

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

Our ref: KM/ABH

24 November 2014

Dear Cecilia

Re: Audit of Licence Model - RIIO ED1 Slow Track Final Determination stage

In accordance with the terms of our engagement per the agreed contract (the “Contract”) of 6 June 2014 we have carried out an independent review of the financial model which has been developed to support Ofgem’s RIIO ED1 Slow Track Final 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 ‘Final Determinations Financial Model V2.xlsm (as received on 21 November 2014) (the “Model”):

- is logically constructed, internally consistent, and that the formulae, algorithms and calculations are arithmetically accurate, in all material respects;
- has been designed as a tool to calculate allowed revenue for the RIIO-ED1 period on the basis of the assumptions and input data contained on the DNO specific input worksheets;
- could be used during the control period to recalculate base revenues using actuals 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; and
- contains a ‘SavedResults’ worksheet which 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.

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; or 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.

Yours sincerely

A handwritten signature in blue ink that reads 'BDO LLP'.

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). The Model has been updated to support the Slow Track Final 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 the Slow Track Electricity Distribution Network Operators (each a “DNO”).
- 1.2 The Model is designed as a tool to calculate base revenue for each DNO during 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. We would typically expect the calculation of dividends to refer to cash available for dividends and retained profits. We note, however, that the Model does not contain a Balance Sheet or other Financial Statements and it is not possible to identify whether any negative retained earnings positions arise. 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 Further to 1.1, the Model does not contain any input data for the four fast tracked DNOs: WMID, EMID, SWALES and WEST. Consequently when these DNOs are selected a number of calculations and outputs of the Model reflect ‘#DIV/0!’ errors.