**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 5 December 2017.

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| **Section 1 - About you**  |
| **Your name**  | Allan Hendry |
| **Job title**  | Head of Licence and Revenue |
| **Contact details**  | 0141 6141971 Allan.Hendry@spenergynetworks.co.uk |
| **Organisation name**  | SP Distribution, SP Manweb and SP Transmission |
| **Please state whether your response is confidential or not**  | Not confidential |

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| **Response**  |
| **Question 1: Do you have any comments on the draft licence condition set out in Appendix 1?** |
| * 44A.9 (a) and (c) – The RIIO Accounts are very complex and rely on significant supporting information which will not be available until 31st July immediately following each regulatory year. Based on our experience to date in respect of the time it has taken to produce 2015/16 and 2016/17 RIIO accounts for one of our Licensees, we believe it will be impossible to produce and have audited three sets of RIIO Accounts in 2 months.
* 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. Therefore we would recommend that any such modification directions are made no later than 31st December immediately prior to the commencement of the Regulatory year for application in that Regulatory year
* 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 to 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.
* 44A.19 – We are unclear why paragraph 44A.19 should be any different from paragraph 44.12
* 44A.20 - The timing and detail of the AUP report on cross-subsidy needs to be considered and agreed as part of this process.
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| **Question 2: Do you have any comments on consequential modifications required to other licence conditions set out in Appendix 2?** |
| * **Standard Condition 29 (para 29.9) and SC B6 (para 4 (b) (i))Restriction on activity and financial ring-fencing**: – RIIO accounts do not technically have a turnover figure on which to assess the 2.5% limit. An option would be to allow the revenue in the ‘audited historical cost accounting statements’ to be used (rolled forward to 31st march for those companies with a reporting year end other than 31st march).
* **Standard Condition 29 (para 29.10) and SC B6 (para 4 (b) (ii)) Restriction on activity and financial ring-fencing**: – 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 (rolled forward to 31st march for those companies with a reporting year end other than 31st march) vs RIIO accounts net assets.
* **Standard Condition 30 (para 30.3 (b)) and SC B7 (para 3 (b)) Availability of resources** – audit work for RIIO accounts will not be completed until 30 September, whilst the current Availability of Resources certificates are required to be submitted by 31st July. As the Licence requirements for the Availability of Resources cross reference to RIIO Accounts then the timing of the Availability of Resources needs to be amended to coincide with the publication of RIIO Accounts on 30th September.

Impact on other licence conditions, not included in Appendix 2:* **Standard Condition 46 and SC B15 Regulatory instructions and guidance**  – includes a requirement in both the Cost & Output template (tables F8 and 1.4 respectively) and the Revenue template (tab R15 and R14 respectively: 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 including the associated complication of companies with a statutory reporting year end other than 31st march. Ofgem need to consider other elements of the Cost & Output template and Revenue template that could be impacted by the proposals.
* **Standard Condition 45 and SC B23 Data assurance guidance** – The Risk Assessment Template, that forms part of the DAG submission, requires the relevant appendices to be amended to reflect RIIO accounts and the submission due date.
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| **Question 3: Do you have any comments on the proposed RCGS Principles set out in Appendix 3?** |
| We believe that the draft principles set out in Appendix 3 are neither required nor appropriate, underpinned by two reasons:* Iberdrola, Scottish Power, and SP Energy Networks (SPEN) currently adheres to best practice principles of corporate governance, in line with its listing on the Madrid stock exchange. Applying the Ofgem proposals to individual lower-level Network Operators (NWOs) would not bring any additional value to, or improve the transparency of, information to investors or other stakeholders;
* Scottish Power is concerned that these regulatory proposal either seek to amend or conflict with UK company law.
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| **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?** |
| No. A more focussed and transparent approach will better meet the objectives of RIIO Accounts. |
| **General response to our further consultation for the Introduction of RIIO Accounts** |
| **Summary**We believe that RIIO Accounts as currently envisaged will fail to meet their stated objectives of providing clear and consistent performance information. The industry and Ofgem have worked together over the last few years attempting to place auditable, accounting disciplines around what is in essence a dynamic, economic regulatory value model. It is an economic model where retrospective adjustments and prospective judgments lie at the heart of reported performance. It has emerged that these do not sit readily within a traditional accounting reporting context. We have suggested an alternative approach below. We include a suggested template within the Annex below. This is the same template which we submitted in our previous RIIO Accounts consultation response on August 4th 2015. Our views have not changed since this initial open letter consultation. **The problems**What has emerged is in our view:* **Too complex**

