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6th December 2017

RE: Introduction of RIIO Accounts – further consultation on licence modification

Dear Mick,

Wales & West Utilities is a licensed Gas Distribution Network (GDN) providing gas transportation services for all major shippers in the UK. We cover 1/6th of the UK land mass and transport gas to over 2.5 million supply points. We have been engaged throughout the RIIO Accounts process and are pleased to have the opportunity to respond to this consultation.

The RIIO accounts process was built on the premise that there was investor, and wider stakeholder, demand for more information regarding the underlying performance of the network operator (NWO or regulated company). The focus was specifically placed on matching costs and revenues relevant for the year to which they related. This would provide an opportunity to simplify, improve clarity and achieve consistency for relative comparison.

The original concept envisaged no more than four pages of accounts and narrative. These would highlight to investors the significant adjustments which may take place in future years or price controls as a result of the regulatory performance in the current and preceding years.

Examples of adjustments required to traditional accounts to achieve this include:

1. Incentives earned for “in year” (year T) performance which are recoverable in year T+2
2. Over/(under) collection of allowed revenue which would either reduce/(increase) revenue in T+2
3. Cost efficiencies in the period which would result in a hand back to the consumer through the sharing mechanism in T+2
4. Timing gains/(losses) which arrive from undertaking work to a different phasing than the allowance may have accounted for (including reopeners where costs are incurred but revenue in a future period is contingent on Ofgem direction)

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We continue to agree that the current reporting, including regulatory accounts, could be improved to better identify such adjustments, and in doing so provide a clearer view of network performance and aid comparability for stakeholders. We also believe that other stakeholders have similar desires for ascertaining relevant performance and simplified reporting.

However, the currently proposed scope and scale of RIIO accounts is now at a point where we believe it is sensible to establish if there is a simpler and or clearer way to arrive at the provision of this information.

We further believe that in particular the investor community and Ofgem already have access to much of the information that underpins the enduring value of the regulated companies and potentially the wider benefit of such reporting is in meeting wider stakeholder needs such as the end consumer.

In addition, fulfilling one of the original RIIO accounts brief points of simplification seems to have been lost.

Potential forms the RIIO accounts project could take include:

1. Additional Narrative disclosure in the NWO's current accounts
2. Requirement for NWOs to provide additional plain English adjustments within companies published RRP commentaries/annual reports
3. Ofgem to utilise information currently reported and provide this to stakeholders centrally, thus ensuring comparability
4. Ofgem to consider streamlining the information currently submitted by NWOs and publishing relevant comparative information in a timely manner, considering the current annual reports Ofgem produce under the RIIO regime

Our preference at this stage is to further develop the concept of the Strategic Performance Overview (SPO). This concept was introduced as an internal trial for NWOs to provide a view of performance in no more than 30 pages and provide key KPIs to Ofgem. We believe that this medium far better reflects the requirements set out by some of our key stakeholders, such as Citizens Advice (reflected in their RIIO accounts response dated 16th December 2015¹). This response provided a clear steer on the wider requirements of the RIIO accounts project. We believe many of these points have been lost in the desire for a 'Fairly Presents' audit opinion but could be adopted into the concept of the SPO. The SPO at this point is also better placed to deliver simplified information around performance. Specifying minimum disclosures and defined KPIs for inclusion would further facilitate the objective of aiding comparability.

These performance metrics should include:

1. Totex spent vs outputs delivered (in year and forecast for the price control)
2. A wider measure of Return on Regulatory Equity (RoRE) so as to highlight actual NWOs performance. For example including the comparison of actual debt costs with the allowance provided.
3. Long term cost flight paths so as to reiterate the continual value the consumer receives over multiple price controls.

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https://www.ofgem.gov.uk/system/files/docs/2016/02/riio_accounts_second_consultation_response_citizens_advice.pdf

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We also believe that to ensure true comparability, it is better for Ofgem to produce the RIIO accounts centrally from the information which they receive annually from the NWOs rather than relying on the NWOs to produce identical RIIO accounts,

We would welcome the opportunity to consider the points highlighted above prior to any potential requirement for RIIO accounts be put into force. The remainder of our response, included as an appendix, does however attempt to address some high level points against each of the four questions posed.

