically integrated companies.

Proposals on the other workstreams were published between November 2011 February 2012[1].

Associated documents

All documents are available at www.ofgem.gov.uk

- Improving Reporting Transparency, January 2012, Reference 09/12
- Financial Information Reporting: 2010 Results, January 2010, Reference 10/12
- Ofgem's Retail Market Review – update and next steps (non-liquidity proposals), June 2011
- Financial Information Reporting: Amended Guidance, May 2011, Reference number: 69/11
- Financial Information Reporting: 2009 Results, March 2011, Reference number: 41/11
- The Retail Market Review – Findings and Initial Proposals, March 2011, Reference: 34/11

[1] Please see the following link: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=70&refer=Markets/RetMkts/rmr

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Executive Summary

Since 2009, the large vertically integrated energy companies have been required to publish Consolidated Segmental Statements (Statements), which separately present the profitability of generation and different supply activities. As part of the March 2011 Retail Market Review (RMR), we appointed accountancy firm BDO to review how the companies are producing the Statements.

In January 2012 we published our proposed way forward to improve the transparency and cross-company comparability of the Statements. We also published BDO's findings and a summary of the 2010 results. This consultation outlines the responses we received, and sets out our proposed way forward.

Below we set out the main recommendations of the BDO review, our position in January, and our current position.

Recommendation	View in January consultation	Proposed way forward
1. Require the companies to publish their Statements to the same year-end	We do not intend to take forward this recommendation	As in January
2. An independent auditor to provide an opinion on the Statements	We propose obtaining an independent opinion, at least for the first year, but not necessarily from an auditor	As in January
3. Instruct reconciliation of the Statements to an audited IFRS income statement	We propose to take forward this recommendation	We propose to take forward a variation of this recommendation and require companies to reconcile to the UK result in their published Group Accounts
4. Require the reporting of trading function results, including disclosure of the risk each trading function assumes	We do not propose to take forward this recommendation, although we do propose companies produce a checklist to identify where functions are undertaken	As in January
5. Perform further work to assess current	We do not intend to take forward this	As in January

transfer pricing policy	recommendation at this stage	
6. Introduce uniform reporting treatments for generation fuel costs and free EU ETS allowances	We propose to take forward this recommendation	We propose to take forward a variation of this recommendation and allow companies that operate toll processing arrangements to provide the fuel costs as a supplementary note to the main results template
7. Guidance on scope and definition of exceptional items	We propose to take forward this recommendation	As a result of our amended proposal on recommendation 3, recommendations 7 and 8 are no longer required in their original form.
8. Specify consistent profit base for reconciliation	We propose to take forward this recommendation	

We believe that these proposals improve cross-company comparability where possible and improve transparency elsewhere. We invite views on our revised proposals by 30 May 2012.

We aim for the 2011 results to be published under the revised requirements. However, given the changes proposed we will not require those companies currently required to publish by the end of June to do so. The earliest we expect the Statements to be published is by the end of September but we will write to the companies with further clarity on timings.

1. Introduction

1.1. In the March 2011 RMR consultation document we set out five proposals to help make the energy retail markets in GB work in the interests of consumers:

- Proposal 1: Improve tariff comparability
- Proposal 2: Enhance liquidity
- Proposal 3: Strengthen Probe remedies – domestic
- Proposal 4: Strengthen Probe remedies – non-domestic
- Proposal 5: Improve reporting transparency

1.2. The proposals presented in this document relate to Proposal 5. In the March RMR consultation we set out our objective to further improve transparency and consumer trust in the market. As part of this, we said we would appoint an accountancy firm to undertake a review of the Statements. In January we published the findings of accountancy firm BDO and our proposed way forward.

1.3. This document outlines our proposed way forward following responses to our January consultation.

1.4. This consultation document consists of three sections: Section 2 presents a summary of responses to our January consultation. Section 3 presents our proposals. Finally, in Section 4 we present the next steps.

2. Consultation responses

Chapter Summary

This chapter summarises the responses to our January Consultation

2.1. We received nine responses to our January Consultation, some of which were confidential. Non-confidential responses are published alongside this document. We summarise consultation responses to BDO's findings and our proposals, in turn below.

BDO's findings

2.2. Responses from large energy supply companies focused on BDO's recommendations and our proposed way forward and offered limited responses on BDO's findings[2]. Another respondent agreed that there was low liquidity in the forward market for energy and that the difference in methodologies employed by the suppliers make comparison between Statements difficult.

