

# Guidance

ESO PCFM Guidance			
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This document provides instructions and guidance to licensed network operators to enable them to complete the reporting requirements associated with updating various variable values and performance data in the Price Control Financial Model (PCFM) during the Annual Iteration Process (AIP).

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## 1. Introduction

### Background

1.1. The PCFM Guidance provides network operators (licensees) with information on how to fill out the PCFM Variable Values and any underlying templates that feed into them, which they are required to submit to us for each Annual Iteration Process (AIP).

1.2. It also sets out the required information that should be submitted to Ofgem in the supporting narrative commentary.

1.3. This document should be read in conjunction with chapter 2 of the ESO Price Control Financial Handbook, which contains a detailed description of the PCFM modification process and the AIP dry runs process. Additionally, this document should be read in conjunction with Appendix 1 ('Glossary') of the ESO Price Control Financial Handbook.

### Legal Framework

1.4. The modification and governance process for the Price Control Financial Model (PCFM) and Price Control Financial Handbook (PCFH), collectively known as the Price Control Financial Instruments, is set out in Special Condition 5.1 (*Governance of the ESO Price Control Financial Instruments*).

1.5. The modification and governance process for the PCFM Guidance and the steps of the Annual Iteration Process are set out in Special Condition 5.2 (*Annual Iteration Process for the ESO Price Control Financial Model*).

### Purpose

1.6. The purpose of this document is to provide guidance to enable the licensee to complete each dry run of an AIP that is submitted to Ofgem. As described in ESO Price Control Financial Handbook, the dry runs process entails amending and confirming values for each Regulatory

Year over a number of months, from 31 July<sup>1</sup> to early November, on an iterative basis to account for updates to the Variable Values as they become known.

1.7. This document provides:

- instructions and guidance on how to populate the PCFM Variable Values for submission for an Annual Iteration Process;
- guidance on the process and timeframe for reporting and submitting the required data; and
- any requirements that apply to supporting information, documentation or commentary to be submitted.

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<sup>1</sup> For the first submission of RIIO-2, this date has been moved to 31 August 2021.

## 2. The Price Control Financial Model

### Background

2.1. We set ex-ante allowed revenues for each licensee at the outset of the RIIO-2 price control based on the information available at the time.

2.2. Throughout the price control, we use the AIP to update the variable values in the PCFM by updating inputs for actual expenditure and performance as well as updating forecasts for the latest view.

2.3. The revenue calculation macro in the model is then re-run to capture this new information and to calculate an adjustment to allowed revenue ( $SOIAR_t$ ) using the latest information.

2.4. This model and the re-calculated value of  $SOIAR_t$  as well as the adjustment to revenue known as  $ADJR_t$  is published on Ofgem's website by 30 November each year and is the value that licensees must use to set their charges for the forthcoming Regulatory Year under Special Condition 4.1 (*System Operator Internal Revenue restriction*).

### Model structure

2.5. The table below sets out the structure and contents of the sheets in the PCFM:

Sheet	Contents
Cover	Content directory and Model key
UserInterface	<p>This sheet contains company and year selector switch allowing the user to switch between companies and Regulatory Years.</p> <p>It also includes the "RunForOne" and "RunForAll" macro buttons, enabling the user to perform the model's recalculation function for either just the selected licensee or all licensees.</p>
Input and Calculation sheets:	The 'SystemOperator' sheet is an input sheet where the blue and grey shaded inputs, also known as the PCFM

