Making a positive difference
for energy consumers

RIIO Accounts: Consultation on our proposed framework

Consultation

		Contact:	FAO - Adanma Joseph-Anyaegbu
Publication date:	4 November 2015	**Team:**	Regulatory Finance
Response deadline:	17 December 2015	**Tel:**	020 7901 7000
		Email:	Reg.Finance@ofgem.gov.uk

Overview:

This document updates our proposals for a new regulatory financial reporting framework for network operators regulated under our RIIO price control regime. It reflects feedback on our open letter consultation (our initial consultation) published on 24 June 2015.

Network operators (NWOs) subject to RIIO price controls transmit or distribute gas and electricity throughout Great Britain. They currently prepare regulatory accounts for each regulatory financial year running from 1 April to 31 March. This is required by licence conditions.[1] We propose to modify these existing licence conditions for relevant NWOs to replace regulatory accounts with RIIO accounts.[2] RIIO accounts will involve more direct reporting of the financial performance of NWOs under RIIO. They will provide more relevant, authoritative and timely information on financial performance and corporate governance.

Responding to this consultation

We would appreciate your answers to the questions throughout this document. Please use the feedback form in appendix 5. Send all responses for the attention of Adanma Joseph-Anyaegbu at Reg.Finance@ofgem.gov.uk. This consultation will be open for just over 6 weeks, closing at 17:00 on 17 December 2015.

[1] Standard special licence conditions A30 on Regulatory accounts for Gas Distribution and Transmission, standard condition B1 on Regulatory accounts for Electricity Transmission and standard condition 44 on Regulatory accounts for Electricity Distribution.
[2] A draft copy of the new licence conditions which will apply to all NWOs can be found in Appendix 3. Appendix 3 applies only to DNOs.

Context

This document is an update on our initial consultation and seeks further views from stakeholders on our proposals. The RIIO accounts project aims to deliver:

- a revised licence condition on regulatory accounts reporting
- a Regulatory Financial Reporting Standard (RFRS)
- a statement of regulatory corporate governance principles

These will be described in this document.

RIIO accounts should provide more transparent and accurate information on the financial performance of NWOs subject to RIIO price controls. We expect that this will help increase investor confidence, ultimately to the benefit of consumers. RIIO accounts should also help investors understand Ofgem's regulatory processes and how they affect NWOs.

Associated documents

Ofgem RIIO-accounts open letter consultation, published 24 June 2015.

UK Corporate Governance Code for public listed companies

Contents

Executive Summary

We regulate the main gas and electricity network companies though our RIIO (Revenue = Incentives + Innovation + Outputs) price control framework. RIIO is an incentive-based framework designed to encourage companies to be cost-efficient and deliver quality services. We believe incentive regulation is more effective when investors in the network operators (NWOs) and other interested parties have timely, high quality and reliable information about performance.

Investors, analysts, consumers and other stakeholders are calling for more transparent and relevant information on regulated NWOs' financial performance, and we are responding to this. Some NWOs have already produced reports that reflect performance against regulatory targets.

We received 13 responses to our initial consultation published on 24 June this year. They came from NWOs, auditors and a consumer organisation. Responses agreed that we should go ahead with developing a RIIO accounts framework, though some were concerned about how it would be implemented. Stakeholders agreed that RIIO accounts would provide more meaningful financial information on NWOs. There is a summary of responses in appendix 1. Full non-confidential responses are available on our website.

Through this consultation, we are now seeking views on more developed proposals for how we implement a RIIO accounts framework. In our initial consultation, we signalled that the new set of accounts would replace the existing regulatory accounts prepared to the end of each regulatory year, 31 March, starting with accounts for the year ending 31 March 2017. We want to make sure this timetable is still viable.

Progress made since our initial consultation

As well as receiving formal responses to our June 2015 initial consultation, we held discussions with representatives of the investor and audit communities, and the International Accounting Standards Board (IASB). We have also been helped with the technical aspects of our development work by some of the NWOs.

We have developed a RIIO accounts support module (RASM), which we consider will be helpful for anyone preparing and auditing RIIO accounts. It is a MS Excel model that will draw from an NWO's Price Control Financial Model (PCFM)[3] and information in its revenue RIGs.[4] It will make the principal calculations necessary to present information in RIIO accounts and allow the NWO to make the appropriate adjustments to make sure the accounts show how the NWO is creating enduring value for investors. The RASM is almost finished, and can generate the main RIIO accounts financial statements and disclosures. We outline our thinking in chapter 3 and include hypothetical output of the RASM for a fictional company in appendix 2.

3 For example, the ED1 PCFM referred to in the special conditions of the electricity distribution licence.
4 RIGs (regulatory instructions and guidance) provide for information to be submitted to Ofgem in annual regulatory reporting packs (RRPs).

We have also been working on our Regulatory Financial Reporting Standard (RFRS). Our discussions with the audit community have highlighted the need for us to develop this as a standalone document and to involve people with recent audit experience in finalising it. We will do this over the coming months, and set out the main principles in chapter 5. We will consult on a draft RFRS early in 2016 and on further iterations of the RFRS during 2016. This will allow NWOs and auditors to consider the practical implications during the reporting season for the 2015-16 regulatory year.

We set out draft regulatory corporate governance principles in our initial consultation. These will inform how NWOs report on their corporate governance. In light of the responses we have received, we propose 'light touch' governance reporting requirements and some additions to these principles. Readers can review and comment on these details in chapter 6. We expect these draft principles will remain broadly as they are, and this will let future development focus on the accounting issues.

Many respondents to our initial consultation were concerned about the timetable for the introduction of RIIO accounts. Creating a new accounting framework for RIIO accounts is an ambitious project with a number of technical accounting and implementation issues that need time to breathe, and time for auditors, companies and ourselves to work them through. We outline, in chapter 2, how we plan to take these issues forward. We believe it remains desirable and feasible for us collectively to implement a RIIO accounts framework in time for companies to report on their 2016-17 results. But it is clear that we will need to use the 2015-16 reporting season to test the draft RFRS and the RASM, and for NWOs and auditors to develop the procedures necessary to implement RIIO accounts.

Principal question for consultation

Although we invite comments on our developing thinking in the chapters mentioned above, we wish in particular to consult on the important question of how we implement licence modifications.

Chapter 2 proposes the form of a licence modification (shown in appendix 3) that means we can be more flexible about implementing RIIO accounts. We consider whether we should make this modification before the start of regulatory year 2016-17. We ask for views on other options for implementing RIIO accounts for 2016-17 and a further option of delaying the implementation of RIIO accounts. We would like to hear from anyone who is interested in these options.

1. Concept and content of RIIO accounts

Chapter Summary

This chapter reiterates what we said in our June 2015 initial consultation about the rationale for RIIO accounts. It gives an update on our thinking and the progress we have made in developing resources for helping prepare and audit RIIO accounts. It builds on this to give an example of what RIIO accounts might look like. We will provide further opportunity for consultation on the content of RIIO accounts, but invite your early comments on this example.

Question 1: Do you have any comments on the form and content of RIIO accounts illustrated in appendix 2?

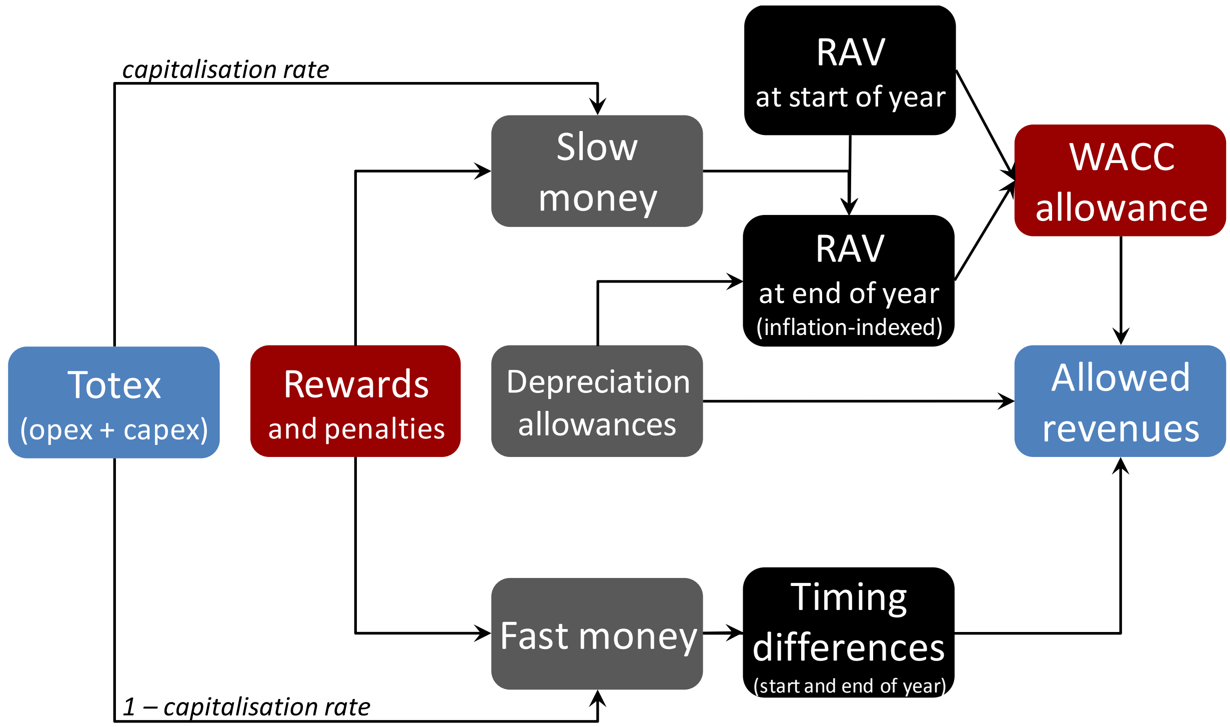
Reminder of the RIIO accounts concept

1.1. Reporting network companies' performance is an important part of our regulation of these, largely monopoly, network operators (NWOs).