2.3. One of BDO's findings related to the potential implications of timing differences between the hedging policies. Given the tendency for some generation businesses to hedge earlier than the supply business of the same company, BDO noted that if there was an expected shape for pricing and demand this could lead to an expected profit or loss in the trading arm, which is not currently reported in the Statements. Consumer Focus were concerned with this finding.

2.4. Consumer Focus were also concerned more generally by the lack of reporting of energy trading activities, feeling this was another example of opaqueness in the Statements.

Ofgem's January Proposals

2.5. BDO's recommendation 1 proposed to require the companies to prepare the Statements at the same time to the same year end. In January we proposed not to pursue recommendation 1. There was broad agreement for this proposal including from a non-vertically integrated respondent. Consumer Focus, on the other hand, felt that the benefit to transparency from increasing short term comparability could

[2] We asked BDO to analyse four areas; the transfer pricing methodologies employed by the Big 6, how the Big 6 account for long term hedges, how each firm represents energy trading activities and how each company treats exceptional items. Further details on their findings can be found in our January consultation.

offset the additional accounting costs and noted their view that Ofgem had failed to plausibly quantify either.

2.6. In January, we proposed to procure an independent opinion on the Statements for at least the first year (a version of BDO's recommendation 2). Feedback on this proposal was mixed, with some questioning the need for an opinion whilst others felt it could be useful.

2.7. Many respondents agreed with our January proposal to require the companies to reconcile their Statements to an audited IFRS income statement (BDO's recommendation 3). Some respondents were opposed to this recommendation, including one who felt that their reconciliation would become less transparent as a result of this proposal.

2.8. There was broad, but not unanimous, support for our proposal not to include trading results in the Statements and for our checklist of functions (our version of BDO's recommendation 4), including from a non-vertically integrated company. Many respondents welcomed further opportunities to comment on the draft checklist and those companies that would be required to complete the checklist sought further guidance on how to complete it. Consumer Focus did not agree with our proposal, and felt the reporting of non-speculative trading function results would increase the visibility of income and profits across a wider part of the value chain.

2.9. There was broad, but not unanimous, support for our proposal not to take forward the recommendation for further work on transfer pricing (BDO's recommendation 5). Consumer Focus felt this recommendation should be taken forward and disagreed with our view that alternatives to current methodologies could not be expected to offer a significant improvement.

2.10. There was mixed support for our proposal to include generation fuel costs in all the Statements (BDO's recommendation 6). Some large energy suppliers questioned the usefulness of this information given the different mix of generation plants (coal, gas, etc) available to different companies. Other respondents agreed with our proposal including one small supplier who felt this was an integral step to transparency. Consumer Focus agreed with our proposal but felt that further work to understand how generation fuel costs can be linked through to the supply business would be beneficial.

2.11. There was mixed support for our proposals to provide more detailed guidance on the scope and definition of exceptional items and to instruct reconciliation to the same profit measure (BDO's recommendations 7 and 8). Whilst many respondents viewed this as being helpful, some respondents felt that Ofgem should not be defining what does or does not constitute an exceptional item. Some stakeholders noted that asset write downs should not be reflected in the Statements. One respondent felt that given four out of the six companies currently reconcile to EBIT, not EBITDA, reconciling to EBIT would be better. Another respondent, who does not produce the Statements, felt that recommendation 7 & 8 were overly prescriptive.

2.12. There was mixed support for our proposal to request information on capital employed. Some respondents felt that it would be hard to agree a common methodology or questioned the value of the measure. Other respondents felt this could be a useful measure and were happy to explore this further.

2.13. There was mixed support with our proposal to increase the customer threshold. Some respondents felt that being vertically integrated (holding electricity generation and supply licences) should be sufficient. One respondent felt that small suppliers might be the most relevant providers of this information for potential entrants. One respondent felt that upstream gas companies with downstream gas supply businesses should also be required to produce the Statements. Another respondent questioned whether using the standard definition of a Small or Medium Enterprise might be more appropriate. One respondent felt that a threshold based on volumes instead of customer numbers might be more appropriate in the non-domestic sector.

Other issues

2.14. One respondent felt that further disaggregation of the non-domestic sector would be useful, particularly if Ofgem specified how to allocate costs to the different sectors. One respondent felt that suppliers should be clear how they recover third party costs such as Feed in Tariff (FiT) and Renewable Obligation costs.