SystemOperator SOIAR	<p>Variable Values, which should be updated as part of an AIP. These are the values that this guidance document pertains to, unless otherwise specified. This sheet is the starting point for all calculations in the PCFM and contains all the inputs necessary to calculate all the components of SOIAR<sub>t</sub>.</p> <p>The 'SOIAR' sheet is a calculation sheet and will be auto-populated by the model when the inputs are updated for each AIP. The calculations within the majority of these sheets follow the algebra set out in the special licence conditions.</p>
Results sheets	<p>The "LiveResults" sheet shows a live summary of the changes to the components of SOIAR<sub>t</sub>, following any input updates. The values in this sheet update automatically following any changes to inputs to the year or company selector switch. This sheet shows results for the selected company.</p> <p>The "SavedResults" sheet hard-codes the values in the "LiveResults" sheet for comparison and record-keeping purposes, after the RunForOne or RunForAll macro has been run in the "UserInterface" sheet. This sheet shows the summary of results for all companies.</p>
Monthly Inflation input sheet Annual Inflation input sheet	<p>The "Monthly Inflation" sheet shows the values for monthly outturn and forecast price indices relating to the Retail Price Index (RPI), Consumer Price Inflation including owner-occupiers' housing costs (CPIH) and Price index (PI), as defined in chapter 2 of PCFH.</p> <p>The "Annual Inflation" sheet shows the derivation of annual indices and inflation rates by aggregating the data in the "Monthly Inflation" sheet.</p>

	The inflation rates in the “Annual Inflation” sheet are used to derive “real to nominal” conversion factors used throughout the PCFM in relation to 2018/19 price base.
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## Supporting models

2.6. As well as the PCFM itself, licensees must submit a number of other templates and files, the values from which will feed into the PCFM Variable Values table. These include but are not limited to:

- Cost and Volumes Regulatory Reporting Pack<sup>2</sup>
- ESO Revenue workbook<sup>3</sup>
- Tax workbook<sup>4</sup>
- Legacy ESO PCFM
- RIIIO-1 ESO Revenue RRP

## Reporting timescales

2.7. The licensee must submit the PCFM, the required supporting models and commentary to the Authority by 31 August 2021 and by 31 July prior to each Regulatory Year t, thereafter<sup>5</sup>.

2.8. Ofgem will maintain up-to-date copies of and make any required modifications to the PCFM and its supporting models, the PCFH and the PCFM Guidance on an annual basis in accordance with the relevant governance processes set out in Special Conditions 5.1 and 5.2.

2.9. To allow licensees sufficient time to populate a PCFM for submission, modifications will be reflected in the version of the PCFM to be used for an upcoming AIP by 1 June 2021 and 1 May prior to each Regulatory Year, thereafter.<sup>5</sup>

<sup>2</sup> Applicable to future Regulatory Years only (regulatory period starting 2022/23).

<sup>3</sup> The ESO Revenue workbook is to be submitted for the submission due on 31 August 2021, only. In future periods, the calculations in this workbook will be moved into the Cost and Volume RRP.

<sup>4</sup> Applicable to future Regulatory Years only (regulatory period starting 2022/23).

<sup>5</sup> See the PCFM functional cut-off dates set out in Table 2.1 of the ESO PCFH.



2.10. There will be one or more dry runs of the PCFM between the licensee's initial submission of the ESO PCFM and the final run in early November. The number of dry runs needed will depend on the number and timing of variable value updates required for the licensee in any particular Regulatory Year.

2.11. The AIP will be completed by 30 November prior to each Regulatory Year  $t$ , or as soon as is reasonably practicable thereafter. The deadline of 30 November reflects the need for the licensee to have confirmation of its Allowed Revenue in time to calculate and set its use of system charges.

2.12. The steps of the AIP are specified in Special Condition 5.2, Part A and the process is further described in the ESO PCFH.

## Submissions

2.13. By 31 August 2021 and by 31 July prior to each year Regulatory Year  $t$  thereafter<sup>6</sup>, the licensee must submit to the Authority the ESO PCFM, with a completed variable values table (covering activity in the prior Regulatory Year and changes to forecast activity<sup>7</sup>), which has been run to calculate  $SOIAR_t$ .

2.14. As well as this, the licensee must submit the relevant supporting models used to derive the variable values and any relevant commentary. For the first submission due on 31 August 2021, the variable values in the "PCFM inputs summary" sheet of the ESO Revenue workbook should be linked to the "SystemOperator" sheet of the ESO PCFM.

2.15. All of the documents submitted as part of a dry run of the AIP must be sent to the Authority either through email or a secure file-sharing application such as Huddle.

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<sup>6</sup> See the PCFM functional cut-off dates set out in Table 2.1 of the GD2 PCFH.

