



Making a positive difference
for energy consumers

To all interested parties

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Dear Colleagues,

RIIO Accounts way forward and alternative approach

We want to see a step change in the how financial performance under our RIIO price controls is reported. We think stakeholders need more transparent and relevant regulatory accounting information to hold companies and the regulatory regime to account. We no longer think this is best achieved, for the remainder of RIIO-1, via full audited RIIO Accounts. In particular, we are not convinced that the audit component is required. Instead we propose to require the network operators (NWOs) to report more targeted and detailed financial information on their RIIO performance. This information would be made publically available and we would distil the key additional information into our RIIO annual reports so that there is consistent reporting within and across the sectors.

We think this approach is more proportionate. It would make the information more accessible and understandable than publishing full RIIO Accounts. We reached this view taking into account the responses to our RIIO Accounts consultation¹ and our continued engagement with Citizens Advice, the investor community and the NWOs. We think that the new approach will best deliver reporting that will help monitor and evaluate current and future price controls.

We plan for this additional reporting to provide insight into the impacts of each NWO's level of gearing, cost of debt, and actual tax payments on its returns under the price controls which current reporting does not easily allow. It will also provide information that will allow stakeholders to transparently reconcile the reported financial data with published (and audited) statutory accounts, which we think is important for the investor community.

The remainder of this letter provides further details on our proposals.

For the remainder of RIIO-1 we consider it appropriate, at this stage, for NWOs to report more targeted detailed financial information on their RIIO performance rather than submitting audited RIIO Accounts (as proposed in our November 2017 consultation). We would expect that their submissions would have director sign-off and a high standard of data assurance. We consider that this approach will see an improvement in financial reporting from what is currently reported and make the NWOs financial performance more accessible and comparable.

¹ <https://www.ofgem.gov.uk/publications-and-updates/introduction-riio-accounts-further-consultation-licence-modification>

We consider this approach will provide a strong platform for improved performance reporting for the RIIO-2 price control period. We retain the option to move to audited RIIO accounts for the start of RIIO-2 if the NWOs do not provide the improved information we are seeking.

We are currently developing Regulatory Financial Performance Reporting (RFPR) guidance and templates with the companies and once these have been developed, we will publish them on our website. These will include the accounting standards that we expect companies to adhere to, and establish common and consistent methodologies in how key financial data (such as the actual cost of debt, gearing and tax liabilities) are reported. We want the companies to submit their initial RFPR to us for the 2017-18 regulatory year at the end of October 2018. We will also consider the need for the current regulatory accounts reporting, but this will be dependent on the quality of the RFPR submitted in October 2018.

What we consider the NWOs should report in the RFPR

We consider that the NWOs should report their actual and forecast financial performance for the full RIIO-1 period. Much of the requirement will be consolidating information the NWOs already report or hold into one place and a single, consistent format that will be much more accessible to stakeholders. We are still developing the RFPR, but consider that it should include a requirement to report the following areas:

- Return on regulatory equity (RoRE) – including and excluding finance and tax; and based on actual as well notional gearing
- Revenue
- Operational costs
- Totex performance
- Incentive performance
- Innovation
- Financing costs
- Debt/gearing – notional vs actual
- Tax
- Enduring value adjustments (see below)
- RAV
- Dividend payments (in absolute terms and as a % of net profit)
- Pensions – relating to pension deficit
- Other Activities
- Supporting commentary and explanatory notes

As part of the reporting, we want NWOs to make adjustments for enduring value where appropriate. Enduring value adjustments will require the NWOs to make a degree of judgement, but we will work with the NWOs to develop a consistent methodology for making such adjustments where necessary. These methodologies will be published so that users of the RFPR can understand how the adjustments have been derived. Examples of what we consider enduring adjustments are:

- The estimated impact of future uncertainty mechanism claims,
- The estimated impact of close out mechanism (eg network output measures (NOMs) incentive),
- The impact of timing differences of delivery of outputs (eg volume drivers),
- The impact of known changes to future output delivery (eg volume drivers), and/or
- The impact of known adjustments not yet made to the PCFM (eg mid-period review decisions)

NWOs will be required to reconcile their RFPR reports to the following:

- Statutory Accounts
- HMRC corporation tax returns – CT600

- The Price Control Financial Model (PCFM)

For regulatory year 2017-18 we will be asking the NWOs to report their first RFRP as part of an information request and intend to include some of our analysis of their submission in our next RIIO annual reports (covering 2017-18), so as to inform RIIO-2 price controls. For the remainder of the RIIO-1 price control we propose to modify the Regulatory Instructions and Guidance (RIGs) to include the requirement to report their RFRP. We also propose that we will require the NWOs to publish their submissions four months after the end of each regulatory year.

I hope that presents a clear way forward. If you have any queries on this letter, please contact my colleague Mick Watson (mick.watson@ofgem.gov.uk) in the first instance.

Yours faithfully,



Akshay Kaul
Director
Network Price Controls, Systems and Networks