1.2. Since we developed the new RIIO approach to setting network price controls, we think it's important to develop what we are calling RIIO accounts. Our objective is to make reporting transparent, which will help reinforce other regulatory objectives. RIIO accounts should present information that is useful to the investor community and other users of the accounts. RIIO accounts will include the regulatory asset value on the statement of regulatory financial position, and information on real returns that can be compared with our cost of capital allowances. They will allow readers of RIIO accounts to assess stewardship of the companies' resources.

1.3. RIIO accounts will reflect the books and records of the company, but in particular the company's Price Control Financial Model (PCFM) and its RIGs. The PCFM is formally updated each year as part of our Annual Iteration Process (AIP), which updates calculations of the company's base revenues, an important component of its overall allowed revenues. It is an authoritative measure of the NWO's regulatory asset value (RAV) and other regulatory balances.

Figure 1.0: Illustration of 'Totex approach'



1.4. Figure 1.0 above illustrates a 'Totex approach', whereby a NWO's costs are recovered either in the year of spend, 'fast money', or over a longer period of time, 'slow money', by being added to the RAV. Value in the RAV is recovered through depreciation allowances in allowed revenues, together with cost of capital allowances to account for the time value of money. Rewards and penalties under RIIO's incentives are also included in allowed revenues either on a fast money or slow money basis.

1.5. We can see that investors generally place value on the RAV rather than on fixed assets. While physical assets are the means to provide services, conventional accounting measures of their book values bear little relationship to the value of future economic benefits that can be derived from using them. In contrast, the RAV is structured to represent the present value of future net cash flows that a company has a right to under the RIIO framework (subject always to incentive performance). The RAV is depreciated according to regulatory policy, which is only loosely informed by conventional accounting policies. It is uplifted annually for inflation.

1.6. In light of these insights, we are designing RIIO accounts to give useful information about the regulatory financial position and performance of a NWO. The remainder of this section considers how we specify the content of RIIO accounts to this end.

Content of RIIO accounts

Consultation responses

1.7. Feedback we received from our initial consultation supported introducing a RIIO accounts requirement that reflects the regulatory arrangements. Concerned that RIIO accounts would increase the burden of complying with regulatory requirements, some NWOs felt that we should retain the regulatory accounts in their current state, but include additional disclosure requirements to tackle the lack of transparency in the current system.

1.8. Some responses supported maintaining some elements of the regulatory accounts (prepared on a statutory basis), as some stakeholders continue to value this. Others supported our proposals for a new form of accounts that properly reflects NWOs' basis of regulation.

1.9. Respondents generally felt that they would be able to comment on the format and content of RIIO accounts once they had been able to see and review more detailed proposals.

Considering responses

1.10. One of the things we hope to achieve with RIIO accounts is to minimise regulatory burden while providing interested parties with better-quality information. The new RIIO accounts will replace the obligations for each NWO to prepare regulatory accounts. We anticipate there will be extra work in establishing the accounting and auditing processes, but have designed the RASM to help minimise the work involved and use information that NWOs collect anyway. We plan to work with the NWOs' auditors to streamline the audit process by eliminating redundant 'agreed-upon procedure'[5] (AUP) requirements as a result of the new licence conditions.

1.11. We have a strong sense from investors – who are our main intended audience of these accounts – that there is limited value in the current regulatory accounts. Rather than add reporting requirements that might make these accounts more relevant (but more cumbersome), we continue to believe it is more efficient and effective to propose a new set of accounts that is fit for purpose (RIIO accounts).

Our proposal on the contents of RIIO accounts

1.12. We proposed in our initial consultation, that RIIO accounts will consist of two primary financial statements, a statement of regulatory financial position and a statement of regulatory financial performance. Through developing the RASM, we have been able to add flesh to that proposal.

---

[5] For instance AUPs are required in Standard special licence condition A30 (Regulatory Accounts), for Gas Distribution, to enable an appointed auditor to review the licensee's compliance with its obligation in respect of the prohibition of cross subsidy.

1.13. Here are the main features of the financial statements we are currently developing:

- A set of RIIO accounts will be prepared annually by each company that holds a network licence[6] and is subject to RIIO price controls.

- RIIO accounts will be prepared for each regulatory year, which ends on 31 March.

- The equity return for the year shown in the statement of regulatory financial performance is reconciled to the movement in equity between the start and the end of the year.

- The statement of regulatory financial performance will present two views of the equity return for the year:
  - a revenue account, showing actual revenues (and allowed revenues) and deducting recognised costs
  - a returns account, showing cost of capital allowances and adjusting for incentive and other gains and losses.

- The equity return is expressed in real (inflation-adjusted) terms, consistent with the real-terms basis for cost of equity allowances in RIIO price controls.

- Incentives and other gains and losses are recognised when the underlying performance takes place (ie not only when they are converted into allowed revenues).

- The RAV and other regulatory balances are presented (on a best available information basis) to permit the user to compare with information that will be included in the PCFM after the next Annual Iteration Process[7] (due by 30 November each year).

- NWO adjustments will be made to ensure that the RAV and other regulatory balances fairly represent enduring value to the investor (eg when reprofiling of the investment programme leads to timing effects for incentives for underspends and overspends under the Totex Incentive Mechanism[8])

- Reconciliations to statutory accounts are disclosed in the notes only for key amounts such as revenues, expenditure and net debt, not at a profit or net assets level.

- Other disclosures should be made in the notes to let readers understand key uncertainties involved.

---

[6] National Grid Gas plc holds two gas transporter licences – one for the national transmission system and one for its distribution networks. However we envisage it would prepare one set of RIIO accounts at company level incorporating those activities.

[7] For example, the AIP as described in the ED1 Financial handbook.

[8] A description of the Totex Incentive Mechanism can be found in the ED1 Financial Handbook found on our website.

1.14. To help people understand what RIIO accounts might look like, appendix 2 shows illustrative accounts for a fictional company. We have used the current version of the RASM to generate these example statements with descriptions of the sorts of disclosures we anticipate will be useful to readers.

1.15. In due course, we expect the form and content of RIIO accounts will be specified in the RFRS.

1.16. We invite interested parties to comment on the form and content of RIIO accounts in light of this illustration. Interested parties will have further opportunities to comment as we continue to develop the RFRS.

The rest of this document

1.17. The rest of this document considers options around how we implement RIIO accounts, sets out the main principles we expect in the RFRS, sets out our thinking on the audit opinion and updates on our more developed proposals for governance reporting.

2. Timetable and licence modifications

Chapter Summary

Respondents' concerns over the timetable for implementing RIIO accounts, how we plan to address them, and four options for implementation.

Question 1: Do you agree that the four implementation planning options set out in this chapter would allow for necessary flexibility in the timetable for implementing RIIO accounts? If not, please suggest an alternative option.

Question 2: Out of the four proposed implementation planning options we set out, which do you consider to be achievable and desirable?

Question 3: Do you have other comments on the draft licence condition set out in appendix 3?

Respondents' concerns about the timetable

2.1. Our initial consultation included a timetable we envisaged at the time. Several respondents were concerned that this was too ambitious and might not be achievable. Some were also concerned about our proposal that RIIO accounts should be published no later than 31 July after the regulatory year end.

2.2. But some investors told us that they thought introducing RIIO accounts for the results of 2016-17 would be beneficial, and that we should avoid delaying it beyond that time. Others in the investor community explained that there would be limited benefit in publishing RIIO accounts before NWOs publish other regulatory information for that year (generally no later than 30 September) so we could specify a more relaxed annual timetable.

2.3. It has also become clear to us that many of the issues we are addressing in the RFRS and RASM will benefit from more reflection and testing. Many NWOs and audit firms support the idea that we collectively develop and test the accounting and auditing processes later in 2016 in light of the results for 2015-16. We have also reflected on recommendations made by audit firms that we involve people with recent senior experience in auditing to help ensure that the RFRS is framed in a way that supports a 'fairly presents' view and that there is enough time to reflect on all the issues carefully.

Annual timetable

2.4. In light of respondents' views, we believe it is not necessary or desirable to require NWOs to publish RIIO accounts before they publish information from their RIGs. We expect them to publish RIIO accounts at the same time that they publish other RIGs information. We propose specifying a requirement for NWOs to publish RIIO accounts no later than 30 September each year.

Development and implementation timetable

2.5. In light of respondents' views and our own experience, we are extending the timeline for developing the RFRS and RASM. We still aim to have advanced drafts of both early in 2016 but we recognise there are important technical and practical issues that will need time to work through and resolve. We believe it is desirable to use the time during the accounts preparation and auditing season for 2015-16 (ie during the early part of 2016-17) for auditors, NWOs and us to work through these issues and ensure we have a high quality, workable result.