<sup>7</sup> Variable Values for Regulatory Years later than Regulatory Year  $t$  do not feed into the calculation of the term  $SOIAR_t$ . Therefore, calculated values in the PCFM for Regulatory Years later than Regulatory Year  $t$  represent only a forecast. This is without prejudice to the status of the Variable Values concerned, which may have been decided and/or directed under licence conditions and which may or may not be subject to subsequent revision.

## Forecasting

2.16. The AIP allows for PCFM Variable Values to be updated during the course of the price control for outturn actual data as well as forecast data.

2.17. Where a PCFM Variable Value is not known at the time of submission, we expect the licensee to forecast a value using its best estimate under Special Condition 5.2.

2.18. It is acknowledged that forecasts will not be as accurate as actual reported data and that all forecasts will be made with a view to truing-up at a subsequent dry run or AIP, however we expect that the inclusion of forecasts will reduce the magnitude of any subsequent true-ups and reduce revenue volatility.

## Price base

2.19. As described in chapter 2 of the ESO PCFH, when ascertaining calculated revenue, the ESO PCFM works in a constant 2018/19 price base except in respect of some calculations internal to the model that use nominal prices, eg, tax and legacy calculations.

2.20. The price base for each PCFM Variable Value is set out in the PCFM input sheets, for the avoidance of doubt.

## Related documents

ESO Price Control Financial Handbook

ESO Price Control Financial Model

ESO Regulatory Instructions and Guidance (RIGs)

ESO Regulatory Financial Performance Reporting

ESORI Arrangements Guidance Document

Other relevant Associated Documents as listed in **Table 3.1**

### **3. The ESO Price Control Financial Model Variable Values**

3.1. The variable values that can be revised during an AIP are set out in Table 3.1 below, and are also included as part of the PCFH.

3.2. For each variable value, the table provides a description, cross-references to the relevant Special Condition(s) (where appropriate), and details of Associated Documents (where relevant). It identifies a list of variable values in PCFM for which further guidance is provided either in this document or the Regulatory Instructions and Guidance (RIGs) as applicable.

**Table 3.1 - PCFM Variable Values (VV)**

VV	Description	SpC	Cross-reference / Associated Document
<b>Actual Totex</b>			
SOANC	Actual Capex		PCFM Guidance
SOACO	Actual Opex		PCFM Guidance
<b>Pass-through expenditure</b>			
RB <sub>t</sub>	Business Rates Payments	SpC 4.1, Part H	PCFM Guidance
WCF <sub>t</sub>	Additional Funding - WCF	SpC 4.1, Part G	PCFM Guidance
SOBD <sub>t</sub>	Bad Debt Allowance	SpC 4.1, Part I	PCFM Guidance
EDE <sub>t</sub>	Pension scheme established deficit	SpC 4.1, Part G	PCFH section 6, PCFM Guidance
<b>Other Revenue Allowances</b>			
NIA <sub>t</sub>	Network Innovation Allowance	SpC 4.6	PCFM Guidance, RIIO-2 NIA Governance Document
CNIA <sub>t</sub>	Carry Over RIIO-1 Network Innovation Allowance	SpC 4.7	PCFM Guidance, RIIO-1 NIA Governance Document
<b>Other Funding</b>			
ADF <sub>t</sub>	Additional Funding - Other	SpC 4.1, Part D	PCFM Guidance
ESORI <sub>t</sub>	Reporting & Incentive Arrangements	SpC 4.3	PCFM Guidance, ESORI Guidance Document
<b>Legacy Adjustments</b>			
LSOMOD <sub>t</sub>	System Operator legacy MOD	SpC 4.8, Part B	PCFH section 7, PCFM Guidance

