

Adanma Joseph-Anyaegbu
Ofgem
9 Millbank
London
SW1P 3GE

17 December 2015

Dear Adanma,

Response to open letter consultation on “RIIO Accounts: Consultation on our proposed framework”

We welcome the opportunity to comment on the proposed framework for the 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 proposed framework for the RIIO accounts. Our response addresses all questions set out in the consultation Feedback Questionnaire, attached as an appendix to this letter.

Our primary comments are as follows:

- We recognise and support what is trying to be achieved through the RIIO accounts process. The comments in the Appendix are intended to assist in achieving increased value in regulatory reporting.
- We believe that further detailed engagement is still required with Network companies to agree the specific content of RIIO Accounts. In particular, we believe that there are a number of subjective areas and forecast areas where we question the inclusion or value within a set of RIIO Accounts. In addition, there is also information that may directly be contained within other Regulatory Reporting publications and it is important to ensure information is published consistently and in the appropriate document.
- Overly subjective areas, such as the ‘enduring value’ principle, will be difficult to justify to the audit profession and do not add value to the meaning of the accounts.
- We believe that, as the RIIO accounts currently stand, due to the inclusion of subjective forecast inputs to the accounts and the development of the Regulatory Financial Reporting Standard (RFRS) being at an early stage, the audit profession is unlikely to be willing to provide a ‘presents fairly’ opinion and further debate and consideration is required.
- A key aspect of further engagement should be to consider whether the content proposed gives sufficient benefit to wider stakeholders. The contents of the RIIO

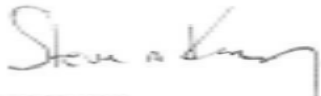
accounts as they stand are overly complicated and may confuse stakeholders rather than informing them.

- We strongly agree with the proposal of a 30 September publication date, as outlined in the consultation, as this timing ties in with other reporting requirements.

We believe that it would be beneficial for Ofgem to make available the engagement performed to date that identified the interests of investors and how the current draft format of the RIIO accounts can be seen as addressing these interests. Given subjective areas and lack of a defined RFRS, it would be useful to confirm whether the audit profession have confirmed their ability to offer a 'presents fairly' opinion over the RIIO accounts.

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,

A handwritten signature in blue ink, appearing to read "Steven Kennedy".

Steven Kennedy
Finance Director
Scottish and Southern Energy Power Distribution

Appendix - FEEDBACK QUESTIONNAIRE

Section 1 - About you	
Your name	Steven Kennedy
Job title	Director of Finance - Networks
Contact details	Inveralmond House 200 Dunkeld Road Perth PH1 3AQ steven.kennedy@sse.com
Organisation name	SSE plc
Please state whether your response is confidential or not	Standard consultation response

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?	<p>We recognise and support the overall objective set out in the RIIO accounts consultation. The comments below are intended to support the overarching goal of increasing the value of regulatory reporting to our key stakeholders.</p> <p>We believe that the form and content of the RIIO accounts as set out in Ofgem’s consultation of 4 November remains overly complex and consider that a more focussed version, such as that set out below, would be of more value for stakeholders. As we noted in our August 2015 response to the open letter consultation we remain of the opinion that development of a further level of regulatory ‘information’ only serves to make the reconciliation back to widely understood statutory terms more complex.</p> <p>Based on the interaction with our key stakeholders from the financial markets the information which investors are interested in understanding for Network Operators (NWOs) are the following:</p> <ul style="list-style-type: none"> • Revenue • K factor • Return on Regulated Equity (RoRE) • Incentive performance • Totex versus Allowances • Reconciliations of key regulatory components to statutory performance

Except for the statutory reconciliations, the above items are, or will be, available through other publications, such as the annual report. We feel that to include such information in RIIO accounts would represent unnecessary duplication.