2.6. We note that there is broad agreement that RIIO accounts will benefit both companies and investors, and consequently consumers, and that it is worth proceeding assuming that we will resolve any problems in time for companies to report on their 2016-17 results. But we still think we should build flexibility into our timetable, and have drafted a proposed licence condition that will build this in.

Proposed licence condition

2.7. We currently expect that a RIIO accounts condition for each type of NWO would overwrite the existing regulatory accounts condition in the respective licence. Some other minor consequential changes to other licence conditions that cross-refer to existing regulatory accounts conditions would also be needed.

2.8. There is a draft of a possible RIIO accounts licence condition at appendix 3 showing, as an example, possible modifications to existing Standard Condition 44 (regulatory accounts) in the electricity distribution licence. This is a generic example and would apply, with only minor changes, to the other sectors.

2.9. The draft condition sets out:

a) the purpose of RIIO accounts
b) possible transitional arrangements for regulatory accounts
c) requirements for the preparation of RIIO accounts and the statements to be included
d) the status of the Regulatory Financial Reporting Standard (RFRS) and RIIO Accounts Support Module (RASM) and how we would issue and modify them
e) audit requirements
f) publication requirements
g) an enduring requirement for agreed upon procedures for prohibiting cross-subsidy and discrimination.

2.10. As we note in the comments above on the timetable for RIIO accounts, we consider that, subject to our consultation, it would be possible to modify licences before the end of regulatory Year 2015-16. This would involve developing final versions of the licence modifications for statutory consultation no later than early January 2016. The transitional arrangements in Part A of the draft condition provide for the production of regulatory accounts (ie not RIIO accounts) for regulatory years 2015-16 and 2016-17,[9]

[9] Where those are the regulatory years under report.

notwithstanding the licence modification. They also provide for the Authority (having consulted with NWOs) to have the option to direct that RIIO accounts, instead of regulatory accounts, be prepared for regulatory year 2016-17. We envisage that such a direction could be given provided that good provisional RFRS and RASM documents were issued soon after 1 April 2016 so technical and practical issues can be worked on during the accounts preparation and auditing season for 2015-16.

2.11. We would, however, welcome your views on the following possibilities:

i. *Licence conditions as drafted, with scope for the Authority to direct implementation of RIIO accounts for 2016-17*

ii. *NWO option to produce regulatory accounts for 2016-17 instead of RIIO accounts*

Licence drafting could specify that RIIO accounts be prepared for 2016-17 by default but NWOs could elect to produce regulatory accounts instead of RIIO accounts for that year by giving a notice to the Authority with reasons. This might assuage concerns about not being ready to produce RIIO accounts for 2016-17.

iii. *Delay licence modifications until after the RFRS and RASM are more or less finalised*

We could consider delaying licence modifications until after the RFRS and RASM documents are finalised or near-finalised, possibly after mid-2016. This might make NWOs more confident in new licence requirements when they are introduced. If this approach were to be followed, we would still need to decide whether to include the NWO option for RIIO accounts for 2016-17 outlined in subparagraph (ii) above.

iv. *Defer formal requirement for RIIO accounts until 2017-18*

We could consider delaying introducing a formal requirement so that the first RIIO accounts would be for regulatory year 2017-18. The disadvantage of this would be a delay in obtaining the benefits of RIIO accounts outlined in this consultation. If we did pursue this option we would expect to work with NWOs on a 'full dress rehearsal' of RIIO accounts preparation for regulatory year 2016-17 as well as working through the issues during the accounts preparation and auditing season for 2015-16.

3. The Regulatory Financial Reporting Standard

Chapter Summary

This chapter highlights the results of our consultation on the RFRS concept so far and describes how we are taking it forward. There is an overview of the main principles that we propose would be contained in the RFRS. Although you will have opportunities to comment on future drafts of the RFRS, we invite comments on our general proposals at this stage.

Question 1: Do you agree that the high level principles and prescribed regulatory accounting framework in this chapter mean that RIIO accounts can be prepared on a 'fairly presents' basis.

Consultation responses

3.1. Five out of 13 respondents agreed with adopting a principles-based Regulatory Financial Reporting Standard (RFRS). A majority highlighted that it was difficult to respond without seeing detailed proposals. They supported a principles-based RFRS and agreed that we should not attempt to provide detailed rules for preparing and auditing RIIO accounts.

3.2. Some responses suggested the RFRS should be a separate document rather than refer to existing accounting standards used for the preparation of statutory accounts. The relevant high-level principles from existing accounting standards could be pasted-in or summarised in the RFRS.

3.3. Some responses were concerned about using forecasts, particularly of future regulatory determinations, to inform accounting estimates.

Considering responses

3.4. In line with feedback received so far from the NWOs' auditor firms, we are preparing a standalone (ie one not referring to existing financial reporting standards) version of an early draft RFRS for further discussion with NWOs and auditors. We will share the results of this work with all stakeholders in due course and we anticipate holding workshops on the accounting issues.

3.5. If you might be interested in attending some of these accounting workshops, email Reg.Finance@ofgem.gov.uk.

3.6. We agree that the RFRS should contain high level principles that would support RIIO accounts being prepared on a 'fairly presents' basis.

3.7. We anticipate that the RFRS will specify disclosure requirements by reference to 'proforma' statements set out in the RASM. There is an example of the output of our current working version of the RASM in appendix 2.

High-level principles built-in to the RFRS

Purpose of RIIO accounts

3.8. We believe the purpose of the RIIO accounts is to provide a wide range of stakeholders, specifically the investor community, with information that is useful for economic decision making. We believe the measurement basis for RIIO accounts will be consistent with how investors evaluate the results of managements' stewardship in a regulated economic environment.

Asset recognition

3.9. We consider that the RAV and, by extension, other regulatory balances meet the criteria in the IASB's conceptual framework (exposure draft) for the recognition of an asset. But the revenue recognition rules currently included in IFRS 15 do not readily support recognition of the RAV. So we have accepted the recommendations of some of the NWO audit firms to develop a stand-alone RFRS to provide a basis for preparers and auditors of RIIO accounts to recognise these assets.

3.10. We think it's reasonable to assume that revenues that the licence permits will be recovered. NWOs are monopolies and the services they provide are considered essential. The risks of networks becoming obsolete, or 'stranded', are relatively remote and can be managed through the regulatory regimes. The licences operate to maintain the economic value of the RAV, in net present value terms, and let under and over-recoveries be carried forward.

3.11. We propose that incentive gains should be recognised in the year that performance is achieved, not when the corresponding revenue is collected.

Measurement

3.12. The RIIO mechanisms and processes help ensure that the core value of regulatory balances can be reliably measured at an economic fair value.

3.13. We anticipate that NWOs will need to assess the enduring value to shareholders when there are material regulatory timing differences. Examples of where these timing differences may arise include:

- recognising efficiency incentives when a NWO re-profiles its expenditure programmes – deferral of projects would lead to apparent underspends, and corresponding incentive value, but this value would not be enduring since it would be largely negated when the deferred projects are undertaken with a corresponding overspend

- when future regulatory determinations and assessments can be expected for conditions existing at a balance sheet date – eg under-delivery of some outputs are only assessed after the end of a control period and determinations for some uncertainty mechanisms may take place after some transactions have been incurred.

3.14. NWOs' assessment of the enduring value to shareholders arising from material regulatory timing differences will generally involve some uncertainty. We would expect NWOs to disclose potential contingencies, such as adverse regulatory determinations.

3.15. We propose that non-regulatory balances, including working capital balances such as debtors and creditors and net debt, be measured at historical cost to minimise the need for differences between RIIO accounting and statutory accounting treatments.

4. 'Fairly presents' audit opinion

Chapter Summary

This chapter presents our thinking on the audit opinion for RIIO accounts in light of feedback we have received on the development of a 'fairly presents' opinion, and further steps towards achieving this.

Consultation responses

4.1. In our initial consultation we asked stakeholders what they thought about our proposal to require a 'fairly presents' audit opinion.

4.2. Many respondents cited a need for an accounting framework that enables a fair presentation of a company's regulatory financial position and performance. They also said it would take time for auditors to understand the regulatory uncertainties involved.

4.3. Respondents generally supported the objective that RIIO accounts should be audited to a 'fairly presents' standard.

Considering responses

4.4. For auditors, forming an audit opinion on RIIO accounts will mean understanding the regulatory environment in which the companies operate and the uncertainties they face. This is a necessary implication of raising the quality of financial reporting to a level that better meets investors' needs, and should not be seen as a net detriment.

4.5. We plan to continue talking to firms who currently audit NWOs (the Big 4), and will keep the Institute of Chartered Accountants in England and Wales (ICAEW) informed. We will continue our discussions with the International Accounting Standards Board.

4.6. Developing the right framework will not be straightforward, and we do not underestimate the work involved. But we are convinced of the benefits to consumers, to investors and to NWOs of a more transparent environment for financial reporting for these regulated businesses.

4.7. While this work continues, we plan to consult on more detailed proposals. If you wish to comment on the development of the audit opinion, you can get in touch using the feedback questionnaire at appendix 5.

5. Reporting on regulatory corporate governance

Chapter Summary

This chapter updates how we propose NWOs report on corporate governance, considering the principles of regulatory corporate governance. We also include our response to the feedback we received on our initial consultation.