VV	Description	SpC	Cross-reference / Associated Document
LSOTRU <sub>t</sub>	Legacy TRU term	SpC 4.8, Part A	PCFH section 7, PCFM Guidance
LSOEMRINC <sub>t</sub>	Legacy Financial Incentives on EMR	SpC 4.8, Part A	PCFH section 7, PCFM Guidance
LSORAV <sub>t</sub>	RIIO-1 net addition to RAV (including disposals)	SpC 4.9	PCFH section 7, PCFM Guidance
<b>Directly Remunerated Services</b>			
DRSR <sub>t</sub>	Directly remunerated services revenue	SpC 4.1	PCFM Guidance
DRSC <sub>t</sub>	Less directly remunerated services cost	SpC 4.1	PCFM Guidance
<b>Finance Inputs</b>			
SOCDE	Allowed percentage cost of debt		PCFH section 4, PCFM Guidance
SORFR	Risk-free rate		PCFH section 4, PCFM Guidance
AND <sub>t</sub>	Adjusted net debt		PCFM Guidance
TDNI <sub>t</sub>	Tax deductible net interest cost		PCFM Guidance
TTE <sub>t</sub>	Tax liability - tax trigger events		PCFH section 5, PCFM Guidance
TAXA <sub>t</sub>	Tax allowance adjustment	SpC 4.1, part J	PCFH section 5, PCFM Guidance
SOOGP <sub>t</sub>	Opening balance brought forward		PCFM Guidance
SOOSRP <sub>t</sub>	Special Rate capital allowance opening balance brought forward		PCFM Guidance
SOOSBP <sub>t</sub>	Structures and buildings capital allowance opening balance brought forward		PCFM Guidance
SOODRP <sub>t</sub>	Deferred revenue expenditure opening balance brought forward		PCFM Guidance
SOOIAP <sub>t</sub>	Intangible assets capital allowance opening balance brought forward		PCFM Guidance
SOOTL <sub>t</sub>	Tax loss brought forward		PCFM Guidance

<b>VV</b>	<b>Description</b>	<b>SpC</b>	<b>Cross-reference / Associated Document</b>
SOARGP <sub>t</sub>	Totex allocation to "General" tax pool		PCFM Guidance
SOARR <sub>t</sub>	Totex allocation to "Revenue" tax pool		PCFM Guidance
SOARSR <sub>t</sub>	Totex allocation to "Special rate" tax pool		PCFM Guidance
SOARSB <sub>t</sub>	Totex allocation to "Structures and Buildings" tax pool		PCFM Guidance
SOARNQ <sub>t</sub>	Totex allocation to "Non Qualifying" tax pool		PCFM Guidance
SOARDR <sub>t</sub>	Totex allocation to "Deferred revenue" tax pool		PCFM Guidance
SOARIA <sub>t</sub>	Totex allocation to "Intangible assets" tax pool		PCFM Guidance
SOCT <sub>t</sub>	Corporation tax rate		PCFM Guidance
SOGCA <sub>t</sub>	Capital Allowance rate		PCFM Guidance
SOSRCA <sub>t</sub>	Special Rate allowance rate		PCFM Guidance
SOSBCA <sub>t</sub>	Structures and buildings allowance rate		PCFM Guidance
SODRCA <sub>t</sub>	Deferred revenue expenditure allowance rate		PCFM Guidance
SOIACA <sub>t</sub>	Intangible assets allowance rate		PCFM Guidance

## 4. Instructions for completing the PCFM Variable Value table

The below table contains instructions for licensees on how to populate the PCFM Variable Values table for submission to the Authority at each dry run of an AIP.

4.1. Unless otherwise specified, all row and cell references relate to the licensee input sheets of the ESO PCFM.

4.2. Where the guidance refers to cost or other data that links to the ESO Revenue workbook from the Cost and Volumes Regulatory Reporting Pack (C&V RRP), these values should be directly input into the ESO Revenue workbook for the PCFM submission due on August 31<sup>st</sup> 2021.

4.3. The first submission of the RIIO-2 Cost and Volumes RRP will be in July 2022 and so for the first PCFM submission in August 2021, the Cost and Volume file will not be available. In the absence of this file, the ESO should enter its best estimate of forecast costs and outputs data into the yellow input cells of the ESO Revenue workbook to calculate the PCFM Variable Values that will be included in the November 2021 AIP.

4.4. The contents of the ESO Revenue workbook will be included within the Cost and Volumes RRP in all future Regulatory Years along with the required guidance for the underlying inputs, which will be included in the RIGs.

