

**November 2000**  
**Regulatory Accounts**  
**Final Proposals**

## Summary

This paper sets out proposals for revised regulatory accounting arrangements in the gas and electricity industries to take effect from the financial year commencing April 2001. The proposals are based on information and ideas discussed in earlier consultation papers. The Office of Electricity Regulation (OFFER) first published a consultation paper on regulatory accounting in October 1998. The responses to that consultation paper were considered by Ofgem and a further consultation paper was published in August 2000.

Ofgem received 31 responses to the August 2000 consultation paper. These responses are summarised in Appendix 1 and have all been considered as part of the process of making these proposals. Generally, respondents supported the majority of the suggested changes to the regulatory accounts. The Public Electricity Suppliers (PESs) were mainly concerned about audit and publication issues and Transco was mainly concerned about the basis of preparation of regulatory accounts. This paper considers those responses, discusses the issues involved and recommends a number of proposals that will change the requirements on gas and electricity companies to prepare and publish regulatory accounts.

This paper proposes that regulatory accounts should be:

- ◆ prepared only by those separate licensed businesses subject to price control;
- ◆ prepared on the basis of historical cost accounting principles but with disclosure of each company's estimate of its regulatory asset value;
- ◆ presented in such a way that they can be reconciled in a reasonably straightforward way with the assumptions underlying the price control and also with the statutory accounts;
- ◆ subject to a more rigorous audit process; and
- ◆ published annually and include more information and narrative

The proposed changes to the relevant licence conditions resulting from these proposals will be published for consultation in April 2001, with a view to incorporating them in the licences of the companies concerned by June 2001. If the proposed changes to the

licence conditions are not accepted by the companies concerned Ofgem would need to consider whether to refer the matter to the Competition Commission.

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# 1. Introduction

## *Background*

- 1.1 This paper continues the review of regulatory accounts that started for the electricity industry with OFFER's October 1998 regulatory accounts consultation paper which was followed by Ofgem's regulatory accounts consultation paper published in August 2000 that covered both the gas and electricity industries. It proposes a number of changes to the requirements on electricity and gas licensees to prepare and publish regulatory accounts.
- 1.2 The provision of high quality information is important in ensuring that the regulatory process is as efficient as possible. Improving the quality and relevance of information that companies provide to the regulator has been the main focus of this review of regulatory accounts. This is also the focus of other important areas of work such as the Information and Incentives Project (IIP).
- 1.3 Regulatory accounts are the primary source of regular audited financial information about the businesses regulated by Ofgem. At present they comprise accounting information on each of the licensed separate businesses of the successor companies to the privatised gas and electricity companies, and also the Independent Public Gas Transporters (IPGTs). New entrants into electricity generation, electricity and gas supply and gas shipping are not required to prepare regulatory accounts.
- 1.4 The main rules governing the preparation of these regulatory accounts are set out in licence conditions. In broad terms these rules require the licensee to keep separate accounting records for each separate business, in the form that would be required by the Companies Act 1985 if the separate businesses were separate companies. Licensees must prepare regulatory accounts for each separate business, including a profit and loss account, balance sheet and cash flow statement. The accounts are audited by each licensee's external auditors.
- 1.5 The EC Directives on the internal markets for electricity and gas include conditions relating to the provision of accounting information. These proposals are consistent with those EC Directives. The full implementation of these Directives is a matter for Government and not Ofgem.

- 1.6 Those licensees owning distribution or transmission networks have obligations with respect to financial ring-fencing and business separation. These require, among other things, the companies undertaking those businesses to safeguard their financial wellbeing. While these obligations have sometimes been added to the licence conditions relating to regulatory accounts they are not part of this review.
- 1.7 An Inter-Regulatory Working Group is also examining regulatory accounting issues in gas, electricity, rail, telecommunications, water and sewerage, and airport and air traffic control services. It published a consultation paper on cross-industry issues in October 2000. That consultation paper summarised the approaches adopted by different utility regulators, discussed consistency of approach and made suggestions for greater co-ordination between regulatory offices where appropriate. These proposals are consistent with the thinking set out in the Inter-Regulatory Working Group's October 2000 consultation paper on the role of regulatory accounts in regulated industries.
- 1.8 This chapter provides an introduction and background. Chapter 2 identifies proposals to revise the scope of the existing regulatory accounting arrangements. Chapter 3 identifies proposals to improve the quality of information in regulatory accounts. Proposals relating to the audit of regulatory accounts are dealt with in Chapter 4 and proposals regarding other matters, such as issues relating to publication and the provision of narrative, are dealt with in Chapter 5. Appendix 1 provides a summary of the responses to the August 2000 consultation paper.