Question 1: Do you have further comments on the revised draft regulatory corporate governance principles?

Consultation responses

5.1. Four of the NWOs agreed with our proposals on reporting on corporate governance.

5.2. Other respondents were concerned that:

a) The existing disclosures under the UK corporate governance codes are sufficient and the consultation's proposals add nothing extra. One NWO proposed licence changes to cover any gaps rather than enforcing compliance with the code.

b) The corporate governance code does not apply to unlisted companies and complying with them (as NWOs are currently required to do in regulatory accounts) would be an additional and unnecessary burden.

c) Directors' principal duties are to shareholders, not consumers. So there is the potential for conflict when interests are not aligned. One NWO also suggested that this aspect of the proposals may also be contrary to law (directors' duties under the Companies Act 2006).

5.3. A consumer advocacy body suggested that the proposals do not go far enough and said that the principles could include consumer welfare too. They also asked who the companies are accountable to.

Considering responses

5.4. We believe there is a wide investor interest in the governance of network companies subject to price control. This is partly because bond holders and lenders to the company recognise that ring fence protections separate the company's governance and longer-term financial viability from any owning group. It is also because a price control regime is likely to affect the company's strategic aims and how it should pursue them. Together, we believe these circumstances mean there is a separate and interested audience for reporting on how these companies are governed.

5.5. Network companies are not listed companies (though some have holding companies that are), and we believe it is not necessary or helpful to require them to report on their corporate governance as if they were. We propose instead that boards report on their governance in RIIO accounts in a more flexible way, referring to the principles set out in UK Corporate Governance Code but without necessarily adopting those principles. This should give directors discretion over what governance reporting would be relevant and helpful to the readers of RIIO accounts.

5.6. Responses to our initial consultation and discussions with representatives in the investor community have reinforced our view that companies should report on their governance with reference to regulatory corporate governance principles. As we explain above, we consulted on a draft set of these principles in our initial consultation. We envisage that investors would reasonably expect the board of a company subject to price control regulation to apply these principles when reporting on its stewardship.

5.7. Some investors suggested that we should impose detailed requirements on companies for their governance reporting. We are not convinced that doing this would make reporting more transparent. We sense that investors are interested in effective governance reporting, and this should create incentives for boards to improve. We anticipate that companies that set new standards of governance reporting will gain reputational benefits and raise expectations for reporting by other companies.

5.8. In light of consultation responses and our developing thinking, we propose some additions to the regulatory corporate governance principles. We set out revised principles in appendix 4, with the additions highlighted in blue.

5.9. We have reflected on the 2014 update to the UK Corporate Governance Code and its focus on how boards report on their longer-term financial viability. This will be particularly relevant to network companies which typically procure long-term financing. We envisage that bond holders and lenders would be interested in how ring-fence and price control protections built-in to network licences inform the board's assessment of the company's longer-term financial viability.

5.10. From our consultation on our proposals for pension deficit funding under RIIO and heightened interest in the governance of industry codes, we are aware that price controlled network companies have opportunities to promote the interests of consumers as well as shareholders when participating in the governance of pension schemes and industry codes. The direct economic interests of shareholders in participation are either largely neutralised by price control arrangements or broadly aligned with the interests of consumers. In these cases, the company and its shareholders would have a wider interest in promoting the interest of consumers. We therefore propose an additional principle that reflects this.

6. Impact assessment

Chapter Summary

Our thinking on the possible impact of introducing a requirement for RIIO accounts.

Question 1: Do you agree with our assessment of the possible impacts?

Question 2: Do you think there are any other potential impacts that we ought to take into account?

Requirement for the Authority to consider the impact of its proposals

6.1. We are keen to hear your views on the impact of the proposals in this paper to replace the existing requirement for NWOs to produce and publish regulatory accounts, with a new requirement for investor-focussed RIIO accounts. We will take any stakeholder responses into account in developing formal licence modification proposals.

6.2. In considering and consulting on the impact of proposals, the Authority considers a number of key issues in the context of relevant legislation and guidelines. These include:

- The Gas Act 1986
- The Electricity Act 1989
- The Utilities Act 2000
- The Energy Act 2004
- Directive 2009/72/EC concerning common rules for the internal market in electricity
- Directive 2009/73/EC concerning common rules for the internal market in natural gas
- Social and Environmental Guidance to the Gas and Electricity Markets Authority issued by the Secretary of State (including published draft guidance)

Impact on existing and future consumers

6.3. We do not think our preferred approach would affect consumers immediately. However, we believe that making NWOs' financial performance more visible will bring long-term benefits for consumers. This is because introducing RIIO accounts should help investors better understand NWOs' earnings potential and risk levels. This should encourage more efficient financing and, in due course, allow us to reflect lower costs of capital in charges to consumers.

Proportionality of proposals

6.4. We consider that our proposals are proportionate for improving financial transparency and gaining the benefits referred to in paragraph 6.3 of this document. A requirement for RIIO accounts would replace the existing requirement for regulatory accounts and, over time, might allow us to consider removing other existing regulatory requirements. Taking this into account, and our proposal to provide the RIIO Accounts Support Module (RASM) to help prepare RIIO accounts, we consider that a new requirement for RIIO accounts should not make NWOs' regulatory burden heavier.

6.5. We think the draft licence modification in appendix 3 should be a basis for an appropriate modification to all NWO licences (that contain RIIO price control conditions), but we are keen to hear from you if you think that any aspect of our proposals would have an undue impact.

Competition and markets / security and reliability of energy supplies and investment in energy networks

6.6. Efficient financing and financial stability of NWOs is important for competition in energy retail markets. Our proposals are intended to make the financial performance and position of NWOs transparent, and to make investors more confident in them.

6.7. We consider that our proposals are positive but would be interested to hear from you if you think otherwise.

Consistency with other regulators

6.8. We do not believe our proposals for RIIO accounts raise any particular concerns over regulatory consistency, neither should have any direct implications for other regulators. But, requirements for financial transparency and the need to achieve efficient financing are likely to be areas of common concern and we would be interested to hear any views on this.

Sustainable development

6.9. This covers five important areas:

- Managing the transition to a low carbon economy
- Eradicating fuel poverty and protecting vulnerable consumers
- Promoting energy savings
- Ensuring a secure and reliable gas and electricity supply
- Supporting improved environmental performance

6.10. Although we consider that our proposal for RIIO accounts would be generally beneficial we do not believe our proposals would have any significant direct impact in these areas.

Health and safety

6.11. We do not believe that our proposals will have any effect on this.

Risks and unintended consequences

6.12. We are aware of some important risks surrounding the implementation of RIIO accounts. We are structuring our work to minimise or mitigate these.

6.13. We are breaking new ground by introducing a new accounting framework to reflect the economics underlying companies' price control regulatory regimes. We have been encouraged by our discussions with auditors and standard-setters in the accounting profession, but we are aware that some of the technical challenges are significant. The options we describe in chapter 2 are designed to help ensure we can manage those challenges and accommodate any consequent delays.

6.14. There will also be challenges in NWOs' and auditors annual processes, which will need to be developed to deliver RIIO accounts. We are structuring our work on the RASM to provide a useful tool that will minimise the risk of undue cost and regulatory burden.

6.15. We are not aware of any material implications that the publication of RIIO accounts might have for overseas owners of NWOs under their respective home regulatory regimes, but ask that you inform us if you know of any.

Costs and benefits

6.16. We expect our proposal for RIIO accounts will have a broadly neutral effect on the regulatory compliance costs borne by NWOs (and so ultimately consumers). It is possible there will be some savings if the introduction of RIIO accounts means that other regulatory reporting can be reduced in future. We consider that there could be significant financial benefits for consumers in the long run if our proposals successfully improve transparency for investors and reduce perceptions of risk so that financing costs can be more efficiently incurred. In any case, we do not consider that there would be any impact on the distribution of costs amongst stakeholders.

6.17. We are interested in hearing your views on these points.

Post-implementation review

6.18. We will do a post-implementation review after any licence modifications have been introduced and implemented.

Conclusion

6.19. We consider that the associated risks are manageable and proportionate in the context of potential benefits we have identified. We also expect that responses to this document should allow us to refine our proposals to minimise any adverse effects.