Variable Value category	Guidance for Completion
Actual Totex: <ul style="list-style-type: none"> <li>Actual Capex</li> <li>Actual Opex</li> </ul>	<p>For the values in rows 13:14, actual data for the reporting period in question should be input directly into the yellow input cells of "PCFM Input Summary" sheet, which should be used to populate the PCFM.</p> <p><b>Forecasting</b></p> <p>Forecasts for future regulatory periods should be input directly into the yellow input cells of "PCFM Input Summary" sheet, which should be used to populate the PCFM.</p>

<p>Pass-through costs:</p> <ul style="list-style-type: none"> <li>• Business Rates Payments</li> <li>• Additional Funding - WCF</li> <li>• Bad debt allowance (guidance provided below)</li> <li>• Pension scheme established deficit</li> </ul>	<p>Pass-through costs are specified costs that are predominantly outside of a licensee's control and may be passed through to consumers. These costs are defined in SpC 3.2, Pass-through items and are reported within the Cost and Volumes RRP.</p> <p>For the Variable Values in rows 18:21, actual data for the reporting period in question should be input directly into the yellow input cells of "Pass-through" sheet, which should be used to populate the PCFM.</p> <p>Where required, further detailed guidance for updating these variable values will be provided in the ESO RIGs.</p> <p><b>Forecasting</b></p> <p>Forecasts for future regulatory periods should be input directly into the "Pass-through" sheet, which should be used to populate the PCFM.</p>
Pass through costs – SO Bad Debt	<p>SO Bad Debt costs relate to any amounts that are incurred (or forecast) by the licensee due to network charges owed to it by one or more Defaulting Connection and Use of System Code Party and are treated as pass-through under SpC 4.1, Pass-through items.</p> <p>Values should be input into the yellow input cells of the bad debt section of the "Pass-through". This data is then picked up in the PCFM Input Summary sheet, which should be used to populate the PCFM.</p>



	<p>The <i>Provisional SO Bad Debt cost</i> should include the SO Bad Debt costs that ESO expects to incur including any RIIO-1 SO Bad Debt. This row contains forecasts only and should not include any actual costs, which should be input in the row below labelled <i>Actual SO Bad Debt cost incurred</i>.</p> <p>The <i>Recovered SO Bad Debt</i> value should be input as a positive value and should include the aggregate value of any bad debt recovered (including RIIO-1 SO Bad Debt ), where the costs have previously been recovered via the BDA term.</p> <p>All values should be exclusive of VAT.</p>
<p>Other Revenue allowances:</p> <ul style="list-style-type: none"> <li>• Network Innovation Allowance</li> </ul>	<p>For the value in row 25, actual data for the reporting period in question should be input directly into the yellow input cells of the "Other Revenue Allowances (ORAt)" sheet, which should be used to populate the PCFM</p> <p>Licenses must input Total NIA Expenditure excluding any expenditure which is deemed to be 'Unrecoverable NIA Expenditure', as it does not satisfy the requirements of the RIIO-2 NIA Governance Document.</p> <p>Further detailed guidance for updating these variable values will be provided in the ESO RIGs.</p> <p><b>Forecasting</b></p> <p>Forecasts for future regulatory periods should be input directly into the yellow input cells of the</p>

	"Other Revenue Allowances (ORAt)" sheet, which should be used to populate the PCFM.
<p>Other Revenue allowances:</p> <ul style="list-style-type: none"> <li>Carry Over RIIO-1 Network Innovation Allowance</li> </ul>	<p>For the values in row 26, actual data for the reporting period in question should be input directly into the yellow input cells of the "Other Revenue Allowances (ORAt)" sheet,</p> <p>Further detailed guidance for updating these variable values will be provided in the ESO RIGs.</p> <p><b>Forecasting</b></p> <p>Forecasts for 2021/22 should be input directly into the yellow input cells of the "Other Revenue Allowances (ORAt)" sheet, which should be used to populate the PCFM.</p>
Additional Funding - Other	<p>The values in row 30, are a pre-determined fixed allowance of £4.8m per year as set out at paragraph 5.28 of the Final Determinations ESO Annex.<sup>8</sup></p> <p>This value does not need to be updated by the ESO, however it may be updated by the Authority during the Price Control Period in line with any licence modifications</p>
Reporting & Incentive Arrangements	<p>Reporting and Incentive Arrangements (ESORI) is used to reward or penalise licensees for their performance.</p> <p>For the values in rows 31, actual data for the reporting period in question should be input directly into the yellow input cells of the "PCFM</p>

