Appendix 5 - FEEDBACK QUESTIONNAIRE (word format)

Section 1 - About you	
Your name	Charles-Emmanuel CHOSSON
Job title	Partner - Global Assurance Leader Power & Utilities
Contact details	Ernst & Young LLP 1 More London PLace, London SE1 2AF, United Kingdom Office: +44 207 951 7869 / Mobile:+33 6 09 45 40 00
Organisation name	EY
Please state whether your response is confidential or not	Not confidential

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?

We concur with the aim of producing RIIO accounts which assist in providing transparent reporting, reflecting the performance of entities in accordance with the price control regime. The intention to base these accounts on a Regulatory Financial Reporting Standard (RFRS) is important. Clearly linking RFRS to regulatory measures through the Price Control Financial Model (OCFM) and Regulatory Instructions & Guidance (RIGs) will be fundamental in ensuring that the RIIO accounts have a clear and consistent basis of preparation. The development of the RIIO accounts support module (RASM) will be a significant step in enabling this consistency in preparation.

The general format and content of the Example RIIO accounts outlined in Appendix 2 of the consultation would appear to be appropriate. However, until we have been able to work through a full set of accounts with all disclosures it is possible that some elements may prove difficult to define and audit. The appendix focuses on providing further detail of primary statement balances and reconciliations to statutory accounts on which we comment further below.

Key to providing an understandable set of financial statements will be a clear explanation of the key accounting policies adopted and narrative explanations of the key judgements and estimates involved in arriving at the RFRS amounts. For example, the current Price Controls Financial Model (PCFM) does not incorporate the latest forecasted regulatory performance. Accordingly reflecting these forecasts in the RIIO accounts would require judgements to be applied. Therefore it will be important for the framework to ensure consistency in the application of any such judgements and require associated disclosure to assist users of the RIIO accounts. We recognise that these will be identified and developed as the project moves forward. A description of the RIIO license framework would also be helpful to include in such accounts and this could be drafted by OFGEM to provide consistency across all NWO accounts and included as an appendix to the RIIO accounts.

We note that a cash flow statement is listed in Part H of the Draft license condition but not included within Appendix 2 as a primary statement. However Appendix 2 does include a Net Debt movement analysis as note 10. It may be appropriate to consider providing this net debt analysis information as a primary statement instead of the cash flow statement.

Reconciliations to statutory accounts could prove difficult and the two sets of accounts (Statutory and RIIO) are necessarily being prepared on different bases. Once these areas are worked through in more detail it may be necessary to amend current intentions. For companies with statutory year ends other than 31 March there will be additional effort and costs involved in preparing and auditing such reconciliations.

In any set of accounts it is important to strike a balance between providing sufficient information but without including unnecessary detail. Required disclosures should be considered in this manner. For example the level of detail in respect of related parties could be voluminous if it reflected current regulatory reporting requirements in respect of which Agreed upon Procedures are undertaken by the auditors.

In summary, we consider appendix 2 to provide a useful basis for the development of the required format for RIIO accounts.

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 any comments on the draft licence condition set out in appendix 3?

We support the view that flexibility in the timetable to implement RIIO accounts is needed. OFGEM should not underestimate the implications of this new framework for the systems and processes of the NWO. They will have to generate financial information from different sources and under a recognition, measurement and presentation basis that will be substantially different from the financial statements currently produced under IFRS and/or UK GAAP. In our view, the question of the timetable could be discussed in terms of the date on which the RIIO framework is first applied (i.e., effective date).

In terms of the effective date, we think that view 3, which plans to delay licence modifications until after RFRS and RASM are more or less finalised, might be the most appropriate in the context of the application of a new set of bases and guidelines like the RIIO accounts. We encourage OFGEM to consider including in view 3 the option for view 2 (i.e., option to postpone application for one year), in a similar way that the IASB uses for early adoption when issuing new accounting standards.

We also think the RIIO framework will have to clarify the requirements for prior year comparatives at the time of initial adoption. That is, the transitional requirements that need to be applied when adopting the RIIO framework for the first time, e.g., would all comparative figures need to be restated using the principles from the RIIO framework, would comparatives only be required in year two, do comparatives need to be audited or would comparative figures prepared under the existing framework be allowed. Flexibility in the date of adoption may facilitate production of audited comparative information that will enhance the understanding of the new RIIO accounts.

At this stage, we have no specific comments on the draft modifications to the licence condition in consideration given it has sufficient flexibility in the timing of its application.

Regarding the date of publication, the end of September will likely be an appropriate timescale to align with other regulatory filings. However, this timing requirement could cause some practical issues in terms of the time required to prepare and audit the RIIO accounts alongside preparation of the financial statements reported under IFRS and/or UK GAAP, especially if reconciliations are required, particularly in the first year.

Furthermore, the proposal to provide reconciliation back to IFRS / UK GAAP financial statements is required will result in a duplication of efforts for those companies that report their annual financial statements as of the end of December as they will have to prepare an additional set of IFRS / UK GAAP accounts and the RIIO accounts

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?	