Appendices

Index

Appendix 1 - Consultation responses

Summary of consultation responses on initial consultation
1. Withdrawal of regulatory accounts
8 out of the 13 respondents support withdrawal of regulatory accounts and replacement with a new reporting framework.
Citizens Advice highlighted the importance of continuity in reporting and that any key information included in the regulatory accounts e.g. KPIs and governance sections are maintained.
Some respondents felt that regulatory accounts already provide a consistent basis of comparison for financial position and performance (under IFRS/UK GAAP) across all NWOs
NWOs use regulatory accounts as an audited basis of reconciliation for the RRPs. This change will be Significant for NWOs that produce statutory accounts to December year ends.
Ensure that the advantages realised from the statutory accounts (broad acceptance, comparability, consistency) are transferred and enhanced under a new accounting framework.
2. Use of RFRS principles as a basis for preparation of RIIO accounts
5 out of the 13 respondents agreed with adopting principles based RFRS. The majority of respondents highlighted that it was difficult to comment without first seeing the detailed proposals.
Ofgem understand that NWOs have different options in choosing the statutory accounting framework e.g. FRS 101-102, IFRS and these will be appropriately reflected in the RFRS principles.
RFRS will be expected to be finalised before the start of the financial year for which the first RIIO accounting numbers would be produced (i.e. the comparative period). An RFRS developed by 31 March 16 could then be used for a set of accounts for the year ending 31 March 18 with comparatives for the year to 31 March 17.
The introduction and implementation of RIIO accounts will increase costs to networks and consumers because of an up-skilling of personnel in the networks
Some networks in electricity transmission have a number of material uncertainty mechanisms where the totex allowance for 2015-16 will be finally known based on outputs delivered up to and including 2018-19, reported in July 2019 and directed by the Authority in November 2019. To be relevant and reliable a set of RIIO accounts would therefore need to make use of forecast data relating to future output delivery and future allowance adjustments.
3. New reporting format for regulatory financial position and performance
GDNs and TOs already publish the following as part of their own RIIO annual reports, which are required under the RIGs: RAV, RORE, performance under TIM, incentive income/penalties, and customer bill impact. Producing separate RIIO accounts that present the same information is perceived to be of no value.
Preparing additional disclosures on a regulatory basis on top of IFRS results retains the consistency and familiarity of IFRS results with the additional insight provided by the regulatory view of performance and position.
Respondents see the usefulness of reporting to investors using a model based, in part, on notional elements. Investors are keen to see actual positions and the current regulatory accounts afford them this key benefit, albeit on a statutory basis.
Inclusion of a glossary to define basic concepts such as RAV, RORE and Totex will be useful.

Overlap with other regulatory reporting, which would give rise to stakeholder confusion if different reporting bases are adopted should be considered.
Consideration of the Red Tape Challenge under the new government's Enterprise Bill - any new requirements arising from the RIGs should be considered in light of the concurrent development of the RIIO accounts and not unnecessarily increase the regulatory burden.
4. Principles of Regulatory Corporate Governance
7 out of the 13 respondents agreed with creating new principles based framework of Regulatory Corporate Governance.
It is worth highlighting the approach adopted by Ofwat, which was to develop a set of principles for good corporate governance that companies in the water sector are expected to follow, rather than requiring adherence to the UK Corporate Governance Code.
The consultation letter is not clear as to whether it is proposing that licensees should report in full in accordance with the UK Corporate Governance Code (the Code), or whether the proposal is to further develop the corporate governance requirements in the licence. Amending the current licence requirements to cover any perceived gaps would be a more effective and cost efficient way to implement the principles than to enforce compliance with the Code.
Clarify the interaction between the obligations on NWOs under the DAG and the new statement of Regulatory Corporate Governance.
The open letter proposals potentially conflict with Directors Duties under CA 2006 S172(1), which are to promote the success of the company for the benefit of shareholders. Where consumer interests and shareholder interests are not aligned there is likely to be an implementation issue.
5. Proposed timeline for implementation
We believe the objectives of RIIO accounts would be best met by extending the timeline to allow more time for engagement with the networks, and by restricting the RFRS to a high level principles document that will allow the RIIO accounts to continue to evolve based on the experience of the first few years. A full and robust process to develop RFRS would take a number of years in line with recent IFRS developments.
The timeline set out in the initial consultation is lacking in detail. There is no guidance on what the "activities" are to develop the RFRS between May 2015 and March 2016, the role of the networks and other stakeholders in developing that framework, or the next steps. Highlight in an amended timeline when Ofgem plans to formally consult on RFRS.
The proposed RIIO accounts are intended to be published at the end of July but the annual PCFM change control process does not complete until the end of September. This could have an impact on the input values for RIIO accounts.
Extending the timetable for completion of a 2015-16 dry run (Autumn 2016) would be advantageous and more realistic in achieving the proposed 2016-17 full roll out (Autumn 2017).
A 31 July publication date for the RIIO accounts would place an even greater burden on the considerable undertaking in completing the existing regulatory reporting requirements that run concurrently alongside the statutory accounts at our March year-end. The Cost and Outputs RRPs are only finalised well into July, having undergone the required assurance and internal sign offs as required by the DAG. A 31 July publication date would seriously challenge the quality, accuracy and auditability of the RIIO accounts.
6. Audit opinion on a 'fairly presents' basis
In order to accept the assurance engagement in the first place, the auditor needs to check that IFAC's pre-conditions for assurance are in place. Applying these foundation principles to the RIIO proposal, the suitability of the criteria and the availability of hard evidence to support management's reported position will be key. In the absence of one or both, independent assurance will not be an option. If management's basis of preparation is to pass the test of 'suitable criteria' it will need to be clear, objective, unbiased, neutral, available to the reader to be read alongside the reported information, etc.

A ‘fairly presents’ opinion requires a clear basis of preparation to be in place. There are a number of aspects of the RIIO accounts that could potentially be subjected to a ‘fairly presents’ opinion, including the costs incurred to date and incentive performance. Providing an audit opinion on forecast information, particularly when considering the values to assume for totex allowances is likely to be more challenging.
If RFRS is to be a high level principles document consideration should be given to providing a different form of independent assurance initially, such as agreed upon procedures.
Auditors are not currently familiar with the detailed regulatory treatments, which will require up-skilling in a regulatory accounting framework. This training requirement will increase costs to consumers.
7. How NWO boards should report on their governance
Ofgem concluded an extensive review of the ring fence regime and governance requirements applicable to network licensees at the end of 2012. This was viewed as being adequate and subsequently no further stakeholder concerns have been raised.
All boards should report on corporate governance in line with the CA 2006, having regard for the size and type of entity reporting. Ofgem must not continue to advocate for the inclusion of UK Code statements in a NWOs RIIO accounts on the basis that they are pseudo listed.
We support the governance disclosures including a section on how creating value for consumers underpins the value for shareholders.
regulatory accounts already refer to detailed corporate governance statements, which are published by their listed owners as part of their annual reports.
NWOs are already fully aware of how they comply with their license obligations as this is a fundamental part of their ability to operate. Issuing a statement to stakeholders merely increases the regulatory burden, but adds no value.

Appendix 2 – Example of what RIIO accounts may look like

GREAT BRITAIN GAS DISTRIBUTION LIMITED
RIIO Accounts for the year ended 31 March 20XX

STATEMENT OF REGULATORY FINANCIAL PERFORMANCE

Part 1: Revenue accounting	Notes	20XV-XW £m	20XW-XX £m
Revenue for the year from regulated tariffs	2		609.5
K factor arising for the year	8		(20.9)
Maximum allowed revenue for the year	2		588.6
K factor utilised in the year	8		-
Underlying price control revenues for the year			588.6
Fast Money Spend	3		(133.1)
Allowance for regulatory depreciation	7		(149.1)
Passthrough and other regulatory allowances	9		(107.9)
Totex incentive value added to the RAV	3, 7		(12.2)
Output incentives earned in the year	9		4.0
Over/(under) recovery of pensions deficit funding	9		-
Over/(under) recovery of pass-through and other true-ups	9		(4.0)
Time value of money adjusted in the RAV	7		3.0
Interest in K-factor	8		-
Time value for money in other regulatory balances	9		(0.0)
Return on non-regulated activities	11		3.0
Gain/(loss) on unfunded pension scheme obligations	12		(25.0)
Equity return before financing and tax			167.1
Real net interest costs	4		(42.5)
Tax payments	5		(40.0)
Equity return for the year			**84.6**

STATEMENT OF REGULATORY FINANCIAL PERFORMANCE

Part 2: Return accounting	Notes	20XV-XW £m	20XW-XX £m
Allowances for the cost of capital on the RAV			119.6
Time value of money adjusted in the RAV	7		3.0
less: cost of debt allowances			(51.4)
Net allowances for the cost of equity		-	71.2
Additional income/IQI			1.6
Totex incentives	3		26.0
Output incentives	9		4.0
Regulatory over/(under) recoveries	9		(4.0)
Return on other activities using assets within the RAV	11		-
Equity return on RAV before financing variances	6	-	**98.7**
Real cost of debt: interest rate variance	4		(5.6)
Real cost of debt: inflation rate variance	4		(15.2)
Tax variance (other than gearing)	5		10.0
Equity return on RAV before gearing variances	6	-	**88.0**
Interest in K-factor	8		-
Time value for money in other regulatory balances	9		(0.0)
Return on activities using assets outside the RAV	11		3.0
Gain/(loss) on unfunded pension scheme obligations	12		(25.0)
Real cost of debt: gearing variance	4		29.7
Tax variance relating to gearing variance	5		(11.1)
Equity return for the year		-	**84.6**

STATEMENT OF REGULATORY FINANCIAL POSITION

Regulatory financial position	Notes	31 March 20XW	31 March 20XX
		£m	£m
Regulatory asset value	7	2,986.4	2,908.0
K-factor balances	8	(2.8)	(23.7)
Other regulatory balances	9	60.3	75.0
Total regulatory balances		3,043.9	2,959.2
Fixed assets: activities using assets outside the RAV	11	20.0	28.0
Non-financing debtors		15.0	6.0
Non-financing creditors		(15.0)	5.0
Unfunded pension scheme obligations	12	(100.0)	(120.0)
Net assets before financing		2,963.9	2,878.2
Net debt	10	(900.0)	(730.1)
Net equity		2,063.9	2,148.1

Movements in net equity		£m
Equity at 31 March 20XW		2,063.9
New equity issued		10.0
Equity return for the year		84.6
Dividends		(30.0)
Indexation of the RAV	7	26.8
Indexation of other regulatory balances	9	0.3
Effect of inflation on the real value of debt	10	(7.5)
Equity at 31 March 20XX		**2,148.1**

NOTES TO RIIO ACCOUNTS

1 **ACCOUNTING POLICIES**

These accounts are prepared in accordance with the Regulatory Financial Reporting Standard (RFRS) issued by Ofgem on [date]. The RFRS provides that these accounts should, unless it is evidently inappropriate, adopt an assumption tha consumer charges permitted under the company's licence are recoverable and that the regime operates to maintain the economic value of regulatory balances and convert them in due course to allowed revenues.

