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Dear Ian,

Response to open letter consultation on Ofgem proposals to develop and introduce RIIO accounts

This letter sets out our response on behalf of Scottish Hydro Electric Transmission plc (SHET), Scottish Hydro Electric Power Distribution plc (SHEPD) and Southern Electric Power Distribution plc (SEPD) to Ofgem's consultation on the development and introduction of RIIO accounts, which are to replace Regulatory Accounts. Our response is set out to address the following aspects of the consultation:

- Content of the proposed RIIO accounts
- Proposed engagement timetable
- Draft principles of corporate governance

We have provided detailed responses to the consultation questions in the appendix to this letter as set out in the consultation document. Furthermore, we have summarised our views on these specific questions as well as any other matters we believe are pertinent to the effective development of RIIO Accounts.

Our primary comments are as follows:

- We are broadly supportive of the withdrawal of Regulatory Accounts from the reporting requirements.
- We strongly believe Ofgem should ensure that, as a result of this consultation, a holistic review is undertaken of Regulatory Reporting requirements and content between the Costs and Outputs team and Regulatory Finance teams within Ofgem and with Network Operators (NWOs). We believe this will benefit stakeholders through provision of information that is "*one source of the truth*" by avoiding duplication, unnecessary reporting overlap, timing discrepancies and excessive complexity.
- We are supportive of the concept of developing a Regulatory Financial Reporting Standard (RFRS) to assist in the production of RIIO accounts. To be effective this guidance must be understandable, applicable, and pragmatic to enable consistency in reporting between

NWOs. We would encourage Ofgem to fully involve NWO's in the development and implementation of this standard.

- The timetable for implementation of RIIO accounts appears challenging and given the complexity of the subject, number of interested parties and importance of this change in Regulatory Reporting, we believe it will need to be extended. During discussions with Ofgem, it was stated that 2015/16 would be a trial year for RIIO accounts that would not be published, whereas the consultation document indicates March 2016 as the “*implementation date*”. We would appreciate clarification of Ofgem’s intentions for 2015/16 and the full implementation date for external publication.
- We strongly believe Ofgem should consider a publication date later than 31 July following the regulatory year for RIIO Accounts. The current proposed date will prove extremely challenging and will increase the Regulatory Reporting burden on NWOs substantially, primarily due to the necessity for Cost and Outputs Regulatory Reporting to be complete prior to the completion of RIIO Accounts compared to the concurrent process with Regulatory Accounts. Therefore, a later date of 30 September would more align with the RIIO Performance Reporting stipulated by the licences¹ for Costs and Outputs as well as allowing time for full data assurance to be undertaken, clarification of incentive revenues and NWO sign off and approval. This will lead to more complete, accurate and informative information being publically available to all interested parties.
- We would strongly advocate a multilateral approach including the relevant audit firms and their technical representatives to ensure that an appropriate level of assurance can be obtained for RIIO accounts.
- We believe clarity is required regarding NWO’s requirements to comply with the Regulatory Corporate Governance (Regulatory Code) in the context of the Data Assurance Guidelines (DAG), and how these elements relate.

We believe it would be beneficial for Ofgem to clarify the engagement they have had with stakeholders to date and how this has informed Ofgem’s preliminary views set out in the consultation. We believe this feedback on the current form of Regulatory Reporting, namely Regulatory Accounts, and the proposed RIIO accounts, should be from a balanced and diverse range of stakeholders.

We welcome and look forward to further engagement on RIIO Accounts and would be more than willing to discuss our views further to help inform the development this change to Regulatory Reporting.

Yours sincerely,



Finance Director
Scottish and Southern Energy Power Distribution

¹For RIIO-ED1, the relevant SLC is 50/RIGs and consultation document for performance reporting is here: https://www.ofgem.gov.uk/sites/default/files/docs/2015/04/the_regulatory_instructions_and_guidance_for_the_electricity_distribution_network_operators_price_control_riio-ed1_0.pdf
For RIIO-T1, the annual performance report obligations contained within the RIGs.

Appendix

Question 1: Do you have any comments on the withdrawal of the current regulatory accounts as specified in 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?

In principle we have no strong objections to the withdrawal of Regulatory Accounts as required under the relevant licence condition. The provision of financial information to our shareholders and investors forms part of our annual Group reporting cycle in May each year. Therefore any information included in the Regulatory Accounts is often considered supplementary and has not seemed to provide value to our shareholders, investors or wider stakeholders based on our experience of each reporting cycle.

