

Appendix 5 - Feedback Questionnaire for Introduction of RIIO Accounts – further consultation on licence modification

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 mick.watson@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 6 December 2017.

Section 1 - About you	
Your name	Richard Allman
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Organisation name	National Grid Electricity Transmission plc and National Grid Gas Transmission plc
Please state whether your response is confidential or not	Not confidential

Response

Question 1: Do you have any comments on the draft licence condition set out in Appendix 1?

Whilst a lot of progress has been made in agreeing how this framework will work in practice, National Grid has significant concerns remaining over the timing of the implementation, the scope of the audit opinion and the benefits case. We have outlined these points in more detail in response to each of the questions raised in this document.

- The proposed licence condition is set out for an Electricity Distribution licence, we would welcome sight of a version specific to the Electricity and Gas Transmission licences prior to the statutory consultation so that we can check all licence references are correct.
- 44A.1 (b) – there is more than one ORFRS, they should be referred to in the licence. We also think there should be a requirement to include the ORFRS as an Appendix to the Licence. The status of the ORFRS should be made clear and a clear process and timeline for how ORFRS could be amended each year should be included in the licence (by expanding para 44A.16).
- 44A.3 – some elements of the Agreed Upon Procedure (AUP) on prohibition of cross-subsidy require reconciliation to the regulatory accounts. This would either need removing once the current regulatory accounts cease to be required or amending to refer to the RIIO accounts and changed to 30 September submission each year (see also 44A.19).
- 44A.14 (d) – it should be made clear that any 28 day notice period must ensure that formal direction is given, at least, before the 31 March or earlier if possible (see next point on 44A.16).
- 44A.16 – changes to ORFRS need to be known and implemented before the start of the financial year, similar to IFRS changes which are known well in advance. This is particularly significant to those entities with a reporting year end other than 31 March. The reason being that additional or changes in reporting requirements may need system changes to allow data to be collected. Changing the requirements during the financial year may not give sufficient time for such system changes to be implemented.
- 44A.18 - a clear process and timeline for issuing consent should be included in the licence i.e. how much notice to be given and how ensure cross-sector treatment is fair.
- 44A.18 - There is still an outstanding requirement to agree the wording of the audit opinion being proposed by the licence condition. The audit opinion wording for existing regulatory accounts may not be appropriate for RIIO Accounts which have a different basis

of preparation. We consider that Ofgem should publish the format and content of the opinion, having agreed this with the audit profession. Such agreement should be reached before the licence modification is implemented. The scope of the audit report may also impact the level of disclosures required. Currently the ORFRS include significant levels of disclosures, for example on pensions, which may be more appropriate to introduce at a later date, should investors or interested parties request the information.

- 44A.19 – elements of the AUP process require the RIIO accounts and a statement of corporate governance statement to be produced. This will not happen until 30 September and the AUP process is currently due for submission by 31 July. We would suggest that the AUP process be delayed until 30 September.

Question 2: Do you have any comments on consequential modifications required to other licence conditions set out in Appendix 2?

- **SC B6 Restriction on activity and financial ring-fencing:** 4(b)(i) – RIIO accounts do not technically have a turnover figure on which to assess the 2.5% limit. We note that ED paragraph 29.12(a) includes reference to ‘audited historical cost accounting statements’ as being an alternative source of the turnover value. There is no such paragraph in the Electricity Transmission or Gas Transmission licence. As such the wording of the licence condition needs to be amended for these businesses. An option would be to allow the revenue in the ‘audited historical cost accounting statements’ to be used.
- **SC B6 Restriction on activity and financial ring-fencing:** 4(b)(ii) – RIIO accounts share capital and reserves (net assets) can be significantly different to the net assets reported in the statutory accounts. We suggest that Ofgem would need to accept a ‘greater of’ rule, statutory accounts vs RIIO accounts net assets.
- **SC B6 Restriction on activity and financial ring-fencing** (SSC A36 for Gas Transmission) – provision of these limits are usually included within the AUP report on 31 July each year. RIIO accounts will not be completed and audited until the 30 September. If the reference to RIIO Accounts remains then the timing of the AUP report needs to be amended to coincide with the publication of RIIO Accounts on 30 September.
- **SC B7 Availability of resources** (SSC A37 for Gas Transmission) – audit work for RIIO accounts will not be completed until 30 September, whilst the current certificate is required to be submitted in July. If the reference to RIIO Accounts remains then the timing of the AUP report needs to be amended to coincide with the publication of RIIO Accounts on 30 September. We note ED paragraph 30.15 seems to give them alternatives of using the audit work performed on the annual accounts, something that is not included in the Electricity Transmission or Gas Transmission licence.