In accordance with the RFRS, incentive value is recognised at the time of performance

Reflecting the real terms concept embedded in the RIIO regulatory regime, the statement of regulatory financia performance presents the real return on equity after taking account the effect of inflation to allow comparison with real terms allowances for the cost of capital in allowed revenues. Indexation of regulatory balances and the inflatior adjustment to interest costs are accounted for as movements in equity

[Details of other material accounting policies. These may be limited to accounting policies regarding non-regulated activities.

2 **REVENUES**

Reconciliation to statutory accounts

[Table showing reconciliation to statutory accounts turnover. Where a company has a December year-end, the table should show full year amounts for year 20XW with adjustment columns for Jan-Mar 20XW and Jan-Mar 20XX.

Allowed revenues

[Information either setting out the calculation/breakdown of allowed revenues or referring readers to published information where the calculations are set out together with a reconciliation to the amount disclosed in the statement of regulatory financial performance where there is any difference.]

3 EXPENDITURE

Analysis of totex and totex incentive mechanism	20XV-XW £m	20XW-XX £m
Repex		35.7
Non-repex		160.6
Totex		196.3
Capitalisation rates:		
Repex		57.14%
Non-repex		26.63%
Repex Capitalised		20.4
Non-repex Capitalised		42.8
Total Capitalised		63.2
Residual: fast money		133.1
Overall totex		196.3
Totex		196.3
Totex allowances		316.8
Underspend		120.5
Incentive rate		63.04%
Totex incentive gain		76.0
Analysed as:		
Slow money TIM (added to the RAV)		37.8
Fast money TIM gain		38.2
Totex incentives for the year		76.0
Adjustment to RAV for enduring value		(50.0)
Net totex incentives		26.0

Reconciliation of expenditure to statutory accounts

[Table showing reconciliation to statutory accounts capital expenditure, operating expenditure etc. Where a company has a December year-end, the table should show full year amounts for year 20XW with adjustment columns for Jan-Mar 20XW and Jan-Mar 20XX.

Analysis of transactions with related parties

[Disclosure of expenditure with related parties, with descriptions of material arrangements in place with related parties for provision of services to the company, confirmation that transactions are on an arm's length commercial basis.

4 **COST OF DEBT (INTEREST COSTS)**

[Table showing reconciliation to statutory accounts interest costs, identifying the adjustment for inflation. Where a company has a December year-end, the table should show full year amounts for year 20XW with adjustment columns for Jan-Mar 20XW and Jan-Mar 20XX.

[Commentary on the interest cost variance analysis included in the statement of regulatory financial performance. Analysis and commentary on comparison of interest costs to cost of debt allowances.]

5 **TAXATION**

[Commentary on the tax variances included in the statement of regulatory financial performance, identifying the principal drivers of any material tax variance other than gearing]

[Table showing the carry forward value of regulatory tax pools in the PCFM together with the tax written down value of tax pools in the company's tax computations highlighting any material differences, the reasons for them and the implications for future regulatory allowances for tax.]

6 **RETURN ON REGULATORY EQUITY (RORE)**

	20XV-XW £m	20XW-XX £m
Equity return on RAV before financing variances		98.7
Equity return on RAV before gearing variances		88.0
Discounted average RAV balance		2,867.2
Notional debt portion at gearing		1,863.7
Equity		1,003.5
RORE % pre financing		9.8%
RORE % post financing		8.8%

7 REGULATORY ASSET VALUE

	PCFM value £m	Future RAV true-up for disposals £m	Adjustments to reflect enduring value £m	Net value £m
RAV at 31 March 20XW, as previously reported	2,949.4	22.0	15.0	2,986.4
Adjustments relating to prior years due to PCFM movements	25.0		(25.0)	-
Updated RAV at 31 March 20XW	2,974.4	22.0	(10.0)	2,986.4
Slow money totex additions	63.2			63.2
Disposal proceeds		(10.0)		(10.0)
Disposals forecast at price control review	(0.4)	0.4		-
RAV uplift from TIM	37.8			37.8
Movement in adjustments to reflect enduring value			(50.0)	(50.0)
Depreciation	(149.1)			(149.1
Capitalised time value of money		3.0		3.0
Indexation	26.6	0.2		26.8
RAV at 31 March 20XX	2,952.5	15.6	(60.0)	2,908.0

The RAV is an account of value maintained in accordance with the company's licence in the PCFM. It is updated each year by Ofgem's annual iteration process (AIP).

[Description of the adjustments to reflect enduring value, for example:] The RAV represents the economic value of future revenues secured as a result of past net investment and performance in respect of the company's totex programmes. The RAV amount included in the PCFM may not include all such value, for example if the company anticipates that Ofgem will determine additional totex allowances in respect of projects on which expenditure has already commenced. It may also overstate value, for example if incentive value accrued in the RAV in respect of past expenditure savings relates to expenditure reprofiling rather than savings solely through efficiency. The company has made provision adjustments to ensure the net regulatory asset value reflects enduring value to investors

[Description of the main uncertainties, including where the company's valuation adopts assumptions about future regulatory determinations, the nature and expected timing of those determinations, the criteria that Ofgem would be expected to apply in reaching those determinations and enough information to give readers a broad understanding of the uncertainties involved.]

8 K-FACTOR

	£m
K factor accrual at 31 March 20XW	(2.8)
Adjustments relating to prior years due to PCFM movements	-
Updated K factor accrual at 31 March 20XW	(2.8)
K factor arising in the year	(20.9)
K factor applied in allowed revenues for 20XW-XX	-
Interest allowed	
Accrued K factor at 31 March 20XX	(23.7)

9 OTHER REGULATORY BALANCES

	31 March 20XW £m	Adjustments relating to prior years due to PCFM movements £m	Incentive or adjustment gain/(loss) £m	Amount incurred/ recognised in the year £m	Amount included in allowed revenues £m	Time value of money/ interest £m	Indexation £m	31 March 20XX £m
Output incentives								
Broad measure of customer satisfaction incentive	2.5	-	0.5		-	0.0		3.1
Environmental emissions incentive	2.6	-	2.8		-			5.4
Shrinkage roller	0.8	-	0.6		-			1.5
Accrued discretionary reward scheme incentive	0.3	-	-		(0.3)			-
Output incentives subtotal	6.2	-	4.0	-	(0.3)	0.0	-	9.9
Adjustments to reflect enduring value		-						-
Accrued output incentives	6.2	-	4.0	-	(0.3)	0.0	-	9.9
Pension deficit funding								
Pension deficit true-up	38.8	-		8.270	(5.2)		0.360	42.2
Pension True up from previous price controls								-
Pension admin and PPF levy				0.1	(0.1)			-
Pension deficit subtotal	38.8	-	-	8.4	(5.3)	-	0.360	42.2
Adjustments to reflect enduring value								-
Accrued pension deficit funding true-up	38.8	-	-	8.4	(5.3)	-	0.360	42.2
Other regulatory true-ups								
Accrued MOD values	(0.4)				0.677	0.060	(0.001)	0.3
Passthrough accruals	(1.1)	-	-	110.8	(112.655)	(0.124)	(0.017)	(3.2)
Miscellaneous passthrough accruals	(0.1)	-	-	-	(0.023)			(0.1)
Passthrough difference			0.9		(0.9)			-
RPI accruals (excluding true-up)	1.9	-			12.8			14.8
RPI true-up accruals	-	-		-	-			-
Network innovation allowances			(0.7)	3.2	(2.5)			-
Other legacy items from previous price controls			(0.3)		0.3			
Subtotal	0.3	-	(0.0)	114.0	(102.3)	(0.1)	(0.018)	11.8
Adjustments to reflect enduring value	15.0		(4.0)					11.0
Total other regulatory true-ups	15.3	-	(4.0)	114.0	(102.3)	(0.1)	(0.018)	22.8
Total other regulatory balances	60.3	-	(0.1)	122.4	(107.9)	(0.0)	0.342	75.0

Note on MOD

The revenues that the company is able to recover through its price controlled tariffs are subject to Ofgem's annual iteration process (AIP). The AIP each year updates base revenue allowances, the main component of allowed revenues. MOD for a year represents the difference between the updated base revenue allowance and the opening base revenues that were determined by Ofgem at the last price control review.

The company anticipates the MOD that will apply to 20XY-XZ, determined in Ofgem's AIP in 20XX due shortly after finalisation of these accounts, will be a negative adjustment to base revenues of £?.?m (20XW AIP for 20XX-XY: £?.?m).

Outturn MOD in the 20XW AIP was £?.?m, a difference of £?.?m. This difference arose from a determination in respect of [description] which Ofgem made after RIIO accounts for 20XV-XW were finalised.