In relation to published accounts, investors are interested in measuring regulatory performance against statutory performance and being able to reconcile the two. This provides stakeholders with the ability to understand the regulatory results in a more familiar, statutory format. Considering this, we feel that the RIIO accounts would be of more value if they were focussed on the areas which are of predominant interest to investors and included the following reconciliations only:

1. Base revenue to statutory reported revenue
2. Totex to statutory operating/capital costs

A RIIO accounts format which included statutory results alongside the reconciliations stated above would provide sufficient detail to investors in an easier to understand format than is currently proposed. The current format introduces more uncertainty as it lacks the regulatory to statutory reconciliation.

The RIIO accounts are heavily regulatory-weighted which only allows valuable analysis and benchmarking in a regulatory world. The reverse is what is required. Our stakeholders need to be able to compare results from the regulated networks in an unregulated context.

The revised proposals above would be:

- readily incorporated in regulatory reporting licence requirements;
- simpler to audit;
- more robust as they eliminate subjectivity

Such reconciliations could be derived from existing prepared information and would therefore ensure that the increased regulatory burden is minimised.

	<p>The current proposed financial statements introduce a number of subjective figures within the draft RIIO accounts, for example the 'enduring' value principle. It will be difficult to provide guidance on how this should be calculated consistently across NWOs which in turn makes it difficult to justify to the audit profession. Items such as the 'enduring value', which are based on a forecast, are subjective by nature. Normal statutory accounts do not include forward looking data and therefore do not place auditors in the position of providing an opinion on uncertain events.</p> <p>Furthermore, within the RFRS, more easily accessible definitions of regulatory terms would be required to enable stakeholders to interpret the financial statements. The current draft contains a proliferation of regulatory wording which is suitable for licensees but not external parties. Therefore we would also recommend the introduction of a glossary where regulatory terms are illustrated by examples. We believe this is necessary to ensure that the RIIO accounts are properly understood.</p> <p>We strongly support the proposal to set the publication date of 30 September. There are other similar reporting requirements in September/October and, as we noted in our response of August 2015, it would be logical and to the benefit of our intended audience to align and / or combine them.</p>
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Chapter 2 – Timetable and licence modifications

<p>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.</p>	<p>The planning options offer flexibility although we would recommend that option (iii) or (iv) are the most appropriate options for the reasons set out at point 2 below.</p>
<p>2. Out of the four proposed</p>	<p>Initial preparatory work is necessary to provide a good quality outcome. We have set out in</p>

<p>implementation planning options we set out, which do you consider to be achievable and desirable?</p>	<p>our response to chapter 1 that uncertainty around the new standards will weaken any value that the RIIO accounts bring. For this reason the Regulatory Financial Reporting Standard (RFRS) and RIIO Accounts Support Module (RASM) must be complete, comprehensive and supported by the audit profession before it would be sensible to consider introducing the requirements as set out in the draft licence.</p> <p>We consider that option (iii) is best aligned to achieving the overall objective. This recognises the need for minimum timescales to prepare the RFRS and RASM. We consider this option desirable to ensure that the accounts are value adding and there is no loss of credibility.</p>
<p>3. Do you have any comments on the draft licence condition set out in appendix 3?</p>	<p>We have set out in our response to the preceding consultation questions and in our response to the open letter of August 2015 the reasons for simplifying the complexity of the RIIO Account statements. For that reason were our proposals to be considered the draft licence condition should be modified to remove the specific references set out in Part B.</p> <p>In order to preserve the flexibility to further develop the RIIO Accounts we would encourage Ofgem to explore moving references to specific financial statements and publication dates, 44.4-44.5 and 44.8, from the licence condition into the RFRS.</p> <p>In light of our concerns that the audit profession may not feel able to provide a 'fairly presents' opinion based on the proposed RFRS we believe 44.14 should be modified to accommodate such a scenario. This would only apply where the Auditor can not provide such a statement as a result of the standards and not the content of the financial statements.</p> <p>The requirements included in 44.4 specify that the licensee prepare accounts in the format set out in the condition in effect as at 1 April 2015. We are concerned that this format of cross referencing current with expired versions of the licence is not the most robust. One option would be to include the condition or relevant sections of SLC 44 as at 1 April 2015 in an</p>

