



Office of Gas and Electricity Markets (Ofgem)
9 Millbank
London
SW1P 3GE
Attention: Mayur Gondhea

Our ref: BT/JDA

19 November 2013

Dear Mayur

Re: Audit of Licence Model - RIIO ED1 Fast Track Draft Determination stage

In accordance with the terms of our engagement and the agreed emails of 5 March 2013 and 20 September 2013 and subsequent correspondence thereon, further defining the services to be provided, we have carried out an independent review of the financial model which has been developed to support Ofgem's RIIO ED1 Initial Business Plan assessment and which has been updated to support the Fast Track Draft Determination.

Our opinion is subject to the assumptions and comments, which we have summarised in Appendix A, and subject to the representations and responses from Ofgem in respect of our Base Case Findings Reports upon which we have relied. As a result of our review, we confirm that in our opinion, the financial model version 'RIIO ED1 Fast Track Draft Determination Financial Model.xlsm (as received on 30 October 2013) (the "Model"):

- is logically constructed, internally consistent, and that the formulae, algorithms and calculations are arithmetically accurate, in all material respects.

Our work was limited to the matters set out above and accordingly did not include, for the avoidance of doubt, any form of review of the commercial merits, technical feasibility, or the factual accuracy of the input data; a review of the Model's consistency with UK Generally Accepted Accounting Principles or International Financial Reporting Standards; and a review of the Model's consistency with current corporate UK tax standards and legislation.

All comments and opinions above are given solely in respect of the Model and cease to be valid if there are subsequent changes to the Model.

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.

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Yours sincerely

A handwritten signature in blue ink, appearing to read "BDO LLP". The signature is stylized and cursive.

BDO LLP Partner
For an on behalf of BDO LLP

Appendices: A Assumptions and Comments on the Model

APPENDIX A

ASSUMPTIONS AND COMMENTS ON THE MODEL

Model Assumptions and Comments on the Model

- 1.1 Ofgem have developed the Model to be used for the Electricity Distribution Price Control Review (RIIO-ED1) Initial Business Plan assessment. The Model has been updated to support the Fast Track Draft Determination as well as for ongoing revenue setting during the control period which will run from 1 April 2015 until 31 March 2023. The Model contains the functionality to reflect data and produce outcomes in relation to all 14 Electricity Distribution Network Operators (each a “DNO”) although we understand that the published model will only contain data for those companies which have been proposed to be fast-tracked. The specific companies to be fast tracked will be confirmed after the date of this letter.
- 1.2 The Model is designed as a tool to calculate base revenue for the RIIO-ED1 period on the basis of the assumptions and input data contained on the DNO specific input worksheets. In accordance with our agreed scope of work we have accepted the hardcoded input assumptions reflected on these sheets as given and offer no further comment thereon.
- 1.3 The Model is also designed to be used during the control period to recalculate base revenues using updated allowances and actual expenditure which will be applied within the Model. These amounts are used as part of the calculation of MOD which is based on the difference between revenue under the Final Determination and the recalculated base revenues.
- 1.4 The ‘SavedResults’ worksheet within the Model has been designed to reflect the key outputs for each DNO. The results are macro generated on a DNO by DNO basis from the ‘Live Results’ worksheet and on this basis this worksheet may be considered to be a key output sheet of the Model.
- 1.5 The Model calculates dividends as being an amount equal to a specified percentage of the current period closing core nominal RAV balance multiplied by the assumed equity portion of RAV (which is assumed to vary between companies). We would typically expect the calculation of dividends to refer to cash available for dividends and retained profits and we note that for at least one of the DNOs, the dividends paid during the RIIO periods will result in negative retained earnings and new external debt is assumed to be drawn to fund these dividends. We understand from the Model Author that the dividend assumption is a simplifying modelling assumption relating to the notional financial structure assumed in Ofgem’s modelling and does not reflect actual dividends paid by the DNOs.
- 1.6 The Model includes a check on the ‘Revenue Profiling!’ worksheet to confirm that ‘Initial Revenue before profiling’ and ‘Revenue after profiling’ are NPV neutral. The check however shows ‘OK’ in the event that ‘Revenue after profiling’ is greater than ‘Initial Revenue before profiling’ rather than specifically checking the two values are NPV neutral as per the label. We would not consider this to have a significant impact on the robustness of the Model, and we note the two values are both NPV neutral for all operators in the model, however, we would suggest that the formula be amended in the next version of the Model.
- 1.7 The Model includes two macro routines (‘Simulation’ and ‘Reset’) which refer to worksheets not contained in the Model and which do not appear to be in use. We understand from the Model



Author that these worksheets may be considered to be outside the scope of our review. On this basis we offer no opinion thereon.

- 1.8 The Model contains a number of worksheets which we have agreed with the Model Author to exclude from the scope of our review. These comprise the following: 'Bill impact', 'Incentives', 'Incentive impact'. On this basis we have not undertaken a review of these worksheets and offer no opinion thereon.