Purpose of RIIO accounts and "fairly presents" basis

It is unclear how a "fairly presents" basis is defined for purposes of the RIIO accounts or if the intention of OFGEM is to analogise to the definition within IFRS.

Paragraph 15 of IAS *1 Presentation of Financial Statements* states that, "Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation."

Furthermore, paragraph OB2 and OB3 of Chapter 1 of *The Conceptual Framework for Financial Reporting* outlines the objective of general purpose financial reporting as being "… to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit. Decisions by existing and potential investors about buying, selling or holding equity and debt instruments depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases. Similarly, decisions by existing and potential lenders and other creditors about providing or settling loans and other forms of credit depend on the principal and interest payments or other returns that they expect. Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity. Consequently, existing and potential investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity."

We note in paragraph 3.8 of the consultation paper that the objective of 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". We also note that the concepts behind the measure of regulatory asset value (RAV) are intended to represent the present value of future net cash flows that a company has a right to under the RIIO framework.

Whilst we acknowledge that general purpose IFRS financial statements consider how the information provided will help stakeholders make decisions about providing resources to the entity, they have a different, broader objective compared to that for RIIO accounts that is specific to the regulatory environment. Moreover, the basis of preparation for general purpose IFRS financial statements is largely based on a control model, contrary to the RAV which is on the present value of future net cash flows regardless of whether the control criteria has been met. In addition, the IASB's Conceptual Framework ED noted that cash-flow based measurement techniques are not measurement bases themselves, but estimation techniques.

In the absence of a clear definition of a "fairly presents" basis and well-defined basis and principles for preparing a set of RIIO accounts, it is difficult to say definitively whether the RIIO accounts will represent a "fairly presents" basis, similar to that of IFRS financial statements. Therefore, we suggest that OFGEM clearly defines what is meant by a "fairly presents" basis for purposes of the accounts prepared under the RIIO framework.

We understand the objective of OFGEM is to establish RIIO accounts that will be prepared under the "fairly presents" basis and we encourage OFGEM to continue heading in this direction, given that the RIIO accounts is intended to provide relevant information to users for decision making purposes, similar to general purpose IFRS financial statements. However, as we and others have already stated in OFGEM's first consultation, we continue to take the view that OFGEM should clearly consider a different conceptual framework in developing a RIIO set of accounts, for reasons as set out in the above paragraphs. This involves having a clearly defined objective and guidance tailored specifically for the purposes of preparing accounts under the RIIO framework, including definitions of key terms.

Based on the high level principles built in to the Regulatory Financial Reporting Standard (RFRS) outlined in the consultation paper, we strongly urge OFGEM to consider the following issues when defining the concept of a "fairly presents" basis:

Asset recognition
We note that paragraph 3.9 of the consultation paper considers that "RAV and, by extension, other regulatory balances meet the criteria in the IASB's conceptual framework for recognition of an asset."

As an audit firm, we continue to support the IASB's efforts and initiatives on rate-regulated activities. In our comment letter dated 2 December 2015 on Exposure Draft ED/2015/3 – *Conceptual Framework for Financial Reporting* (Conceptual Framework ED), we highlighted to the IASB the need to be mindful of any revisions it intends to make to the definitions of asset and liability in the Conceptual Framework as there could be a wider impact on the rate-regulated activities project.

Furthermore, in our comment letter to the IASB, dated 15 January 2015, in response to its Discussion Paper DP/2014/2 – *Reporting the Financial Effects of Rate Regulation* (DP), we expressed support for the third financial reporting approach set out in the DP to recognise the impact of rate regulation through specific IFRS requirements. As discussed in the DP, the IASB has not formed a preliminary view on whether regulatory deferral account balances meet the revised proposed *Conceptual Framework* definitions of asset and liability. Therefore, our comment letter noted that, if the Board decides to continue with the rate-regulated activities project, it will need to clarify its position on this matter either by revising the asset and liability definitions in the *Conceptual Framework* such that regulatory deferral account balances will meet those definitions or by explicitly stating that the recognition of regulatory deferral account balances is a departure from the asset and/or liability definitions under the *Conceptual Framework*. Without such revisions, it is unclear how the asset definition concepts under IFRS are consistent with those high-level principles under section 3 of the consultation paper. In particular, we do not see how paragraph 3.10 of the consultation paper provides a sound conceptual basis or support for how regulatory balances meet the asset definition in the Conceptual Framework ED or how some of the RIIO mechanisms (e.g., Totex remuneration scheme, allowed revenues part of revenue account) are considered within the IFRS framework.

We believe the outcome of both the *Conceptual Framework* and the rate-regulated activities projects will be important for companies in the Power & Utilities (P&U) industry, in particular the NWOs. Therefore, we urge OFGEM to monitor the IASB's developments and discussions on these topics. In particular, if the IASB decides to develop a separate standard for accounting for rate-regulated activities, OFGEM should consider whether the benefits for the investor community under the IASB's new rate-regulated standard will be similar those expected from a set of RIIO accounts.