Impact on other licence conditions, not included in Appendix 2:

- **SC B15 Regulatory instructions and guidance** (SSC A40 for Gas Transmission) – includes a requirement in both the Cost & Output template (table 1.4) and the Revenue template (tab R14: Rec to Reg Accs) to provide reconciliations of regulatory totex and revenue to that reported in the regulatory accounts. These are required to be submitted to the authority by the 31 July each year. RIIO accounts will not be completed until 30 September. These tables either need to be removed or an alternative reconciliation needs to be developed to reconcile to statutory accounts. These need to be considered and agreed before the RIGs are issued by 31 March. Ofgem need to consider other elements of the Cost & Output template that could be impacted by the proposals.
- **SC B23 Data assurance guidance** (SSC A55 for Gas Transmission) – includes a requirement in its risk assessment template to undertake processes and activities for the purpose of reducing the risk, and subsequent impact and consequences, of any inaccurate or incomplete reporting relating to the regulatory accounts. This needs to be amended to refer to the RIIO accounts from the point that the new licence becomes live.

- **SC B5 Prohibition of cross subsidies** (SSC A35 for Gas Transmission) – as stated in our response to Question 1, the timing and detail of the AUP report on cross-subsidy needs to be considered and agreed as part of this process.

Question 3: Do you have any comments on the proposed RCGS Principles set out in Appendix 3?

- We consider that guidance, or lack of it that Ofgem are proposing to give, and the comment that ‘NWOs engage with the anticipated primary users’ is not helpful. Our investors, who we understand are meant to be the primary users, have shown no interest in RIIO accounts to us and in the context of this it seems odd that we should ask them such detailed questions. As such we feel Ofgem should provide more guidance if they consider the additional principle items to be so critical.
- We believe that this lack of guidance in this area and on the operational and regulatory financial performance and position commentary is contrary to the high level of detailed disclosures that the ORFRS includes for the ‘back half’ of the RIIO Accounts. We consider that the level of disclosures needed in the ORFRS, in the draft to be issued in December 2017, should be reduced and expanded later if there is a need from the primary users of the RIIO Accounts for additional disclosures.
- We would like further guidance on whether a directors’ report or statement of directors’ responsibilities are required to be included in the RIIO Accounts. Currently these are not included as a requirement in the ORFRS or listed in the licence modification (44A.10). If statements are required the form and content need to be agreed as the current Companies Act requirements may not be fully compatible with RIIO Accounts.

Question 4: Considering the one-year delay in introducing RIIO Accounts and potential impact on consumer benefit it may have for RIIO2, do you agree that licenced NWOs should report RIIO Accounts for the Regulatory Year 2017-18?

Auditability

- Our primary concern relates to the ability of the networks to secure a fairly presents audit opinion and the implications of not achieving this. Our own auditors have commenced their review of the March 2017 statement of financial position and this has identified a number of conceptual audit issues which they have brought to your attention and were discussed at a working group meeting on 17th November 2017.
- Our audit review has concentrated on understanding the areas of audit risk, most noticeably relating to enduring value adjustments associated with totex performance and adjustments to the balance sheet. The performance statement, including tax and financing principles, and all the disclosure notes have yet to be tested.
- We and our auditors are seeking a better understanding from Ofgem on the reliance that can be placed on balances that are driven directly from the PCFM. This includes the ‘base’ RAV balances and a number of the ‘other regulatory balances’. Many of these balances are unauditable without assurances being given by Ofgem that they can be relied upon. It has not yet been confirmed what assurances Ofgem are prepared to give and when this issue would be resolved.
- Depending on the level of assurance Ofgem are prepared to give our auditors on certain balances, they may have to audit historical information all the way back to the start of the RIIO period. This will have additional time and cost implications for the first year of implementation. This is something Ofgem should take into consideration when deciding on an introduction date for RIIO Accounts.