Overall, we would welcome the simplification and alignment of Regulatory Reporting where possible and believe RIIO Accounts may achieve this if implemented accordingly. As such, we believe further discussion is required with NWOs and Ofgem covering all aspects of Regulatory Reporting requirements. In addition we encourage Ofgem to ensure there is alignment on timing and content in the publication of information between the Regulatory Finance and the Cost and Outputs teams within Ofgem. This would help inform the discussion of RIIO accounts content and timing before proceeding to full implementation.

In addition, we would encourage Ofgem to review the requirements for other audited regulatory information such as the Agreed Upon Procedures information required in relation to revenue reporting and EU cross subsidy. This would allow the alignment and relevance of all regulatory financial information requirements to be assessed.

Question 2: Do you agree with the use of RFRS principles as a basis for the preparation of RIIO accounts? If not, please give further information why.

Without seeing the substance and form of the proposed RIIO accounts or having worked through this in practice, it is difficult to support the principle in full without reservations. However, the concept of an RFRS would be an appropriate addendum to RIIO accounts assuming it provides the necessary guidance that is understandable, applicable, and pragmatic. In principle we would see it as a necessary requirement for RIIO Accounts to effectively achieve their objectives including provision of consistent information across NWOs to investors and wider stakeholders. We believe it is critical that NWO's are fully involved with Ofgem and other stakeholders in the development and implementation of the RFRS principles.

Question 3: Do you agree that the new framework for reporting on Network's financial position and performance would be more beneficial to users and stake holders? If you don't please explain.

With regards to the proposed content of RIIO Accounts, the framework set out in the consultation and in previous meetings does not seem unreasonable conceptually. The theoretical concepts for reporting the economic performance of NWOs seem reasonable and cover the primary aspects we consider of importance to stakeholders, namely, returns, RAV, revenue, incentive performance and capital expenditure. Delivering these will be challenging

and the proposal to operate a *dry run* for 2015/16 as proposed by Ofgem during discussions with NWOs seems necessary if somewhat ambitious. We would appreciate clarification of Ofgem's intentions for 2015/16 and the full implementation date for external publication as the consultation document indicates March 2016 as the "*implementation date*".

We would be concerned with any attempt to "*reconcile*" the economic financial statements to that included in statutory financial statements due to the complexity and usefulness to stakeholders. Any attempt to undertake such a reconciliation would be likely fraught with difficulties and would be hard to make *simple* which seems contradictory to the objectives of RIIO accounts. Additionally, where NWOs do not have a statutory year end of 31 March, any reconciliation would be extremely difficult and would add to the regulatory burden furthermore unnecessarily.

We believe it would be beneficial for Ofgem to detail the feedback they have had with stakeholders to date and how this has informed their views. The feedback obtained should be from a balanced and diverse range of stakeholders and considerate of the work ongoing to develop Performance Reporting for Electricity DNOs² and other NWOs (for example Annual Performance Report required under RIGs for Electricity Transmission and Gas Distribution). Ofgem's objectives for that process are to determine:

- *what information can be made available and what is useful for stakeholders to see*
- *who should be providing the information - us or DNOs*
- *how the information should be presented*
- *when the information should be provided, which will consider both how often and how quickly information can be shared.*

We believe that the development of RIIO accounts interlinks strongly with this process and should operate in parallel. This would mitigate the risk of producing information that does not achieve its objectives, is overly complex, has various timing deficiencies, and is duplicated in other Ofgem/NWO publications which may confuse stakeholders.

Question 4: Do you have any comments on the principles stated in the statement of regulatory corporate governance contained in Appendix 1 of this letter and do you support the development of such principles?

In principle, the statement of regulatory corporate governance appears uncontroversial. However, there is a large degree of overlap through the UK Corporate Governance Code (UK Code) for which we apply for our overall Group, SSE plc, and this may not be of additional value to investors in the presence of an already robust framework for corporate governance. A statement of corporate governance would be appropriate to include in a set of "*Accounts*" and as such whether this is the UK Code or a Regulatory Code seems inconsequential.

We believe it would be beneficial for Ofgem to clarify the overlap and interaction between the obligations on NWOs under DAG and this new statement of corporate governance under a Regulatory Code.