<sup>8</sup> See [https://www.ofgem.gov.uk/system/files/docs/2021/02/final\\_determinations\\_-\\_eso\\_annex\\_revised.pdf](https://www.ofgem.gov.uk/system/files/docs/2021/02/final_determinations_-_eso_annex_revised.pdf)

	<p>Inputs Summary” sheet, which should be used to populate the PCFM.</p> <p>The value of <math>ESORI_t</math> will be directed by the Authority and will be no greater than a maximum value of £30m, in aggregate, across each 2 year period of the Business Plan Cycle and not less than a minimum value of negative £12m, in aggregate across each 2 year period of the Business Plan Cycle, as determined under Special Condition 4.3 and the ESORI Arrangements Guidance Document.</p> <p>Further detailed guidance for updating these variable values will be provided in the ESO RIGs and the ESORI Arrangements Guidance Document.</p> <p><b>Forecasting</b></p> <p>Forecasts for future regulatory periods should be input directly into the yellow input cells of the “PCFM Inputs Summary” sheet, which should be used to populate the PCFM.</p>
Legacy SOMOD	<p>Legacy values will be directed by Ofgem following the formal close-out of the RIIO-ET1 price control.</p> <p>In the interim period between the beginning of RIIO-2 and the direction of these values and the establishment of a close-out methodology, the licensee must calculate its provisional Legacy SOMOD values in accordance with the processes set out in chapter 7 of the PCFH.</p> <p>The licensee must update its legacy ESO PCFM for any outturn data relating to the 2020/21 Regulatory Year as taken from its 31 August</p>

	<p>2021 RIGs submissions. The legacy ESO PCFM must then be run to generate the legacy SOMOD<sub>2022/23</sub> value. This should then be inflated using the RPIF figure from the GD1 Revenue RRP and input in the Legacy SOMOD (LSOMOD) variable value input row in the SystemOperator sheet in the RIIO-2 ESO PCFM for 2022/23.</p> <p>The Licensee may choose to incorporate other modifications as it considers necessary to the Legacy ESO PCFM to reflect any anticipated close-out adjustments for which Ofgem has not yet provided a methodology in the Legacy SOMOD value for 2022/23.</p> <p>If the Licensee chooses to do this, it must also submit a description of the specific modifications made to the Legacy ESO PCFM along with a justification for them in its PCFM Dry Run Commentary (see section 5 of this Guidance).</p>
RIIO-1 Legacy net RAV additions (after disposals)	<p>Legacy values will be directed by Ofgem following the formal close-out of the RIIO-ET1 price control.</p> <p>In the interim period between the beginning of RIIO-2 and the direction of these values and the establishment of a close-out methodology, the licensee must calculate its provisional RIIO-1 net RAV additions (LSORAV) values in accordance with the processes set out in chapter 7 of the PCFH.</p> <p>The licensee must update its legacy ESO PCFM for any outturn data relating to the 2020/21 Regulatory Year as taken from its 31 August 2021 RIGs submissions. The legacy ESO PCFM must then be run to generate the provisional</p>

	<p>closing RAV position and this should be input in the LSORAV variable value input row in the SystemOperator sheet in the RIIO-2 ESO PCFM, covering the historical RIIO-1 period to 31 March 2021.</p> <p>The Licensee may choose to incorporate other modifications as it considers necessary to the Legacy ESO PCFM to reflect any anticipated close-out adjustments, for which Ofgem has not yet provided a methodology, in its LSORAV values.</p> <p>If the Licensee chooses to do this, it must also submit a description of the specific modifications made to the Legacy ESO PCFM along with a justification for them in its PCFM Dry Run Commentary (see section 5 of this Guidance).</p>
<p>Other Legacy adjustments:</p> <ul style="list-style-type: none"> <li>• LSOTRUT</li> <li>• LSOEMRINCT</li> </ul>	<p>Legacy values will be directed by Ofgem following the formal close-out of the RIIO-ET1 price control.</p> <p>In the interim period between the beginning of RIIO-ESO and the direction of these values following the close-out of ET1, the licensee must use the legacy values for input in rows 36:37 of the PCFM in accordance with the processes set out in the "Legacy Adjustment to Revenue section" of chapter 7 of the PCFH.</p>
<p>Directly remunerated services:</p> <ul style="list-style-type: none"> <li>• Directly remunerated services revenue</li> <li>• Less directly remunerated services cost</li> </ul>	<p>For the values in rows 42:43, actual and forecast data for the reporting period in question should be input directly into the yellow input cells of the "PCFM Inputs Summary" sheet, which should be used to populate the PCFM.</p>