### ***Timetable***

- 1.9 These proposals are designed to take effect for the financial year commencing April 2001. Ofgem has appointed Deloitte & Touche to assist in developing Regulatory Accounting Guidelines (RAGs) for electricity distribution, which it is also hoped will take effect for the financial year commencing April 2001.

1.10 The timetable for the introduction of the RAGs is:

**Electricity Distribution RAGs**

- ◆ Deloitte and Touche's draft paper sent to Ofgem on Friday 1 December 2000;
- ◆ an industry seminar with the electricity distribution companies will be held on Wednesday 13 December in order to discuss the draft RAGs for the electricity distribution sector;
- ◆ RAGs published in January 2001;

**RAGs for the National Grid Company and the Scottish transmission businesses**

- ◆ consultation paper published in September 2001; and
- ◆ RAGs published in December 2001.

**Transco's RAGs**

It is hoped that a consultation paper will be published in 2001 or 2002 followed by the RAGs, depending on progress with the present price control review and the experience gained in developing the RAGs for the other industry sectors.



## 2. The Scope of Regulatory Accounting Arrangements

2.1 This chapter considers the main issues relating to the scope of regulatory accounting arrangements and in particular examines:

- ◆ what should be the main purpose of regulatory accounts;
- ◆ which businesses should prepare regulatory accounts; and
- ◆ when these proposals should be implemented.

2.2 In general respondents agreed with the suggestions made in the August 2000 consultation paper, although most respondents suggested that the timetable for implementation was too ambitious.

### *The main purpose of regulatory accounts*

#### **Summary of the August 2000 Consultation Paper and Respondents' Views**

2.3 The paper said that the main purpose of regulatory accounts in the gas and electricity industries should be to inform price control reviews and to monitor company performance between price control reviews. This is mainly because without the publication of the comparison of actual results to the assumptions underlying the price control:

- ◆ customers and their representatives would feel disenfranchised, as they have no way of accurately mapping how a company's operational performance relates to its financial results or how it is performing against the assumptions underlying its price control;
- ◆ investors would be more uncertain about a company's financial results because they are not able to determine how a company is performing against the assumptions underlying its price control; and
- ◆ Ofgem would not be able to monitor efficiently the performance of those companies subject to network price controls or compile financial information for future price control reviews. This has led to an undue emphasis on the periodic review process with Ofgem needing to collect and

analyse a disproportionate amount of information at the time of a price control review. The importance for companies of price control proposals and their ability to influence the outcome of the review in favour of their shareholders may have led to a disproportionate amount of management time and effort being devoted to this process, with certain companies engaging in a form of regulatory gaming. This is not in the interests of customers.

- 2.4 Respondents generally agreed that the main purpose of regulatory accounts in the gas and electricity industries should be to inform price control reviews and to monitor company performance between price control reviews. However, they were concerned about the level of detail any comparison with the assumptions underlying the price control would require and what information should be published.

#### **Assessment and Proposals**

- 2.5 Two respondents said that the information required by the IIP offered a better means of monitoring company performance than regulatory accounts. Nevertheless, Ofgem considers that regulatory accounts are designed to provide predominantly financial information about a company's performance which when taken together with the information derived from the IIP (which mainly considers quality of service and standards of performance) and other sources can be used to evaluate the overall performance of a company.
- 2.6 One respondent said that after the separation of the PES electricity distribution business from the PES electricity supply business regulatory accounts would no longer be necessary for these businesses. They also said that if Ofgem maintained the requirement for the electricity distribution business to prepare regulatory accounts it would be undesirable to publish two different sets of accounts (statutory accounts and regulatory accounts), when they would probably be prepared using different accounting policies. Ofgem does not consider that this is undesirable given that the two sets of accounts fulfil different purposes. Statutory accounts are primarily designed to meet the requirements of UK Company Law, and where relevant, Stock Exchange listing requirements whereas regulatory accounts are designed to meet the requirements of the

regulator. These requirements are different although there are many similarities. Thus regulatory accounts will be prepared using RAGs rather than UK Generally Accepted Accounting Practice (UK GAAP). While the majority of accounting policies included in the RAGs will be consistent with UK GAAP it is likely that there will be some differences between the two, for example in relation to detailed matters such as capitalisation policy. The RAGs will address these detailed issues and will form the basis of the regulatory accounts. It is unlikely that the companies concerned would want to base their statutory accounts on the accounting policies contained in the RAGs and may not want to include the additional detail that will be required in the regulatory accounts. This means that it will usually be impractical to have just one set of accounts for these companies.