2.15. Consumer Focus explained that they would welcome greater clarity on the objectives and audiences of the Statements. Consumer Focus do not feel the Statements are of significant use to a consumer audience at this time, nor that this would be altered by our proposed way forward.

3. Proposed way forward

Chapter Summary

This chapter presents our proposed way forward.

Question box

Question 1: Do respondents have any further comments on our unchanged proposals on recommendation 1?

Question 2: Do respondents have any further comments on our unchanged proposals on recommendation 2?

Question 3: Do respondents have any comments on our updated proposals on recommendations 3, 7 and 8?

Question 4: Do respondents have any further comments on our unchanged proposals on recommendation 4?

Question 5: Do respondents have any further comments on our unchanged proposals on recommendation 5?

Question 6: Do respondents have any comments on our updated proposals on recommendation 6?

Question 7: Do respondents have any comments on our proposal to not take forward work on publishing capital employed as part of the Statements?

Question 8: Do respondents have any further comments on our unchanged proposals to increase the customer number threshold?

Question 9: Do respondents have any views on the usefulness of further breakdown of the non-domestic segment in future Statements?

Question 10: Do respondents have views on the usefulness of further clarity on how third party costs are recovered across the segments?

Our proposals

Individual proposals

3.1. **Recommendation 1:** We do not intend to require the companies to publish the Statements at the same time and to the same year end. As we set out in January, we recognise that having the same reporting period could lead to an improvement in cross-company comparability. However we continue to consider that the recommendation would result in a large, disproportionate impact on the one company that reports to a different financial year-end. We note that no company, whether required to provided the Statements or not, disagreed with our proposal.

3.2. Consumer Focus felt that we did not plausibly quantify either the costs or the benefits of this proposal. We note that the quantification of the benefits of increased transparency, and in particular the additional benefits to transparency of requiring the information to be prepared for the same period, is not straight forward.

3.3. To take forward this recommendation one of three options could be implemented: First, we could investigate the possibility of the company changing its financial year. Second, we could require the publication of an additional set of accounts for our chosen time period. Third, we could base the information on internal management information.

3.4. We judge that each possibility raises concerns about proportionality. We expect that the additional audit costs of the first two options would be significant. There would also be significant management costs with the first option, in order to explain the changes to company stakeholders. We note that the first option would also have implications for the reporting of other parts of the company's business, such as networks. The third option could reduce transparency as the figures in the Statements would no longer relate to a separately published and audited profitability figure. We therefore remain minded not to take forward recommendation 1.

3.5. **Recommendation 2:** Whilst we recognise the mixed response to our proposal to obtain an independent opinion on the Statements we intend to take this recommendation forward, for at least the first year after implementation of the proposals. In particular, we view that this will be helpful in providing a view on how some of our changes, such as the checklist of functions and fuel costs have been enacted.

3.6. We view that it may be helpful for the independent provider of the opinion to interact with companies ahead of publication and we will investigate this possibility with the companies. We do not currently expect this assessment to be necessary on an ongoing basis, however we will return to the option of procuring an independent opinion for later years following the publication of the 2011 Statements.

3.7. **Recommendations 3, 7 and 8:** Following our January consultation we have modified how the Statements are to be reconciled to published, audited accounts. Reconciliation is important because it sets the Statements in context and enhances confidence in their reliability.

3.8. Our January proposals asked that the figure used to reconcile the Statements should be an audited income statement prepared under International Financial Reporting Standards (IFRS - recommendation 3). We also stated that the level of reconciliation should be calculated before the inclusion of exceptional items and be the same across companies (EBITDA) (recommendations 7 and 8, respectively).

3.9. The January proposals aimed to maximise cross-company comparability of the information presented in the Statements by ensuring consistency in how the companies perform the reconciliation.

3.10. Our revised proposals require companies to reconcile to the UK result in their published Group accounts. These accounts are prepared using IFRS by all the companies, continuing to ensure comparability. Using the UK result in Group accounts will help to ensure that the Statements can be understood in the context of an easily available profit figure. Any user of the Statements can find the value used in the reconciliation by going to the companies' website and downloading the annual report. Currently, two companies reconcile to documents only available from Companies House, access to which incurs a small fee.

3.11. Our revised proposal will also help to ensure that the Statements will be based on the same profit measures as those presented to the investor community and avoids the risk of different messages being presented to different audiences. Any differences in the profitability reported to investors in their Group accounts and published in the Statements must be reported and made clear as part of the Statements.