	<p><b>Forecasting</b></p> <p>Forecasts for future regulatory periods should be input directly into the yellow input cells of the “PCFM Inputs Summary” sheet, which should be used to populate the PCFM.</p>
<p>Allowed return on debt (SOCDE<sub>t</sub>)</p> <p>Risk-free rate (RFR)</p>	<p>These finance inputs are calculated by the Authority using the WACC allowance model and feed into the licensee’s allowed return on capital.</p> <p>The input values in rows 47:48 are calculated and populated by Ofgem during the final dry run of each AIP, which usually takes place in early November.</p> <p>These values are sourced from the updated WACC allowance model. The methodology for the derivation of SOCDE and RFR is described in chapter 4 of the PCFH.</p>
Adjusted net debt	<p>For this variable value, actual data for the reporting period in question should be input directly into the company specific input sheets of the PCFM. The licensee may also update forecast data.</p> <p>The figures used to update this variable value should be those reported as “Net Debt as per the Regulatory (RIIO-1) definition” in the licensee’s submitted RFPR.</p> <p>See the RIIO-1 RFPR Guidance for further detail on what this value comprises.</p>
Tax deductible net interest cost	<p>For this variable value, actual data for the reporting period in question should be input directly into the company specific input sheets of the PCFM. The licensee may also update forecast data.</p>

	<p>The figures used to update this variable value should be those reported as “Net Interest as per the Regulatory (RIIO-1) definition” in the licensee’s submitted RFPR.</p> <p>See the RIIO-1 RFPR Guidance for further detail on what this value comprises.</p>
Tax liability allowance adjustments – driven by tax trigger events	<p>This value will not be applicable unless the licensee has followed the notification process set out in chapter 5 of the PCFH.</p> <p>Ofgem will provide confirmation of the final figure to be used for this variable value.</p>
Tax liability allowance adjustments	<p>This value will not be applicable unless the Authority has directed a value following a tax review under Special Condition 4.1.</p>
Capital allowance opening pools brought forward	<p>The opening capital allowance pool balances should be set using the actual pool balances as per the ESO’s CT600 return as at March 2021.</p> <p>A copy of this CT600 form should be provided alongside of the submission and referred to in the commentary.</p>
Tax loss brought forward <sup>9</sup>	<p>Legacy values will be directed by Ofgem following the formal close-out of the RIIO-ET1 price control.</p> <p>In the interim period between the beginning of RIIO-2 and the direction of these values following</p>

<sup>9</sup> This variable value relates to a licensee’s regulatory opening tax losses and not statutory tax losses per corporation tax returns.

	<p>the close-out of RIIO-1, the licensee must use the provisional closing balance taken from the legacy ESO PCFM to populate the Tax loss brought forward in its RIIO-2 PCFM.</p> <p>The closing balances should come from the same version of the legacy ESO1 PCFM that the LSORAV and LSOMOD values are taken from.</p>
Tax pool allocation rates	<p>For the values in rows 62:68, the rates used to allocate totex into the different tax pools should be updated using the calculations in the "Tax Pools Totex allocations" sheet of the ESO Revenue workbook.</p> <p>Allocation percentages of totex categories to tax pools should be input by the licensee in the yellow input rows based on their best estimate of the allocation rates at the time of updating the inputs. These rates will then be used to derive capital allowance allocation rates used by the PCFM.</p> <p>Allocation rates should not be retrospectively updated for a year where the ADJR* value has already been published and charges have already been set.</p>
CPIH Outturn	<p>This value is shown in the "Monthly inflation" sheet of the PCFM and will be updated by the Authority in line with the methodology for the Price Index calculation set out in chapter 2 of the PCFH.</p> <p>Ofgem will update the CPIH outturn index during the final dry run of each AIP using data that is available as at 31 October.</p>