Accrued MOD values in other regulatory balances represent the value of future MOD accrued by the end of the year. It does not include adjustments in respect of depreciation and return on the RAV after 31 March 20XX that were included in the MOD in the 20XW AIP and will be included in the 20XX AIP since these relate to the RAV balance on 31 March 20XX.

[Notes on other regulatory balances as required to help readers understand their nature and any uncertainties involved.]

10 NET DEBT

Movements in net debt during the year	£m
Net debt at 31 March 20XW	(900.0
Equity Issued	10.0
Revenues	609.5
Totex	(196.3
Non-controllable opex	(110.8
Asset disposal proceeds	10.0
Pension admin and PPF levy costs	(0.1)
Funded pension deficit repair contributions	(8.3)
Unfunded pension deficit repair contributions	(5.0)
NIA expenditure	(3.2)
Net interest	(50.0)
Tax payments	(40.0)
Dividends	(30.0)
Revenue from non-regulated activities	10.0
Operating expenditure on non-regulated activities	(5.0)
Net additions to fixed assets for non-regulated activities	(10.0)
Movement in creditors	(20.0)
Movement in debtors	9.0
Net debt at 31 March 20XX	(730.1

Reconciliation of net debt to statutory accounts

[Net debt includes all financing balances, including cash. Table showing reconciliation to statutory accounts, identifying the components in the statutory accounts balance sheet included in net debt. Where a company has a December year-end, the table should show amounts included in statutory accounts as at 31 December 20XW and equivalent amounts as at 31 March 20XX.]

Analysis of net debt

[Table summarising the interest rate terms, indexation and maturity dates of net debt, identifying amounts due to or from related companies.]

[Description of the company's approach to financial risk management and hedging, identifying how much of the company's net debt obligation is covered by indexation and hedging instruments.]

11 **EXCLUDED SERVICES AND OTHER NON-PRICE CONTROLLED ACTIVITIES**

Return on excluded services and non-regulated activities

	20XV-XW	20XW-XX
	£m	£m
Other activities using assets within the RAV		
Revenues		
Operating costs		
Return on other activities using assets within the RAV	-	-
Activities using assets outside the RAV		
Revenues		10.0
Operating costs		(5.0)
Depreciation and other value adjustments		(2.0)
Return on activities using assets outside the RAV	-	3.0

Fixed assets: activities using assets outside the RAV

	£m
Book value at 31 March 20XW	20.0
Net capital expenditure	10.0
Depreciation	(2.0)
Book value at 31 March 20XX	28.0

12 **PENSION SCHEME DEFICIT NOT FUNDED THROUGH ALLOWED REVENUES**

[Description and analysis of residual exposure to obligations to pension schemes sponsored by the company after taking account of consumer funding of established deficits.]

Appendix 3 - Draft licence condition for RIIO Accounts

Condition 44. RIIO Accounts

Introduction

44.1 This condition requires the licensee to produce and publish RIIO accounts in respect of each Regulatory Year and sets out:

(a) transitional arrangements with respect to Regulatory Accounts;

(b) the statements that are to be included in the licensee's RIIO Accounts;

(c) a requirement for the licensee's RIIO Accounts to be prepared under the Regulatory Financial Reporting Standard (RFRS) issued by the Authority for that purpose;

(d) a requirement for the licensee to have its RIIO Accounts audited; and

(e) the timings by which RIIO Accounts must be prepared, audited and published by the licensee.

44.2 This condition also sets out the process under which the Authority will issue and modify:

(a) the RFRS; and

(b) the RIIO Accounts Support Module (RASM) referred to in the RFRS.

Purpose of RIIO Accounts

44.3 The purpose of RIIO Accounts is to provide accurate and meaningful information on the licensee's regulatory financial performance and position in a format that will be particularly useful to the investment community so as to promote:

(i) efficient financing of the licensee's distribution business; and

(ii) the achievement of the objectives of the RIIO-ED1 price control arrangements.

Part A: Transitional arrangements with respect to Regulatory Accounts

44.4 Subject to paragraph 44.5, for the Regulatory Years commencing on 1 April 2015 and 1 April 2016 only, the licensee must prepare Regulatory Accounts in accordance with the requirements provided for in this condition in the form in which it was in force at XX XXX 20X

44.5 If the Authority specifies by direction that the licensee must produce RIIO Accounts for the Regulatory Year commencing on 1 April 2016 under the RFRS issued for the purposes of this condition instead of preparing Regulatory Accounts, the licensee must comply with that direction.

44.6 A direction issued by the Authority under paragraph 44.5 will be of no effect unless:

(a) before issuing it the Authority has:

(i) given Notice to all licensees in whose licence this condition has effect that it proposes to issue a direction requiring the licensee to produce RIIO Accounts for Regulatory Year 2016/17;

(ii) specified in the Notice referred to in subparagraph (i) the period (which may not be less than 28 days from the date of the Notice) within which the licensee may make representations to the Authority about its proposal; and

(iii) considered any representations duly received in response to the Notice referred to in subparagraph (i);

and

(b) the Authority issues the direction on or before 31 October 2016.

Part B: Licensee's obligations under this condition

44.7 Subject to the transitional arrangements set out in paragraphs 44.4 to 44.6, unless and so far as the Authority otherwise consents, the licensee must:

(a) produce RIIO Accounts under the RFRS in respect of each Regulatory Year;

(b) arrange for its RIIO Accounts to be audited in accordance with the provisions of Part F of this condition;

(c) publish its audited RIIO Accounts on its Website by 30 September following the end of the Regulatory Year to which those RIIO Accounts relate, such publication to include the presentation of the constituent numerical values and associated labels in CSV File;

(d) keep a copy of its most recent RIIO Accounts at the disposal of members of the public at its principal place of business; and

(e) have in place and maintain appropriate systems, processes, procedures and records to enable it to carry out its obligations in subparagraphs (a) to (d).

Part C: Statements to be included in RIIO Accounts

44.8 The following statements must be included in the licensee's RIIO Accounts:

(a) a Regulatory Financial Performance Statement;

(b) a Regulatory Financial Position Statement;

(c) a Regulatory Cash Flow Statement; and

(d) a Regulatory Governance Statement,

prepared in each case under the RFRS.

Part D: Scope of the Regulatory Financial Reporting Standard

44.9 The RFRS may include requirements for:

(a) the format and content of the statements set out in Part C;

(b) the basis for ascertaining:

(i) opening balance positions;

(ii) relevant values referred to in Regulatory Instructions and Guidance applicable to the licensee;

(iii) expected adjustments to price control parameters applicable to the licensee provided for in the special conditions of the licence; and

(iv) well-reasoned adjustments for the purpose of fairly presenting the licensee's regulatory financial performance and position, for use in the production of the statements set out in Part C;

(c) the elective use of the RASM by the licensee for the purpose of preparing the statements set out in Part C; and

(d) [any additional matters to be covered by the RFRS as developed].

Part E: Process to issue and modify the Regulatory Financial Reporting Standard and the RIIO Accounts Support Module

44.10 The Authority will issue, and may modify:

(a) the RFRS; and

(b) the RASM,

by issuing a direction for that purpose to every licensee in whose licence this condition has effect.

44.11 A direction issued by the Authority under paragraph 44.10 will be of no effect unless, before issuing it, the Authority has:

(a) by Notice to all licensees in whose licence this condition has effect, set out the form of or, as applicable, the modifications to:

(i) the RFRS; and

(ii) the RASM,

that it proposes to direct;

(b) specified in the Notice the reasons for the Authority's proposals;

(c) specified in the Notice the date on which it proposes that the RFRS, RASM, or modifications should take effect;

(d) specified in the Notice the period (which may not be less than 28 days from the date of the Notice) within which the licensee may make representations to the Authority about its proposals; and

(e) considered any representations duly received in response to the Notice.

44.12 The requirements for the issuing of, or modification to the RFRS or the RASM set out in paragraph 44.11 may be satisfied by actions taken by the Authority before as well as after the coming into effect of the of this condition in its present form.

Part F: Requirement for audit of RIIO Accounts

44.13 Unless the Authority otherwise consents, the licensee must at its own expense, procure an audit by an Appropriate Auditor of its RIIO Accounts and a report by the Appropriate Auditor, for inclusion in the licensee's published RIIO Accounts.

44.14 The Auditor's report under paragraph 44.13 must state whether, in his opinion the licensee's RIIO Accounts fairly present its regulatory financial performance and position under the RFRS in respect of the Regulatory Year under report.

Part G: Agreed Upon Procedures in relation to the prohibition of cross-subsidy and discrimination applicable to the licensee

44.15 The licensee must at its own expense appoint an Appropriate Auditor for the completion of Agreed Upon Procedures in relation to the prohibition of cross-subsidy and discrimination generally and in particular under paragraph 9 of standard condition 4 (No abuse of the licensee's special position) and under standard conditions 19 (Prohibition of discrimination under chapters 4 and 5) and 39 (Prohibition of discrimination under chapter 9).

44.15 The contract of appointment with the Appropriate Auditor must require that the Agreed Upon Procedures are conducted in relation to each Regulatory Year and that the Appropriate Auditor addresses a report to the Authority by 31 July following the end of each Regulatory Year that:

(a) states that he has, in a manner consistent with the relevant auditing standards, completed the Agreed Upon Procedures issued by the Authority in respect of the Regulatory Year under report; and

(b) sets out his findings.