- 2.7 Consistent with the August 2000 consultation paper, Ofgem's view is that the main purpose of regulatory accounts in the gas and electricity industries should be to inform price control reviews and to monitor company performance between price control reviews.

### ***Anti-competitive behaviour and financial wellbeing***

#### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 2.8 The paper suggested that regulatory accounts are insufficient for the purpose of investigating anti-competitive behaviour in markets where competition is developing. This would be better served by up to date information on how a company has arrived at a particular price and on wider aspects of a company's market behaviour, as well as the flexibility to examine these matters over various time periods. In contrast regulatory accounts provide more aggregated data and relate to fixed time periods. The Competition Act 1998 addresses the issue of anti-competitive behaviour and is designed to operate without the support of annual accounting information.
- 2.9 With regard to financial wellbeing the paper said that, in the light of the large amount of corporate restructuring that has taken place since 1995, Ofgem has introduced financial ring-fencing provisions designed to safeguard the financial wellbeing of distribution, transmission and transportation businesses. These conditions, which are continuously active and forward looking, provide a more

effective approach to protecting the financial position of a business than monitoring regulatory accounts. Nevertheless, if the quality and consistency of information in regulatory accounts were improved, they would provide more useful information which might assist a variety of users to assess trends in the financial position of a regulated business.

- 2.10 Generally respondents agreed with this view. A number of respondents said that there should be transparency in the transactions between the monopoly business and the competitive business.

### **Assessment and Proposals**

- 2.11 Consistent with the discussion set out above it is clear that in the gas and electricity industries the main purpose of regulatory accounts should not be to detect anti-competitive behaviour and financial ring-fencing provisions are the best way of ensuring that the financial wellbeing of a licence holder is safeguarded.

### ***Which businesses should prepare regulatory accounts?***

### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 2.12 The paper suggested that regulatory accounts should only be prepared by those separate licensed businesses subject to price control. This would have the following implications:
- ◆ the requirements on electricity transmission businesses to prepare regulatory accounts would be retained;
  - ◆ the distribution businesses of the PES's would continue to prepare regulatory accounts;
  - ◆ for Scottish Power and Scottish Hydro, regulatory accounting requirements for their generation, supply and wholesale activities, will be removed once Ofgem is satisfied that there are competitive trading arrangements in Scotland. These trading arrangements will be introduced as part of the introduction of British Electricity and Transmission Trading Arrangements (BETTA);

- ◆ regulatory accounting requirements for the interconnector activities of Scottish Power and Scottish Hydro will be reconsidered once BETTA is introduced;
- ◆ the requirements on all other gas or electricity supply businesses and gas shipping businesses to prepare regulatory accounts would be removed as price controls were removed;
- ◆ Transco's gas transportation business would continue to prepare regulatory accounts, but the scope of the requirements would be reconsidered following the completion of the present price control review; and
- ◆ for Independent Public Gas Transporters (IPGTs) the scope of the regulatory accounting arrangements would be reconsidered following the review of IPGT regulation in 2001.

2.13 Respondents generally agreed with this view. Some respondents wanted the immediate removal of the requirement on suppliers, shippers, generators and the Scottish generation, supply, wholesale and interconnector businesses to prepare regulatory accounts. Other respondents said that the requirements on supply companies should be maintained until the price control is lifted and generators should continue to prepare regulatory accounts until the New Electricity Trading Arrangements (NETA) are introduced.

### **Assessment and Proposals**

2.14 In some of the existing licence conditions there is an arrangement whereby regulatory accounts are only required if Ofgem issues an instruction in relation to those matters. This arrangement will be extended to all suppliers, shippers, generators and the Scottish wholesale and interconnector businesses that are presently required to produce regulatory accounts. The main purpose of regulatory accounts is to inform price control reviews and to monitor company performance between price control reviews. Given the developments in the gas supply and electricity supply markets and that generation is no longer price controlled, it is Ofgem's present intention not to require further regulatory accounts from suppliers, shippers and generators. With the exception of the

generation, supply, wholesale and interconnector businesses of Scottish Power and Scottish Hydro will still be required to prepare and publish regulatory accounts. Taking account of the above modifications it is proposed to make the changes identified in the August 2000 consultation paper and summarised in paragraph 2.12.

