



Accountants &
business advisers

Private & Confidential

Ofgem
9 Millbank,
London,
SW1P 3GE

Our ref: DH

18 March 2013

Dear Sirs,

Re: Improving Transparency – Review of Consolidated Segmental Statement – Centrica

In accordance with the terms of our agreed proposal of October 2012 setting out our scope of work, we have carried out an independent review of Centrica's Consolidated Segmental Statement (CSS) for the 12 months to 31 December 2011.

1. Scope of our review

The aim of the work is to review the submission of the 2011 Statement covering relevant licensees (e.g. generator and supply licence holders) to:

- assess whether the licence condition (and Guidelines) has been interpreted appropriately, with particular attention paid to the modifications made in August 2012; and
- assess whether the Statement's reconciliation with the company's group accounts has been carried out appropriately. Part of this should be to assess the suitability of the use of notable items in the reconciliation on a per-company basis.

The review was specifically limited to Centrica's published CSS and the published group accounts. In undertaking the review, no information or explanation was sought from Centrica or its auditors and we have not considered the accuracy of information provided in the CSS or tested its reasonableness.

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2. Results of our review

We have presented the results of our review under the following sub-headings:

- *CSS profit and loss table¹ and financial information interpretation* reviews the information submitted in the CSS profit and loss table and its supporting notes, which explain what the various volume, cost and revenue items represent.
- *Transfer pricing* reviews the explanation of the transfer pricing methodologies that Centrica employ and are required by Ofgem to include in their CSS. Transfer pricing applies to sales and purchases between companies within the same group (i.e. generator, supply companies and energy trading arms).
- *Joint ventures and associates* reviews the requirement for the CSS to include the proportions of volume, cost and revenue for joint venture and associated companies that are represented by Centrica's investment in these licensed businesses.
- *Business function statement* reviews the table and supporting notes that show the separation of the specified business functions across generation, supply and another part of the business.
- *Reconciliation to group accounts under IFRS²* reviews how the CSS segmental information may be reconciled to audited segmental information in the group accounts.

2.1 CSS profit and loss table and financial information interpretation

Centrica is an integrated energy company operating predominately in the UK and North America. Centrica operates its downstream business under the British Gas name and Scottish Gas in Scotland. Following the investments in Venture and British Energy in 2009 the group has a more balanced UK upstream business with the combination of gas production and lower carbon power generation.

The CSS profit and loss table has been prepared in accordance with the licence condition and shows generation, electricity and gas supply by domestic/non domestic/aggregate and is in line with the Guidelines and notes on revenue, cost, EBITDA³, DA, EBIT and volumes. We confirm notes on revenue from sales of electricity and gas, other revenue, direct fuel costs, other direct costs, indirect costs, WACO E/F/G⁴, volume and aggregated supply business are included. In all cases Centrica has specifically confirmed compliance (generally by restating the licence condition wording with very little/no additional commentary).

A high level description is provided of how shared costs⁵ have been allocated across the segments. However, there is no explanation of how Feed in Tariff costs and Renewable Obligation Certificate (ROC) costs are allocated across the supply segments.

2.2 Transfer pricing

Centrica provides a short explanation of its transfer pricing methodology for supply and how this relates to the revenue, cost and profit information in the CSS. Centrica explains that energy supply to domestic energy customers is procured at open market prices prevailing at the time of procurement. However, the CSS includes no specific comment regarding transfer pricing for the generation business. It may therefore be unclear to a reader of the CSS whether this is an omission or simply does not apply.

¹ See Annex 1 to Ofgem's Guidelines

² IFRS – International Financial Reporting Standards

³ EBITDA – earnings before interest, taxes, depreciation and amortisation

⁴ WACO E/F/G – weighted average cost of electricity/ fuel/ gas

⁵ Shared costs are those which are relevant to more than one segment.

With respect to the transfer price for energy supply, Centrica provides an explanation of the methodology used. However, it does not confirm that the methodology reflects how each licensee acquires energy, which is required by Ofgem.

2.3 Joint ventures and associates

The CSS states that revenue and earnings from joint ventures and associates are included but little detail is provided.

2.4 Business function statement

The business function statement¹ has been completed by Centrica, but no explanatory notes have been included.

2.5 Reconciliation to group accounts under IFRS

The reconciliation compares the segmental information from the Centrica Group financial statements (Note 4 on pages 74 and 75) and the performance review in the Directors' Report (page 133) with all the segments included within the CSS. The reconciliation has been provided for revenue, earnings before interest and taxes (and separately for depreciation). The reconciliation between these two sources is mathematically correct. Furthermore, we have not identified any further reconciling items from our review of the group accounts.


We note that because this review has only focused on the CSS and group accounts there may be items that are not published by Centrica in either document that would be apparent from a review of the underlying records. While including these items would increase the accuracy of the reconciliation we do not believe they would affect the level of profitability that Centrica reports.

3. Opinion on Centrica's CSS submission

As a result of our review, which was limited to the information within the published CSS for 2011 and the related published group accounts, we confirm that, in our opinion, the relevant licence conditions (19A of the electricity and gas supply licences, and 16B of the generation licence) and supporting Guidelines issued by Ofgem have been interpreted appropriately and the Statement's reconciliation with group accounts has been carried out appropriately other than any exceptions stated above.

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

Yours faithfully,



PKF (UK) LLP

¹ Annex 2 to Ofgem's Guidelines