It has proved enormously challenging to convert the economic regulatory model into a ‘double-entry’ accounting context. Preparing 2015/16 and 2016/17 draft RIIO Accounts for two DNO’s and one TO has taken several man months of effort and is not yet currently complete. It is not clear to us how anyone without very detailed knowledge and experience of the PCFM, RRP and Revenue Rigs could ever reliably and consistently produce these accounts year after year. We have shared our work so far with our auditors. It is not plausible that Auditors would ever be able to reach that level of expertise such that they could give a fairly presents or any other dilluted audit opinion on RIIO Accounts as currently envisaged.Most DNOs will have teams of accountants who currently maintain general ledgers and prepare regulatory and statutory accounts. Whilst RIIO Accounts will still require underlying IFRS accounting numbers prepared by these teams, their perceived value would rely fundamentally on detailed knowledge of a single or very few individuals – those as highlighted above with very detailed knowledge and experience of the PCFM, RRP and Revenue Rigs.* **Unduly costly to produce**

To reliably produce RIIO Acccounts and have these audited would be costly. Additional internal staff would be required to prepare RIIO Acccounts. It is likely that a considerable increase in audit fees would be incurred (in part following on from the complexity above).* **Not likely to give transparent comparable performance measure**

A principles based ORFRS would theoritically be the only practical option absent extensive regulatory intervention in terms of prescribing a regulatory accounting framework. We do not believe Ofgem are resourced to achieve the latter. Formulation of traditional accounting standards is an extremely lengthy and rigorous process conducted by experienced professionals in this specialist field.However the current draft ORFRS is intentionally principles based and gives no guidance on key issues such as ‘enduring value’ save for suggesting *‘but not limited to..’* three possible bases of recognition. As a result the ORFRS and the proposed audit opinion that it supports gives no additional assurance of consistency in reported performance. Worse still it gives the misleading impression to stakeholders that audited RIIO Accounts achieve just that.* **Not auditable**

Our auditors have told us that they could not currently give a fairly presents audit opinion on the RIIO Accounts for many of the reasons highlighted above. Furthermore it is our view that a weaker audit opinion of ‘properly presents in accordance with..’ gives no tangible benefit to stakeholders. We do recognise that there is some, albeit limited, value in engaging with auditors to follow agreed upon procedures (AUPs). This would give Ofgem a level of confidence that Network Operators were faithfully sourcing numbers from approved sources, e.g. PCFM, RRP and other sources. That said we believe it would be far more cost effective for consumers if Ofgem arranged this centrally. It should not be overlooked that the greater part of useful performance information is currently reported under Licence Conditions and subject to rigourous DAG procedures or AUPs. **Next Steps**We are supportive of the objectives of RIIO Accounts but believe these can be better achieved by alternative means.For 2017/18 reporting, the objectives would be better met by the provision of a limited set of tables or graphs accompanied by explanatory commentary, covering for example RORE, RAV and totex/output performance. These might be included within the Summary Performance Overview and ultimately subject to audit in accordance with Agreed Upon Procedures. Where enduring value judgments are required, these could be documented in a methodology statement and subject to review by Ofgem. This approach does not remove comparability problems arising from judgments. However a more focussed report will make them considerably more transparent in the few areas that they are significant. This performance reporting approach would subsequently inform a far more comparable and balanced cross-sector Ofgem Annual Performance Review.Attempts to formulate RIIO Accounts have been well intended but it is time to change direction. It is our view that RIIO Accounts as currently envisaged do not present good value for customers nor meet their objectives any better than our suggested alternative means set out above. |