- 2.15 In making any licence modifications it is necessary for Ofgem to act in a way that is consistent with the EC's Gas Directive 98/30/EC and the EC's Electricity Directive 96/92/EC on the production of accounting information within the gas and electricity industries. In light of this it is likely that a new licence condition may be required in relation to generation that will require British Energy, BNFL, First Hydro, Innogy, International Power and PowerGen to keep separate internal accounting records in respect of these activities. This new licence condition would also have to be introduced for Scottish Power and Scottish Hydro if the requirement on them to produce regulatory accounts for their generation activities was removed.

### ***Quality of information in regulatory accounts***

#### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 2.16 The paper said that Ofgem does not receive regular financial information of sufficient quality to facilitate the monitoring of the performance of those companies subject to network price controls or compile financial information for future price control reviews. It also said that it would be useful to compare a company's performance across time, with other companies and with the assumptions underlying price controls. In order to ensure that these comparisons are valid, the information provided in the regulatory accounts has to be reasonably consistent.
- 2.17 In general respondents agreed with the view that the quality of the information provided in the regulatory accounts should be improved. Some respondents said that the main issue was that in the past the quality of the information provided was good but the information was not always relevant. Also some respondents said that the cost of improving the quality of the information has to be in proportion to the benefits that the use of improved information will bring.

## **Assessment and Proposals**

- 2.18 It is clear that the information in the regulatory accounts has to be made more relevant and where necessary improved. It is also important not to increase unduly the regulatory burden.
- 2.19 By developing the RAGs (see paragraphs 3.16 to 3.22) and defining a standard template for the regulatory accounts, it should be possible to achieve greater consistency in regulatory accounts both across time and between companies. This will facilitate comparisons with the assumptions underlying price controls. In developing the RAGs and the standard templates careful consideration will be given to ensuring that the costs of implementing and maintaining any new arrangements are proportional to the benefits that the use of improved information will bring.

### ***Timetable***

#### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 2.20 The paper said that the new regulatory accounting arrangements would take effect from the financial year commencing April 2001. It also suggested that RAGs would be in place for the electricity distribution businesses for the year commencing April 2001. The paper also said that similar guidelines would be developed for National Grid Company's (NGC's) transmission business and the Scottish electricity transmission businesses for the financial year commencing April 2002. For Transco's transportation business RAGs will be developed following the completion of the present price control review.
- 2.21 In general respondents said that this timetable was ambitious, particularly if the implementation of the revised RAGs required significant changes to financial accounting systems. In most cases regulatory accounts are currently prepared by amending accounting data provided by the company's financial accounting systems. These are typically designed for the primary purpose of statutory accounting and internal management reporting. With the development of RAGs this approach may no longer be suitable, particularly if the activity analysis required by Ofgem is significantly different to the company's internal organisational structure. In these circumstances the financial accounting systems

of the companies concerned may need to be modified, in order to produce efficiently, data that is suitable for inclusion in the regulatory accounts.

### **Assessment and Proposals**

- 2.22 Ofgem notes the concerns of the respondents and agrees that the timetable would be ambitious if the adoption of the RAGs required major changes to their financial systems. This issue is being considered as part of the development of the RAGs and if major changes are required, the timetable may have to be either relaxed or an interim solution adopted. This issue will be resolved before any RAGs are finalised.
- 2.23 Bearing this in mind it is proposed that the timetable will be as summarised above and set out in detail in paragraphs 1.9 and 1.10



### 3. Regulatory Accounts and Price Controls

3.1 This chapter sets out proposals to define more clearly the relationship between regulatory accounts and price controls, in particular how the regulatory accounts should be prepared. The main issues it examines are:

- ◆ the basis of preparation of the regulatory accounts;
- ◆ RAGs; and
- ◆ the content of the regulatory accounts.

3.2 In general respondents agreed with the suggestions made in the August 2000 consultation paper, although some respondents said that Modified Historical Cost Accounting (MHCA) or Regulatory Asset Value (RAV) should be used as the basis of preparation of regulatory accounts and some respondents questioned the level of detail to be contained in the RAGs.