	<p>appendix to the revised version from where it can be referenced.</p> <p>Paragraph 44.12 includes incorrect wording, ‘..coming into effect of the of this...’.</p> <p>Furthermore we would like to understand the purpose of providing for circumstances where the requirements to notify of RFRS and RASM changes do not have to occur post changes to the licence condition in which requirement to notify is set out. Our concern is that could lead to scenarios where the need to provide suitable notification is removed.</p>
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Chapter 3 – The Regulatory Financial Reporting Standard

<p>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?</p>	<p>We do not believe that the audit profession can commit to providing a ‘fairly presents’ opinion in advance of the opportunity to review the RFRS. We understand the aspiration for such an opinion but do not believe that it is achievable within the current proposals.</p> <p>Our experience leads us to believe that the audit profession is unlikely to be comfortable with providing an opinion on subjective areas, such as the ‘enduring’ value principle. As the RIIO accounts are presented in the current consultation form we believe the audit profession will only be prepared to provide an agreed upon procedures-type report, rather than a ‘fairly presents’ opinion.</p> <p>To facilitate the current proposals the RFRS must be both prescriptive and descriptive. Prescriptive, in order that auditors have clarity of the standard against which they must conduct the audit. Descriptive, in order that users of the RFRS are not required to interpret terms, reducing the risk of inconsistency across network reporting. However, the consequence of increased detail will be to make the audit process more onerous.</p> <p>The proposed changes represent new audit activities across a complex set of accounts. This will increase both the workload and cost of the audit. We would be keen to understand whether the increased costs associated with the preparation and audit of these accounts has been assessed against the expected benefits to investors.</p>
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	<p>We agree that RIIO accounts should be published. However, in order to achieve a 'fairly presents' opinion, a more focussed version may be required, in line with that referred to in the response at Chapter 1. An essential 'next step' in the RIIO account process should be for Ofgem and NWO's to engage with the audit profession to determine whether the required audit opinion, §44.14, can be provided based on the current draft RFRS.</p>
<p>Chapter 5 – Reporting on regulatory corporate governance</p>	
<p>1. Do you have further comments on the revised draft regulatory corporate governance principles?</p>	<p>No, the proposed regulatory corporate governance principles appear to be in line with current corporate governance disclosures in the current regulatory accounts.</p>
<p>Chapter 6 – Impact assessment</p>	
<p>1. Do you agree with our assessment of the possible impacts?</p>	<p>Impact on consumers: We do not believe that the detail proposed is required for investors to better understand NWOs. The current format is overly complex and has the potential to confuse investors. A simplified version of the accounts, in line with the reconciliations referred to at Chapter 1, would better serve investors.</p> <p>Proportionality: The current format is not overly transparent due to there being subjective areas and complex regulatory terms which are not sufficiently defined. A focussed version would allow stakeholders to more readily 'translate' regulatory performance into standard measures and therefore would represent better value for the end user.</p> <p>We believe the proposed RIIO accounts will increase NWOs' regulatory burden; the proposed format is much more complex than the existing regulatory accounts and as described above will lead to additional time being spent both in their preparation and the subsequent audit process.</p> <p>Competition and markets:</p>

	<p>Our view is consistent to that stated above. The current format is not transparent and will not increase confidence due to the extent of complexity.</p>
<p>ANY OTHER COMMENTS</p>	
<p>1. Please use this section to let us know of any other thoughts you might have on the further development of RIIO accounts.</p>	<p>The draft RIIO accounts should be reviewed and simplified in order to make them more meaningful for key stakeholders. Subjective components should be removed or at least minimised; reconciliations of standard regulatory components to a statutory basis should replace the current proposed format. By supporting a more ready understanding of the results in line with the statutory position, subsequent analysis by users is of added. The ultimate aim is to provide an understanding of the results of the regulated world in the un-regulated context.</p> <p>Workshops should be held for NWOs and their auditors to review the RIIO accounts, RFRS and licence condition and provide further feedback prior to the necessary licence modifications.</p>