3.12. As a result of our amended proposal on recommendation 3 there are implications for our recommendation on the presentation of exceptional items and the profit measure used for reconciliation (recommendations 7 and 8).

3.13. In terms of exceptional items (recommendation 7) we remain committed to the principle that the Statements should reflect the ongoing profitability of individual businesses. Therefore, following BDO's recommendations and the January consultation we would only expect the revenues, costs and profits to reflect company activities relating to that year of operations. Examples of financial items we would not expect to be included in the Statements are, but are not limited to, mark to market adjustments, profit or losses on disposal, restructuring costs that have been identified as such in the Group's annual report and impairment charges. Where the Relevant Licensee has included any such items for the purpose of reconciliation, or otherwise, a clear and full explanation must be provided.

3.14. Following our amended proposals on recommendations 3 and 7 it is no longer necessary to prescribe which profit figure is used for reconciliation (recommendation 8) as our proposals will ensure that the Statements are comparable. Therefore the companies are able to choose the most transparent profit measure in their Group accounts.

3.15. We are of the view the changes to our January proposals, taken together, enhance transparency without loss of comparability.

3.16. In terms of transparency benefits, our new proposal will help to avoid situations where different messages about profitability are given to different audiences. In terms of comparability, as in January, this proposal will ensure that each company uses the same accounting basis (IFRS) to prepare the Statements. It will also ensure that each company uses the same source document i.e. it's annual report[3].

3.17. **Recommendation 4:** We remain committed to improving the transparency of the Statements by introducing a checklist of functions to highlight which activities are represented by the Statements. We have amended the checklist of functions following comments from Stakeholder and welcome further comments.

3.18. We still do not intend to take forward BDO's recommendation of including the trading results within the Statements. We note that both of BDO's options have their own difficulties. A limitation of "basic inclusion" is that it would not be possible to identify which trading profits relate to speculative profits. "Detailed inclusion" would require a clear and legally robust definition of both speculative and non-speculative trading. Both would additionally require the checklist to provide transparency about the performance of individual segments.

3.19. We remain of the view that increased information made available to users through the publication of fuel costs across all companies and the enhanced visibility of how the Statements relate to business models (the checklist of functions) is a proportionate response to the different business models employed by the companies and the consequent differences in functions and results that are shown in the Statements.

3.20. **Recommendation 5:** We remain minded not to take forward further work on transfer pricing. Given BDO's view that the transfer pricing methodologies were broadly fit for purpose and the different business models used by the companies[4], we remain unconvinced of the benefits of further work.

3.21. **Recommendation 6:** Following the January consultation we remain of the view that information on fuel costs should be provided as part of the Statements. We view fuel input expenditure as an integral part of the activity of generation and as such we consider this information should be included as part of all company Statements.

3.22. We recognise that some companies do not use their generation business to procure fuel. Rather, the generation businesses sell capacity or the capability to generate to a trading arm. The trading arm is then responsible for decisions on when to run individual plants and for procuring the necessary fuel and allowances to do so. For these companies, we recognise the inclusion of fuel costs as part of their Statements template would not reflect the way these companies run their businesses

[3] We note that in future there may be companies who do not produce Group accounts in this way. Should this be the case we retain the possibility of reconciling to Statutory accounts. We do not expect this to apply to any of the companies that have provided Statements to date.
[4] BDO's review showed that different companies allocate key functions to different parts of the business. This is consistent with the different transfer pricing methodologies utilised by the companies.

and may detriment the transparency of the Statements. However, to ensure this information is still published we ask these companies to provide information on fuel costs by way of a footnote to the Statements template.

3.23. We expect the information provided to be based on actual costs incurred for delivery of the fuel to generation units. Failing this the information should be based on the market value of the fuel at the time of delivery to the generation unit, or at the time of use by the generation unit. An explanation of the methodology used for the calculation of the fuel costs and the audit process used should be included as part of the footnote.

3.24. For companies utilising this option we would expect to agree a methodology in writing ahead of implementation, and for the companies to provide a confidential summary spreadsheet to Ofgem showing the main components of the calculations.

3.25. We recognise that the cross-company comparability of this information is limited by different fuel mixes, the breakdown of which is not provided as part of the Statements. However, given the integral nature of fuel inputs to generation activities, we remain of the view that the information is important for transparency.