44.16 If the Authority is satisfied that the report referred to in paragraph 44.15 demonstrates that the licensee has complied with the obligation to avoid discrimination and cross-subsidies that is specified in Article 31 of Directive 2009/72/EC of the European Parliament and of the European Council of 13 July 2009 and is imposed on the licensee by the standard conditions of this licence referred to in paragraph 44.14, the report will be deemed to represent the results of an audit of that obligation, as required by the Article.

Part H: Interpretation

44.17 For the purposes of this condition:

CSV File	means a 'comma-separated values' electronic file in which each numerical value and its associated label comprises a data record in plain text, separated by a comma (or other field separator) from the next data record
Regulatory Accounts	means the accounts of that name referred to in this condition in the form in which it was in force at XX XXX 20XX
Regulatory Cash Flow Statement	means the statement of that name referred to in the RFRS
Regulatory Financial Performance Statement	means the statement of that name referred to in the RFRS
Regulatory Financial Position Statement	means the statement of that name referred to in the RFRS

Regulatory Financial Reporting Standard	means the document referred to in paragraph 44.1(c) of this condition
Regulatory Governance Statement	means the statement of that name referred to in the RFRS
RIIO Accounts	means the accounts of that name that the licensee is required to prepare under this condition and which are referred to in the RFRS
RIIO Accounts Support Module	means the Excel® workbook of that name which will be issued to the licensee under the provisions contained in Part E of this condition.

Appendix 4 – Draft regulatory corporate governance principles

Introduction

These principles expand on the principles of corporate governance set out in the UK Corporate Governance Code (UK Code) to help boards of directors and users of accounts interpret the UK Code's application to licensed operators of energy networks subject to price control under RIIO. They may also be relevant to the governance of groups that contain licensee companies.

These principles are not a rigid set of rules and an alternative to following them may be justified in particular circumstances if good governance can be achieved by other means. A condition of doing so is that the reasons for it should be explained clearly and carefully to shareholders in the company's annual RIIO accounts.

The main focus of these principles remains the relationship between the company and its shareholders. In light of their regulated status, companies are encouraged to recognise the role of other stake holders and to confirm the board's interest in listening to their views and understanding their interests insofar as these are relevant to the licensee company's overall approach to governance.

While governance of a company is the responsibility of that company's board, these principles recognise that some aspects of the governance of a company subject to licence obligations may be shared with companies within a group. It would be for the company's board of directors to be satisfied that the company's governance, taking all aspects together, operates in the company's interest and meets appropriate standards.

Leadership

RA1 When setting the company's values and standards and ensuring that its obligations to its shareholders and others are understood and met, the board is encouraged to recognise the obligations the company has under its licence. The board is also encouraged to recognise that the longer term success of the company's licensed businesses depends on effective engagement with, and maintaining the shared interest of, a wide range of other stakeholders - including consumers and the regulator.

Effectiveness

RB1 When identifying in the annual report each non-executive director it considers to be independent, if relevant, the board should refer to the company's licence requirement to have two Sufficiently Independent Directors, explain the roles played by those directors, and explain the governance relationships between any wider group and the company.

Accountability

RC1 These principles are relevant to the annual RIIO accounts of a company that is required to prepare them and should be considered by the board in presenting its statement of regulatory corporate governance.

RC2 In exercising its responsibility to present a fair, balanced and understandable assessment of the company's position and prospects, the board should take account of the company's regulated business model and the wider range of stakeholders who have an interest in and an ability to influence its future.

RC3 The directors' explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company should refer to the regulatory incentive regime the company operates under, and the shared interests of consumers and investors in the company's success.

RC4 Reflecting the benefit-sharing nature of the regulatory regime the company's licensed businesses operate under and that demonstrating benefits for consumers helps maintain the perceived legitimacy of the regime, the directors should explain how consumers have benefited from performance alongside the benefits for shareholders. The directors should also explain how they satisfy themselves that the company's participation in the governance of pension schemes and industry code governance arrangements promote the interests of consumers as well as of shareholders.

RC5 In explaining the basis on which the company preserves value over the longer term (the business model), the directors should describe how the ring fence conditions and price control arrangements in the company's licenses help ensure the company's longer term financial viability.

RC6 In confirming their robust assessment of the principal risks facing the company, the directors should describe how the principal risks affecting consumers, both in terms of tariff and service levels and in the shorter and longer term, are being managed or mitigated.

RC7 The board's report on its review of the company's risk management and internal control systems should cover its controls over compliance with its licence obligations.

RC8 The board should satisfy itself that the terms of reference for the main role and responsibilities of the audit committee that the board relies on for oversight of the company's risk management and internal control systems, which may be a committee of the holding company's board, covers the company's controls over compliance with its licence obligations.

Appendix 5 – Feedback questionnaire

An editable version of this questionnaire is separately attached as a word document

Thank you for taking the time to respond to our questions. We hope all the questions are understandable, If you have any difficulties please email Reg.Finance@ofgem.gov.uk

Once the questionnaire has been completed, please send it back to us using the email address above. Please return the completed questionnaire by 17 December 2015.

Section 1 - About you	
Your name	
Job title	
Contact details	
Organisation name	
Please state whether your response is confidential or not	

Questions	**Response**
Chapter 1 – Concept and content of RIIO accounts	
1. Do you have any comments on the form and content of RIIO accounts illustrated in appendix 2?	
Chapter 2 – Timetable and licence modifications	
1. Do you agree that the four implementation planning options set out in this chapter would allow for necessary flexibility in the timetable for implementing RIIO accounts? If not please suggest an alternative option.	
2. Out of the four proposed implementation planning options we set out, which do you consider to be achievable and desirable?	
3. Do you have other comments on the draft licence condition set out in appendix 3	

Questions	Response
Chapter 3 – The Regulatory Financial Reporting Standard	
1. Do you agree that the high level principles and prescribed regulatory framework set out in chapter 3 mean that RIIO accounts can be prepared on a 'fairly presents' basis?	
Chapter 5 – Reporting on regulatory corporate governance	
1. Do you have further comments on the revised draft regulatory corporate governance principles?	
Chapter 6 – Impact assessment	
1. Do you agree with our assessment of the possible impacts?	
2. Do you think there are any other potential impacts we ought to take into account?	

Appendix 6 - Glossary

A

Allowed revenue

The amount of money that a network company can earn on its regulated business and recover from customers through its distribution or transmission use of system charges. Allowed revenue comprises base demand revenue, incentive rewards or penalties, regulatory timing differences and allowances from uncertainty mechanisms.

Annual Iteration Process (AIP)

Ofgem's Annual Iteration Process updates the PCFM each year to compute base demand revenue, an important component of a NWO's allowed revenue.

Authority/Ofgem

Ofgem is the Office of Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority (the Authority, or GEMA), the body established by section 1 of the Utilities Act 2000 to regulate the gas and electricity markets in Great Britain.

B

Base demand revenue

The core amount of money that a network company can earn on its regulated business in order to recover the efficient costs of carrying out its activities.

D

Data Assurance Guideline

Guidance issued by Ofgem on the risk assessment and data assurance activities that NWOs should perform on information submitted under RIGs, including RRPs.

I

International Accounting Standards Board (IASB)

The International Accounting Standards Board is the principal setter of accounting standards

N

Network operator (NWO)

A holder of one or more gas or electricity distribution or transmission licences. In this document, network operator primarily relates to a network operator that is subject to price control regulation under RIIO.

O

Ofgem/Authority

(See the Authority/Ofgem)

P

Price Control Financial Model (PCFM)

A spreadsheet-based model incorporated into NWO licences that annually computes base demand revenue, an important component of a NWO's allowed revenue

R

Regulatory Asset Value (RAV)

The measure of a NWO's enterprise value recognised in its licence and used in determining future revenue allowances. It represents an estimate of the initial market value of each licensee's regulated asset base at privatisation updated by subsequent net investment and incentive performance.

Regulatory Financial Reporting Standard (RFRS)

A document to be issued and maintained by Ofgem that will specify the accounting principles and disclosure requirements for RIIO accounts

RIIO

Ofgem's price control framework for network operators (stylised as
Revenue = Incentives + Innovation + Outputs)

RIIO Accounts Support Module (RASM)

A spreadsheet-based module that Ofgem is developing to assist preparers of RIIO accounts

Regulatory Instructions and Guidance (RIGs)

A document that Ofgem publishes when it sets price controls which sets out further detail on how the price control is to be implemented and how compliance with it will be monitored. In particular, RIGs provide for information to be submitted by NWOs annually in regulatory reporting packs (RRPs).

Regulatory Reporting Pack (RRP)

Information submitted by NWOs annually to Ofgem as provided for in RIGs

Return on Regulatory Equity (RORE)

The financial return achieved by shareholders in a NWO. It is expressed as a percentage of equity in the business. The aim of the RoRE measure is to provide an indication of the return achieved by the owners of a NWO which can be compared to the cost of equity originally allowed in the price control settlement and to the return achieved by other NWOs on an equivalent basis.

T

Total expenditure (Totex)

Generally consists of all the expenditure relating to a licensees regulated activities but with the exception of some specified expenditure items and in some cases is net of the proceeds of asset disposals. It is a measure of a NWO's expenditure prescribed in its licence that combines components of expenditure treated as operating expenditure (opex) and capital expenditure (capex) in its statutory accounts.