Yours sincerely,



Steven Edwards
Director of Regulation & Commercial
Wales & West Utilities

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Appendix A

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

Part F requires the Auditors report to be based on a 'fairly presents' basis. We believe that there remain a number of challenges which are still to be resolved to allow such an opinion without Auditor qualification. These include:

1. The absence of supporting guidance (including examples) against which the Auditor can consider an element of what would be considered 'fair' for certain transactions
2. A number of balances, such as RAV, would require third party confirmation from Ofgem in order to anchor them to a point in history. There currently is no agreement in place for this to be achieved.

From discussion with our auditors, our understanding is that currently they may find it challenging to confirm that judgements made by the company are fair when there is limited scope to compare the reasonableness of such judgements against comparators or guidance. However an opinion of "Properly Prepared in accordance with" would be more achievable in the absence of guidance notes and comparators. This would allow judgement guidance to be drafted in respect of year 2019/20 and give companies the opportunity to amend systems and processes to capture data to support the required disclosures. This would therefore result in the first year of RIIO accounts prepared under the "True and Fair" basis being 2020/21.

Furthermore, a number of judgements require assessment of forecast information; systems and processes which are currently not in scope for any current audit requirement. The cost (which we understand from our Auditors would not be insignificant) and resource required to potentially support this increased audit plan may detract from other priorities within the business, such as engaging with our stakeholders to shape our RIIO-GD2 submissions. A "properly prepared in accordance with" opinion from the auditors would provide a more gradual step change in audit resource which may provide a better outcome for the consumer.

44A.13 (and 44A.22) provides Ofgem the ability to modify and issue the Ofgem Regulatory Financial Reporting Standard (ORFRS) and Regulatory Corporate Governance Statement (RCGS) principals. We believe that this should provide protection for mid year changes to be made which would require retrospective data gather, controls or accounting, which may not be achievable or beneficial to stakeholders.

It is typical for accounting standards to only be mandated prospectively (i.e. for a future accounting period) rather than retrospectively, and we support that approach. In doing so the NWO has a better opportunity to put in place systems and processes to effectively capture and account for the current year accounting requirement.

44A.20 should be revised to reflect gender neutral language in preference to its current form of 'set out *his* findings'.

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

We welcome the continued premise that the RIIO accounts will form a substitute for the Regulatory Accounts.

Further consideration is also required to amend the current RRP reporting. Currently (SSC A40 for Gas Distribution) – includes a requirement in both the Cost & Output template (table 1.4) and the Revenue template (tab Rec to Reg Accounts) 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.

Question 3: Do you have any comments on the proposed Regulatory Corporate Governance Statement (RCGS) Principles set out in Appendix 3?

The section Accountability RC2, refers to information being understandable. We are concerned that the current disclosures that would be required to be made to support RIIO accounts with a “fairly presents” opinion puts at risk this aspiration. The RIIO accounts have become very complex and there is a consequential risk that stakeholders will not find them useful or beneficial. We support Ofgem’s wider aspirations of ‘Simpler/Clearer/Fairer’ however adjustments for deferred tax, detailed pensions narrative and the judgement required in ascertaining an enduring value are unlikely to achieve these aims in a way that would be understandable for all potential stakeholders.

It is important therefore that stakeholders are clearly identified, needs assessed and a conclusion that delivery of RIIO accounts is the best way of addressing these needs for all parties.

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

In addition to the comments raised within the introduction to this response we are unclear of what the potential benefits (or costs) would be for RIIO2. We refer to costs as the ongoing requirement to audit has a financial cost associated with it. For RIIO1 this will form part of an increased cost base which will reduce the benefits currently being handed back to consumers from network efficiency.

For RIIO2 NWOs would expect to receive an allowance to cover the cost of the efficient audit to be performed. The scope and scale of the RIIO Accounts is likely to see the overall audit cost increase when compared to those anticipated for regulatory accounts in RIIO1, which the consumer will bear.

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Furthermore, as previously noted it is unusual for an accounting standard to apply retrospectively, preventing an organisation from implementing robust financial controls to capture relevant information prior to the commencement of that accounting period.

We therefore do not support the retrospective application of the standard for the year 2017/18.

We also urge a project gateway assessment to ensure that the Project Objective is properly defined and still being met, and that the delivery model proposed remains the most efficient for the consumer.

We believe that there are a number of measures NWOs could take to streamline information in a more meaningful measure of enduring performance. For example networks already set out their views across the price control of potential adjustments expected through the Price Control Financial Model (PCFM) via the Joint Office in their revenue forecasts published; however this information is not necessarily included with the Regulatory Accounts (but may be included in the annual reports of the NWO).

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