- We believe there is still substantial risk in any audit firm being able to satisfy a fairly presents view at this stage. We would express caution in implementing RIIO Accounts whilst such issues remain unresolved. Any qualification or exceptions in the audit opinion may raise concerns with the users of the accounts as to the reasons why such assurance is not possible. This will erode confidence in the RIIO regime, having the exact opposite impact that the RIIO Accounts introduction was meant to deliver.
- All of the above would justify a further delay in the implementation date.

Additional Costs

- We have been advised by our auditors that the costs for RIIO Accounts will be significantly higher than for the current regulatory accounts. We also understand that this would be replicated across the industry. These additional costs will in part be borne by both investors and consumers. As such we believe the consumer benefit case needs to be reflective of these additional costs and would encourage Ofgem to ensure that they have included these in their benefit assessment.
- We consider that the net consumer benefits have not been clearly or transparently explained. As such it is not evident whether the additional costs that will be involved, both external audit and internal company costs, have been considered as part of the benefits case. To date no investor or interested party responses have been published to substantiate the benefits of RIIO Accounts.
- We remain committed to the principles of RIIO Accounts in providing comparable and transparent regulatory performance and balance sheet information to investors. National Grid currently publishes externally, on an annual basis, an operational returns metric, regulatory financial performance results (including a reconciliation to IFRS operating profit) and key regulatory balance sheet values (RAV and other regulatory balances, net of enduring value adjustments). Our investors value this information but have not indicated to us that they are seeking any additional assurance or information to be made available. The issuing of key metrics rather than a full set of RIIO Accounts could meet investor needs but achieved at a lower cost to investors and consumers than the current RIIO Accounts proposal. It would also keep the performance metrics more focused and less confusing for the reader. To gain comparability across companies, these metrics could be prepared using the principles included in the ORFRS.

ORFRS

- The ORFRS are principles based and do not include practical examples and guidance notes. These would normally be provided when new IFRS are introduced to ensure preparers of accounts treat items on a comparable basis. Without such examples and guidance being provided it raises concerns whether the accounts would be truly comparable across all companies.
- We believe that the ORFRS technically and formally need consulting on separately as part of this process. We would expect to see formal audit firm approval of the ORFRS as a sound basis on which to give the fairly presents opinion.
- Proposed minimum disclosure states 'the statements specified in the ORFRS' – a clear list should be provided in Section 2 of the ORFRS (Form and Content). As our last response to question 3 references, we consider the current proposed disclosures are incomplete. Having a complete list in a single place either in the licence or the ORFRS would be beneficial and ensure all parties are aware of the minimum contents to be included.

General response to our further consultation for the Introduction of RIIO Accounts

- **Appendix 4 – timetable** - Note 1 allowing Ofgem to amend dates at their discretion is not really appropriate. We believe the 2nd February date should be firmed up to allow proper planning with auditors to be undertaken and business processes considered. e.g. regulatory accounts audit v RIIO accounts audit, RRP table changes discussed and agreed as part of the annual RIGs process before 31 March etc.
- **Stakeholder views** – The consultation states that stakeholders’ views are still sought on the introduction of RIIO accounts. We consider that, as part of this process, Ofgem need to encourage investors, consumer groups etc. to demonstrate a strong desire for these accounts.
- **AUP requirement on Revenue RRP** – we remain unclear whether there is an intention to continue with the AUP requirement for the Revenue RRP. We believe that an audit of RIIO accounts (which includes regulatory revenue) should provide sufficient assurance for Ofgem without the additional need for a separate AUP audit report. This may help offset any incremental costs of preparing RIIO accounts. We would like to understand Ofgem’s position on this.
- **Impact on RRP** – as stated in our response to earlier questions, we believe that consideration of the impact RIIO accounts will have on the RRP process should be built into the RIGs process ASAP for it to be discussed and agreed ahead of the RIGs being issued by 31 March 2018. Ofgem’s Cost & Outputs teams need to be included in the process.
- **Overlap of operational performance reporting with RRP** – we seek further clarity on the purpose and format of the operational performance reporting requirements in the RIIO accounts and their potential overlap/duplication with the RRP narrative, Strategic Performance Overview and the External Stakeholder documents. We would welcome further discussion in this area.