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 – EDF Energy

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 EDF Energy'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 but excluding the energy trading business) 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 EDF Energy's published CSS and the published group accounts. In undertaking the review, no information or explanation was sought from EDF Energy 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 table[1] 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 EDF Energy 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 EDF Energy'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 IFRS[2]* 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

EDF Energy (UK) Limited and its subsidiaries (EDF Energy) is structured around three main business units: Energy Sourcing and Customer Supply (ESCS); Nuclear Generation; and Nuclear New Build (NNB) supported by Corporate and Steering Functions (CSF). The Nuclear New Build business, responsible for the development and construction of new power plants in the UK, falls outside the scope of the CSS and has been excluded from the statement for 2011.

EDF Energy describe the generation segment as including coal and gas fired generation, nuclear generation, wind farms, independent power purchase agreements, virtual tolling agreements (VTA) and other contractual relationships entered into by EDF Energy.

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 Guideline notes on revenue, cost, EBITDA[3], 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/G[4], volume and aggregated supply business are included. The generation segment shows non-nuclear and nuclear as separate columns due to their differing cost structures. We note that while EDF Energy confirm which elements have been excluded from their calculation of WACO E/G, they do not explain which elements have been included.

A high level description is provided of how shared costs[5] have been allocated across the segments, although more information on the cost drivers would be useful. There is also an explanation of how individual costs such as Feed in Tariff costs and Renewable Obligation Certificate (ROC) costs are allocated across the segments. There is, however, no information on the treatment of the Reconciliation by Difference (RBD) costs.

[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.

2.2 Transfer pricing

A brief explanation is given of the transfer pricing methodology used by the relevant licensees and how this relates to the revenue, cost and profit information in the CSS. Where volume is transferred between the generation and supply businesses, EDF Energy states that the prices reflect market prices at the time of each transfer. It is not clear, however, when this point of transfer occurs with respect to the purchase or use of the product being transferred, neither is it clear the extent of the involvement of the trading arm or 'Optimisation division'. Further, EDF does not confirm that the transfer pricing methodology reflects how each licensee acquires energy, which is required by Ofgem.

2.3 Joint ventures and associates

Since 2009, Centrica plc (Centrica) has held a 20% interest in Lake Acquisitions Limited, the company in which EDF Energy's Nuclear Generation business unit sits. Accordingly, the CSS is stated to show 80% of Lake Acquisitions Limited's revenues, costs and earnings.

The CSS states that EDF Energy is involved in several joint ventures, primarily in relation to the production of power from renewable sources. Joint ventures are accounted for in the CSS and EDF Energy's share of their results is included within the non nuclear generation segment.

EDF Energy refers to one associate whose results have been included within the non-nuclear generation segment.

2.4 Business function statement

The business function statement[1] has been completed by EDF Energy and explanatory notes included. While the table appears to have been compiled appropriately, EDF Energy has labelled "P/L" as "Financial impact of that function recorded in that area". This contrasts with how "P/L" is recorded in the statements of four other companies, making the interpretation of the table more difficult. Additional context around the role of the trading arm or 'Optimisation division' would also be helpful.

2.5 Reconciliation to group accounts under IFRS

EDF Energy has reconciled its revenues and earnings before interest, taxes, depreciation and amortisation within the CSS to the EDF Energy Holdings Limited[2] Annual Report and Financial Statements. The reconciliation has not been undertaken at CSS generation and supply level because the EDF Energy Holdings consolidated accounts do not include this information. 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 EDF Energy 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 EDF Energy reports.

[1] Annex 2 to Ofgem's Guidelines

[2] EDF Energy Holdings Limited – The parent company of EDF Energy

3. Opinion on EDF Energy'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.

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