3.26. With respect to free carbon allowances, we remain of the position that all companies should report the number of free carbon allowances they receive during the relevant reporting period. For those companies that will be providing a footnote detailing their fuel costs, this should also include the number of free carbon allowances granted for the relevant reporting period. For those companies who report fuel costs as part of the main results template, they will be required to publish the volume of free allowances granted for the reporting period elsewhere in their Statement.

Other issues

3.27. We recognise the difficulties involved in obtaining consistent information on capital employed and we are not minded to take forward work on capital employed as part of the work on the Statements.

3.28. We note the mixed response to our proposals on increasing the customer number threshold.However, we remain of the view that increasing the customer number threshold avoids unnecessary costs for small suppliers and better meets the original policy intent.

3.29. We note the response requesting the disaggregation of the non-domestic sector, and welcome further views on the usefulness of this information from stakeholders. We are not currently minded to implement this in time for the preparation and publication of the 2011 results but would be happy to investigate this for future periods.

3.30. We also note the response requesting further clarity on how third party costs such as Feed in Tariff and Renewable Obligation costs are recovered across the segments. We propose that companies should explain how they allocate these costs across the segments.

4. Next steps

4.1. We invite responses to our proposal by 30 May 2012. We are happy to engage further with stakeholders during this consultation period.

4.2. We aim for the 2011 results to be published under the revised requirements. However, given the changes proposed we will not require those companies currently required to publish by the end of June to do so. The earliest we expect the Statements to be published is by the end of September but we will write to the companies with further clarity on timings.

Appendices

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Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 30 May 2012 and should be sent to:

Stefan Bojanowski
Energy Market Research and Economics
Ofgem
9 Millbank
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020 7901 7068
css@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Any questions on this document should, in the first instance, be directed to:

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CHAPTER: Three

Question 1: Do respondents have any further comments on our unchanged proposals on recommendation 1?

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Appendix 2 – Draft licence condition

1. The Relevant Licensee must prepare and publish on its Website a Consolidated Segmental Statement in respect of information relating to the revenues, costs and profits of its activities in the generation and supply of electricity and the supply of gas to any premises taking account of the Guidelines.

2. Where applicable, the Relevant Licensee must prepare and publish the Consolidated Segmental Statement referred to in paragraph 1 in conjunction with any Affiliates.

3. The Relevant Licensee must, in conjunction with any Affiliates, prepare and publish a Consolidated Segmental Statement

(a) no later than six months after the end of the Relevant Licensee's financial year; or

(b) no later than a date specified by the Authority, which can be no earlier than six months after the end of the Relevant Licensee's financial year.

4. Subject to complying with this paragraph the Relevant Licensee may, for the purpose of preparing the statement pursuant to paragraph 3, prepare and compile the information according to the licensee's annual accounting procedures. The Relevant Licensee must include in every such statement an explanation of:

(a) how it defines the terms revenues, costs and profits;

(b) how the revenues, costs and profits can be reconciled with audited figures (prepared under International Financial Reporting Standards) published in Group accounts;

(c) or, if Group accounts are not prepared or published, how the revenues, costs and profits can be reconciled with its UK statutory accounts;

(d) its transfer pricing methodology and how this relates to the revenues, costs

and profits information published;

(e) where individual business functions are captured in the Consolidated Segmental Statement, as specified by Appendix 2 of the Guidelines.

5. The Relevant Licensee must ensure that the information prepared and made public pursuant to paragraph 3 includes the cost of fuel used to generate electricity and its share of revenues, costs, profits and volumes of Joint Ventures and Associates.

6. Subject to complying with Paragraph 5 the Relevant Licensee must ensure that all the information prepared and made public pursuant to paragraph 3 is in all material respects consistent with the information prepared pursuant to paragraph 4 and the information is presented with a clear and full explanation.

7. (a) The Authority shall prepare Guidelines in relation to the requirements of this condition and may modify, in whole or in part, the Guidelines following consultation with the Relevant Licensees.

(b) The Authority shall modify the definition of Consolidated Segmental Statement as described in Appendices 1 and 2 of the Guidelines in accordance with section 11A of the Act.

8. For the purposes of this condition:

“Affiliate” means any holding company or subsidiary of a holding company of the Relevant Licensee, in each case within the meaning of sections 1159 and 1160 of the Companies Act 2006.

“Associate” means an entity, including an unincorporated entity such as a partnership, over which the Relevant Licensee has significant influence and that is neither a subsidiary nor an interest in a joint venture.

“Consolidated Segmental Statement” means a statement as described in Appendices 1 and 2 of the Guidelines.