The IASB intends to publish a second discussion paper on rate-regulated activities during the first half of 2016. Feedback from respondents to the initial DP indicated concerns about complexities in the interaction between the rate-regulated project and other projects, in particular the *Conceptual Framework* and IFRS 15 *Revenue from Contracts with Customers*. The second discussion paper is expected to explain and explore these issues more thoroughly and also to describe a proposed accounting model and how the outcome of the model may represent a more faithful presentation of the financial effects of rate regulation. We encourage OFGEM to participate in the IASB's project by responding to their consultation paper and/or proposals on this subject because we think the objective of RIIO accounts is consistent with the overall objective of the IASB's rate-regulated activities project, to reflect the financial effects of rate regulation in entities' IFRS financial statements.

Measurement
We noted in paragraph 3.12 of the consultation paper that the main basis of the RIIO mechanisms and processes is to ensure that the "core value of regulatory balances can be reliably measured at an economic fair value".

The basis of preparation for general purpose IFRS financial statements is largely based on a mixture of historical cost and fair value bases, contrary to the proposed measurement of RAVs which is based on the present value of future net cash flows. It is also unclear how "economic fair value" is defined or how it relates to any measurement model under IFRSs. We suggest that OFGEM clearly defines this term, given it is referred to as a high-level principle for the measurement basis and how it differs from the measurement model under IFRSs.

In addition, when considering the principles to be developed under the RIIO framework, we would like to highlight the following aspects:

- There is an element of prudence introduced in the IABS's Conceptual Framework ED when making judgements under conditions of uncertainty. This may not always be aligned with the overarching objective in the RIIO framework to reflect the core value of the regulatory balances at economic fair value, as referred in paragraph 3.12 of the consultation paper.
- In addition, using the present value of future cash flows in the RIIO accounts requires companies to develop judgements, estimates or forecasted expenditure/incentives and/or expected revenues. There is an inherent trade-off between introducing a level of measurement uncertainty in the amounts to reflect future anticipated cash flows to the entity versus using historical amounts. Too much measurement uncertainty may render the information within the RIIO accounts to be less relevant or subject to more volatility. From an auditor's perspective, it would also be a challenge to audit and/or express a view on the fair presentation basis of such judgements, estimates and forecasted

numbers. This depends on a number of factors, for example, whether there is sufficient predictive evidence/data that is available.
- Furthermore, it would be a challenge to achieve consistent application of the judgements and estimates that companies across the P&U industry would apply in their RIIO accounts. This may ultimately impact the comparability of RIIO accounts across P&U companies.

Other comments

We note that the last sentence under paragraph 3.9 of the consultation paper states "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." It is unclear how this relates to an asset recognition principle and hence we suggest OFGEM further clarify this point.

Paragraphs 3.13-3.14 make reference to "enduring value to shareholders". However, it is unclear what is meant by this term. We note that Note 7 in the illustrative accounts in Appendix 2 of the consultation paper provides an example of adjustments to reflect enduring value. We suggest that OFGEM considers including a discussion of the appropriate adjustments to make and a clear definition of this term within the measurement principles under the RIIO framework.

Linked to the question of whether the accounts can be prepared on a "fairly presents basis" is whether the audit opinion can be on a "fairly presents basis". We note OFGEM's desire to consult on more detailed proposals around the appropriate form of audit opinion which may be possible on the proposed RIIO accounts. EY would be interested to participate in such discussions given the range of matters to be considered.

Chapter 5 – Reporting on regulatory corporate governance
1. Do you have further comments on the revised draft regulatory corporate governance principles?

Given most NWO who will be preparing the RIIO accounts are not themselves listed entities subject to the UK Corporate Governance Code (UK Code) requirements, we think that the current proposals are unclear as to what exactly is expected from companies in a "comply or explain" regime.

Whilst section 5 of the consultation recognises that it is not necessary for the boards to report on their governance as if they were a listed company, Appendix 4 goes on to "expand on the principles of the corporate governance code set out in the 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". This could be read that these requirements are supplemental to and thus additive rather than replacing provisions within the UK Code.

We think it would therefore be helpful to clarify OFGEM's expectations as to whether they see the RIIO accounts require a "comply or explain" approach to the UK Code as supplemented by Appendix 4 or whether they want NWO to follow the general principles of the UK Code without stating compliance. Consideration should also be given as to what impact any stated compliance with the UK Code has on the form of the audit report to be developed.

Chapter 6 – Impact assessment
1. Do you agree with our assessment of the possible impacts?

We would endorse the comments made in para 6.14 on the challenges which will face companies and their auditors in the early years of implementation of the RIIO accounts given that the current IFRS accounts and audit thereof require a very different approach to the financial information of the NWO compared to the RIIO accounts