RPI Outturn	<p>This value is shown in the “Monthly inflation” sheet of the PCFM and will be updated by the Authority in line with the methodology for the Price Index calculation set out in chapter 2 of the PCFH.</p> <p>Ofgem will update the RPI outturn index during the final dry run of each AIP using data that is available as at 31 October.</p>
RPI inflation forecast (Calendar year)	<p>This value is shown in the “Annual inflation” sheet of the PCFM and will be updated by the Authority in line with the methodology for the Price Index calculation set out in chapter 2 of the PCFH.</p> <p>Ofgem will update the RPI inflation forecast during the final dry run of each AIP using Office of Budget Responsibility (OBR) data that is available as at 31 October.</p>
Long term CPIH inflation forecast	<p>This value is shown in the “Annual inflation” sheet of the PCFM and will be updated by the Authority in line with the methodology set out in chapter 4 of PCFH.</p> <p>Ofgem will update this inflation forecast during the final dry run of each AIP using OBR data that is available as at 31 October.</p>
CPI inflation forecast (Calendar year)	<p>This value is shown in the “Annual inflation” sheet of the PCFM and will be updated by the Authority in line with the methodology for the Price Index calculation set out in chapter 2 of the PCFH.</p> <p>Ofgem will update the RPI inflation forecast during the final dry run of each AIP using OBR data that is available as at 31 October</p>



## 5. PCFM Dry Run Commentary

### Background

5.1. This licensee's PCFM submission should be accompanied by supporting commentary as well as any applicable supporting models and underlying workings.

5.2. The main purpose of the PCFM dry run commentary is to provide a useful summary of the updates that have been made to the PCFM variable values and the impact that these have had on the licensee's Allowed Revenue for the Regulatory Year  $t$ , in narrative form.

### Structure of the commentary

5.3. The outline structure of the commentary is as follows:

- Executive summary
- Updates to the PCFM Variable Values
- Impact on Allowed Revenue
- Statement on forecast data
- Corporate governance narrative
- Data assurance statement
- Other relevant information

5.4. The sections outlined above should contain sufficient detail such that the Authority is able to re-perform the updates made and arrive at the same value for ADJR and SOIAR $t$ .

5.5. The licensee should provide detail on the following areas at a minimum:

- a summary of the updates the licensee has made to the PCFM Variable Values in the input sheet(s) since the last published version of the PCFM that was made available by Ofgem;
- the source of the data used to update the PCFM Variable Values (ie, Ofgem directions, Cost and Volumes RRP, Legacy PCFM or forecast data);
- a description of the impact of the changes on ADJR and Allowed Revenue and the key driver(s) of this impact;
- for any forecast data, the licensee should include a statement confirming that it has used its best estimate to ensure forecasts are reasonable in light of the information available at the time and that any significant changes to forecast values have suitable supporting statements;

- A statement on corporate governance including detail on the licensee's executive remuneration and its dividend policy.<sup>10</sup>
- A data assurance statement briefly setting out the assurance processes that the information in the commentary, the PCFM inputs sheet and any underlying input files (eg, Cost and Volume RRP) are subject to; and,
- any other information the Licensee considers is appropriate to explain the PCFM submission.

## Submission

5.6. A dry run commentary is required from all Licensees. Where a Licensee is part of a company that has more than one licence within a sector they may submit a single commentary to cover all licensees.

5.7. The dry run commentary should reconcile with and refer to the PCFM dry run submitted. Any narrative or tables in the commentary should be clearly disaggregated by licensee. A full dry run commentary is required for the first dry run submission and for any subsequent dry runs, a narrative will only be required for any variable values, which have been amended from the prior dry run.

5.8. Where appropriate, the licensee may cross-reference to other information that supports their submission. Any cross-referencing should clearly direct the Authority to the source data used eg, through hyperlinks.

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<sup>10</sup> This requirement does not apply for the 31 August 2021 submission; however, beginning next year, licensees are expected to provide this information for which Ofgem will consult and provide additional guidance.