“Joint Venture” means a contractual arrangement whereby the Relevant Licensees and one or more parties undertake an economic activity that is subject to joint control.

“Relevant Licensee” means the holder of an electricity generation licence granted or treated as granted under section 6(1)(a) of the Act if it or any of its Affiliates:

i. jointly supply electricity to more than 250,000 domestic customers; or

ii. jointly supply gas to more than 250,000 domestic customers; or

iii. jointly supply electricity to more than 250,000 non-domestic customers; or

iv. jointly supply gas to more than 250,000 non-domestic customers, respectively.

“Website” means a website controlled and used by the Relevant Licensee or an Affiliate for the purposes of providing information and communication.

Appendix 3 – Draft guidance

1.1. These guidelines relate to Standard Condition 19A of the Gas and Electricity Supply Licences and Standard Condition 16B of the Electricity Generation Licences (collectively referred to as 'the Conditions' for the purposes of these guidelines).

1.2. The guidelines have been prepared by the Office of Gas and Electricity Markets ('Ofgem') pursuant to paragraph 8/19A.8 of the Conditions (throughout this document the first paragraph number relates to the generation licence and the second relates to the supply licences).

Scope and Application of the Licence Condition

1.3. The Conditions only apply to those companies that are “Relevant Licensees” as defined in the Conditions. Where information required under the Conditions is held by an Affiliate the Relevant Licensee is required to obtain and publish the information. Annex 1 provides further information on the scope of information required (eg the requirement for which generation volumes should be included in note 9).

Financial Year

1.4. Under paragraph 3/19A.3 of the Condition, the financial year should be taken to mean the Relevant Licensee’s current financial reporting year. For the avoidance of doubt this may differ between companies.

Interpreting the Financial Information

1.5. Under paragraph 4(a)/19A.4(a) of the Conditions a clear and full explanation of how the Relevant Licensee defines the terms revenues, costs and profits should be set out, so as to enable understanding of what the information published pursuant to paragraph 1/19A.1 does and does not represent. The licensee should describe the methodology or methodologies used to allocate marketing, shared and corporate costs across generation, supply and other activities. The licensee should also describe how individual third party costs such as Feed in Tariff costs and Renewable Obligation costs, are allocated across the segments. Where issues pertaining to the data are unexpected or unusually complex these issues should be set out in full.

1.6 We would only expect the revenues, costs and profits to reflect company activities relating to that year of operations. Examples of financial items we would not expect to be included are, but are not limited to, mark to market adjustments, profit or losses on disposal, restructuring costs that have been identified as such in the Group’s annual report and impairment charges. Where the Relevant Licensee has included any such items for the purpose of reconciliation, or otherwise, a clear and full explanation must be provided.

1.7. Under paragraphs 4(b) & (c) /19A.4(b) & (c) and 6/19A.6 of the Conditions a clear and full explanation of the reconciliation should be provided, so as to enable an individual to understand as much as can be reasonably expected as to how revenues, costs and profits reconcile to the Relevant Licensee’s audited figures. For the avoidance of doubt, the companies that published Consolidated Segmental

Statements in 2009 and 2010 would fall under paragraph 4(b) / 19A.4(b) and not 4(c) / 19A.4(c) If a licensee separately identifies a column which it attributes to trading or portfolio optimisation, the explanatory notes should contain a detailed description of its significant component parts. An explanation of any reconciliation would be expected to take the form of a numerical table and a written statement.

1.8. Paragraph 6/19A.6 of the Conditions provide for the information required pursuant to paragraph 1/19A.1 to be presented with a clear and full explanation. This clear and full explanation should be sufficient to inform an industry stakeholder of the financial data's proper interpretation and context (eg any structural constraints the business operates within, such as tolling agreements).

Transfer Pricing Methodology

1.9. Under paragraph 4(d)/19A.4(d) of the Conditions a clear and full explanation of the Relevant Licensee's and Affiliates' transfer pricing methodology should be provided, so as to enable an industry stakeholder to understand as much as can be reasonably expected about the transfer pricing methodology adopted. The transfer pricing methodology used to calculate WACOE and WACOG should reflect how each licensee actually acquires energy. This explanation should include:

- how the methodology relates to open market prices and/or a cost plus methodology;
- the treatment of allocated costs and corporate charges (eg head office charges); and
- the allocation of financial risk between group companies and / or business segments (eg treatment of internal tolling agreements/capability payments).