²For RIIO-ED1, the relevant SLC is 50/RIGs and consultation document for performance reporting is here: https://www.ofgem.gov.uk/sites/default/files/docs/2015/04/the_regulatory_instructions_and_guidance_for_the_electricity_distribution_network_operators_price_control_riio-ed1_0.pdf
For RIIO-T1, the annual performance report obligations contained within the RIGs.

Question 5: Do you have any comments on the proposed time line in Appendix 3?

The timetable for delivery of RIIO Accounts is challenging. We believe NWOs and interested stakeholders require further granularity of the timeline to determine whether it can be achieved as set out. For example, RFRS only denotes “*activities*” but does not indicate first and second drafts, consultations or involvement of the audit or accounting profession in its development. Similarly, we have not been able to review the proposed PCFM module as indicated in the timetable. We have also not been privy to a proposed audit opinion or level of work that may be required to obtain assurance over the RIIO Accounts by the auditors of NWOs. We do believe that extending the timetable for completion of a 2015/16 *dry run* would be advantageous and more realistic in achieving the proposed 2016/17 full roll-out.

We believe the timing for publishing RIIO accounts needs to be reconsidered in the context of the regulatory reporting process and burden on NWOs. The current date for publishing Regulatory Accounts is 31 July after the regulatory year with RIIO accounts being proposed as the same publication date. However, the regulatory accounts are audited in parallel to the Regulatory Reporting process for Costs and Outputs tables, and as such can be completed in the set timescales.

The RIIO accounts, as proposed, require a significant input from the Costs and Outputs tables which are not finalised until well into July due to their complexity, granularity and the required data assurance and internal sign off processes. RIIO Accounts could not be complete until after the finalisation of Costs and Outputs tables. Therefore a 31 July publication date would seriously challenge the quality, accuracy, internal data assurance and auditability of the RIIO Accounts. Additionally, incentives are not finalised with Ofgem by 31 July, with some not being directed to later in the year. By pushing the publication date for RIIO Accounts to later in the year (i.e. 30 September for the Annual Performance Report in RIIO-T1 or 31 October as set for Business Plan Commitments Reporting per SLC 50 for RIIO-ED1), Ofgem would allow sufficient time for RIIO accounts to be audited fully, as well as removing discrepancies in timing of published data. This would allow Ofgem to finalise data and direct NWOs for incentives and would align the Cost and Outputs Performance Reporting and RIIO accounts to the same time using the same information.

Question 6: Do you have any comments on our proposal to develop an audit opinion that provides assurance on the proposed RIIO accounts on a ‘fairly presents’ basis?

We have concerns around the level of assurance that our auditors or the audit profession could provide over a set of RIIO Accounts in absence of understanding the detailed mechanics of the PCFM, and in particular the *comfort* over the data that would be required to populate it. We strongly advocate that all of the relevant audit firm’s technical representatives are fully involved and engaged throughout this process.

We strongly believe that the requirement to provide a reconciliation between the regulatory and statutory financial information would be highly problematic, difficult, and ultimately of no value to investors and stakeholders (as outlined in our response to question 3).

Question 7: What are your expectations on how NWO boards should report on their governance (comments from investors are particularly welcome)?

We are supportive of the UK Code and the requirements for NWOs to report on their compliance with this code. We believe Ofgem must ensure the Regulatory Code is not simply a tailored version of the UK Code for NWOs rather than continuing to advocate for inclusion of UK Code statements in a NWOs Statutory Financial Statements on the basis they are *pseudo* listed (if they are not part of a listed Group or applying an exemption). We are part of a larger FTSE 100 listed Group in SSE plc and therefore are already subject to the UK Code and apply this in our Regulated subsidiaries. We therefore provide a significant amount of detail in our accounts for both the Group and subsidiaries covering compliance with the UK Code.

We cannot comment regarding investors interest in such statements, and believe we provide appropriate information on how our NWOs Board reports on our compliance with the UK Code.

We believe Ofgem should clarify how these principles will interact with the obligations on NWOs under the DAG and the timing discrepancies that will reside in the publication of RIIO accounts prior to all information being finalised (such as totex expenditure or incentives performance).

Question 8: Please use this section to let us know of any other thoughts you might have on the introduction of RIIO accounts.

We have set out our primary comments and concerns above.