Treatment of Joint Ventures and Associates

1.10. Under paragraph 5 of the Conditions the Relevant Licensee must ensure that the information provided in the CSS includes its share of revenues, costs, profits and volumes of any Joint Venture and Associates. In preparing the CSS, the Relevant Licensee should account for Joint Ventures and Associates (which hold a generation or supply licence relating to the generation or supply of gas or electricity in the UK) as follows:

- the share of revenues of Joint Ventures and Associates to be included within revenue;
- the share of the profit before tax of Joint Ventures and Associates to be included with EBIT and EBITDA; and
- the share of the generation volumes of Joint Ventures and Associates to be included within the generation volumes.

1.11. For each of the items, the Relevant Licensee's share of the income and expenses of a Joint Venture or Associate should be combined line by line with similar items in the Relevant Licensee's CSS or reported as separate line items in the Relevant Licensee's CSS.

1.12. The remainder of the guidelines consist of Annex 1 and 2.

Annex 1

	Unit[1]	Generation	Electricity supply		Gas supply		Aggregate supply business[10]
			Domestic	Non-domestic	Domestic	Non-domestic	
		2010	2010	2010	2010	2010	2010
Total revenue	£M	£0	£0	£0	£0	£0	£0
Revenue from sales of electricity and gas[2]	£M	£0	£0	£0	£0	£0	£0
Other revenue[3]	£M	£0	£0	£0	£0	£0	£0
Total operating costs	£M	£0	£0	£0	£0	£0	£0
Direct fuel costs[4]	£M	£0	£0	£0	£0	£0	£0
Other direct costs[5]	£M	£0	£0	£0	£0	£0	£0
Indirect costs[6]	£M	£0	£0	£0	£0	£0	£0
WACO F/E/G[7]	£/MWh, p/th	0	0	0	0	0	NA
EBITDA[8]	£M	£0	£0	£0	£0	£0	£0
DA	£M	£0	£0	£0	£0	£0	£0
EBIT	£M	£0	£0	£0	£0	£0	£0
Volume[9]	TWh, therms	-	-	-	-	-	NA

Notes

1. The financial data should be provided to the nearest £million, WACOE and WACOF to the nearest pence in £/MWh, WACOG in p/therms to 1 decimal place and volumes to 1 decimal place in TWh. The grey shadings denote summations that can be calculated by using other information within the statement, eg EBITDA can be calculated using the total revenue and total operating cost lines in the statement.

2. For the generation business segment this means revenue from sales of electricity output generated; or if the business operates in a tolling-agreements structure, the revenues received from the capability or capacity payments including any account of associated fuel costs (an explanation/clarification of the latter type of revenues should be provided). For the respective supply segments this means electricity and gas sales. Revenue for domestic supply should be less dual fuel discounts where applicable; that is these discounts should be deducted from revenue, with the discount split evenly between electricity and gas. Social tariff costs should also be deducted from domestic supply revenue directly.

3. Other respective segmental revenues not covered in Note 2, eg in the generation segment may include capacity payments, other physical options and ancillary services.

4. Direct fuel costs for supply should include aggregate electricity and gas costs as outlined in Note 7. Direct fuel costs for generation should include an associated input cost for fuel, irrespective of the business model of the Relevant Licensee or its Affiliate. If the business operates in a tolling-agreements structure the direct fuel costs for generation may be presented in the form of a footnote to the template. The footnote should include a description of the volume, total cost, and average cost. It should also specify the volume of granted free carbon allowances.

5. Other direct costs for supply should include network costs, BSUOS, environmental costs (including ROCs, CESP and CERTs) and the transport element of Reconciliation-by-Difference (RBD) costs.

6. Indirect costs should be defined as licensees' own internal operating costs including sales and marketing costs, bad debt, costs to serve, IT, staffing costs, billing and all meter costs.

7. For generation this means the weighted average input cost of fuel (eg gas, coal, uranium, etc) used by the generation business, shown as £/MWh. This should reflect the delivered cost of fuel. For the supply businesses, WACOE/G should cover the wholesale energy cost, losses, the energy element of RBD costs, balancing and shaping costs incurred by supply licensees.

8. EBIT means earnings before interest and tax; and EBITDA means earnings before interest, tax, depreciation and amortisation.

9. Volumes should be supplier volumes at the meter point (ie net of losses). Generation volumes should be the volume of power that can actually be sold in the wholesale market, ie generation volumes after the losses up to the point where power is received under the Balancing and Settlement Code but before subsequent losses.

10. The supply aggregation column (aggregation of domestic and non-domestic electricity and gas supply businesses) sums the horizontal supply figures and thereby helps facilitate reconciliation to group accounts.

Annex 2

Business function	Generation	Supply	Not included in CSS
Operates and maintains generation assets			
Responsible for scheduling decisions			
Responsible for interactions with the Balancing Market			
Responsible for determining hedging policy			
Responsible for implementing hedging policy / makes decisions to buy/sell energy			
Interacts with wider market participants to buy/sell energy			
Holds unhedged positions (either short or long)			
Procures fuel for generation			
Procures allowances for generation			
Holds volume risk on positions sold (either internal or external)			
Matches own generation with own supply			
Forecasts total system demand			
Forecasts wholesale price			
Forecasts customer demand			
Determines retail pricing and marketing strategies			
Bears shape risk after initial hedge until market allows full hedge			
Bears short term risk for variance between demand and forecast			

Notes:

1. Companies should indicate where functions reside by way of a tick in the appropriate cell of the table. If profits or losses are not recorded in the same area, then an “F” should be used to indicate where the function resides and a “P/L” should be used to indicate where the profits or losses are recorded. If a payment is made or received by either generation or supply in lieu of a profit or loss this should be referenced by way of a footnote.
2. “Not included in CSS” should include entries if neither the Generation nor Supply Segments as reported in the CSS are responsible for a particular

function, but that function is undertaken by the Relevant Licensee or an Affiliate. If a function is not undertaken then no entry should be recorded.

Glossary of terms:

- "Scheduling decisions" means the decision to run individual generation units
- "Responsible for interactions with the Balancing Market" means interactions with the Balancing Mechanism in electricity.
- "Interacts with wider market participants to buy/sell energy" means the business unit responsible for interacting with wider market participants to buy/sell energy, not the entity responsible for the buy/sell decision itself, which falls under "Responsible for implementing hedging policy /makes decisions to buy/sell energy".
- "Matches own generation with own supply" means where there is some internal matching of generation and supply before either generation or supply interact with the wider market. For the avoidance of doubt, if an entry is provided in this row, a footnote explanation of the scale of volumes involved is permitted.
- "Forecasts total system demand" means forecasting total system electricity demand or total system gas demand.
- "Forecasts customer demand" means forecasting the total demand of own supply customers.
- "Bears shape risk after initial hedge until market allows full hedge" means the business unit which bears financial risk associated with hedges made before the market allows fully shaped hedging.
- "Bears short term risk for variance between demand and forecast" means the business unit which bears financial risk associated with too little or too much supply for own customer demand.

Appendix 4 - Glossary

E

EBIT

Earnings before Interest and Tax: Operating Profit, in Profit & Loss account.

EBITDA

Earnings before Interest, Tax, Depreciation & Amortisation: Operating profit excluding non-cash items, in Profit & Loss account.

EU ETS

European Union Emission Trading Scheme: The EU-wide greenhouse gas emissions trading scheme, under which governments must set emission limits for all large emitters of carbon dioxide in their country.

H

Hedging

Buying or selling energy ahead of the time the energy is actually delivered to reduce the risks associated with price movement.

I

International Financial Reporting Standards (IFRS)

A set of international accounting standards stating how particular types of transactions and other events should be reported in financial statements.

M

Mark-to-market

Mark-to-market gains and losses refer to unrealised profits and losses associated with open positions at the end of the financial year.

N

Non-speculative trading

In this report non-speculative trading is taken to mean trading for the purpose of cost-effective management supply for customers.

R

Return on Capital Employed (ROCE)

A measure of the returns that a company is realising from its invested capital. It represents the efficiency with which capital is being utilised to generate revenue.

S

Speculative trading

In this report speculative trading is taken to mean trading for the purpose of profit and not for the cost-effective management supply for customers.

T

Transfer pricing

Transfer pricing refers to the attribution of a price to transactions between related parties.

U

UK GAAP

UK Generally Accepted Accounting Principles. The basis under which all UK companies operated before 2005. Companies listed on the stock exchange must now use International Financial Reporting Standards.

Upstream

In this document when we refer to upstream we mean the electricity generation sector.

V

Vertically integrated businesses

Where one supply group owns two or more parts of the energy supply chain. For example, where the same supply group owns generation capacity and also supplies energy to the retail market.

Appendix 5 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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