#### *The basis of preparation of regulatory accounts*

##### **Summary of the August 2000 Consultation Paper and Respondents' Views**

3.3 The paper suggested that using Historical Cost Accounting (HCA) principles together with a reconciliation to RAV and the company's statutory accounts was the best approach to the basis of preparation of regulatory accounts in the gas and electricity industries.

3.4 Most respondents generally agreed with this view. However there was some support for the use of MHCA or RAV and one respondent preferred the use of Current Cost Accounting (CCA). Two other respondents also wanted CCA information as well as RAV information to be disclosed.

##### **Assessment and Proposals**

3.5 There is general agreement that there should be a single set of accounting principles used as the basis of preparation of regulatory accounts across the gas and electricity industries but that no one asset valuation method meets all the needs of all of the users of regulatory accounts. It is also important that the regulatory accounts include sufficient information that would allow the users of

the regulatory accounts to compare actual results to the assumptions underlying the price control. Among other things this will require the disclosure in the regulatory accounts of the company's estimate of its RAV.

- 3.6 Price controls are set using the RAV method of valuing fixed assets and other accounting principles. RAV is not a set of accounting principles and there is no one set of conventional accounting principles consistent with UK GAAP that reflects the whole of the price control process used in the gas and electricity industries. In most cases RAV has generally been based on the market value of the company at privatisation plus fixed asset additions less fixed asset disposals less regulatory depreciation (calculated using regulatory asset lives and methods) together with an inflation adjustment based on RPI. Both fixed asset additions and fixed asset disposals are based on the accounting principles used for price control purposes which are not necessarily the same as those used in drawing up statutory accounts.
- 3.7 HCA and MHCA both comply with UK GAAP and are the normal bases of preparation used in the statutory accounts of UK companies. This suggests that either HCA or MHCA should be used as the basis of preparation of regulatory accounts and that reconciliations to both the company's statutory accounts and the assumptions underlying the price control should be disclosed in the notes to the regulatory accounts.
- 3.8 In the interests of improving consistency across the regulatory accounts of the companies in the gas and electricity industries, the choice between HCA and MHCA needs to be resolved. At present Transco uses MHCA for its statutory accounts whereas all the other companies that will be required to prepare regulatory accounts in the future use HCA as the basis of preparation of their statutory accounts.
- 3.9 Transco also uses MHCA as the basis of preparation of its regulatory accounts and its internal management accounts. Transco has said that the use of HCA does not provide useful information about its business and it would prefer RAV to be used as the basis of preparation for its regulatory accounts. Transco also said that in their view historical cost values are also often a matter of chance and timing, particularly in the energy and water sectors where asset bases have been

created over long periods of time. Most of the other companies that will prepare regulatory accounts in the future favour HCA as the basis of preparation together with the disclosure of RAV information because HCA is more generally understood, less subjective and they already prepare their statutory accounts using this basis of preparation.

3.10 Transco's regulatory accounts for the year ended 31 December 1999 can help to illustrate the potential differences that can result from using different bases of preparation. In those accounts the value of the fixed assets at 31 December 1999 on a MHCA basis was £13 billion (which is similar to its RAV as estimated by the Monopolies and Mergers Commission in its 1997 report on BG plc) while on a HCA basis it was £7 billion. In order to determine the valuation of its fixed assets on a MHCA basis, Transco increased the value of its fixed assets by £10 billion to reflect the net replacement cost of those fixed assets but also reduced the value of those fixed assets by £4 billion to reflect their value in use. This value in use adjustment was necessary because whether HCA, MHCA, or CCA is used as the basis of preparation of accounts, under UK GAAP, fixed assets cannot be carried at a valuation greater than their recoverable amount (which is the higher of either net realisable value and value in use).

3.11 On balance, HCA seems preferable as the basis of preparation because:

- ◆ it is a relatively simple and straight forward approach that is widely used and understood;
- ◆ there is less subjectivity over the valuation of fixed assets;
- ◆ it is preferred by the large majority of companies that will prepare regulatory accounts in the future; and
- ◆ it will provide greater consistency between gas and electricity companies which will also more readily allow comparisons to be made with gas transportation companies in other countries, particularly in the USA and the rest of Europe.

- 3.12 The deficiencies to which Transco refer can be overcome by:
- ◆ requiring a reconciliation to the assumptions underlying the company's price control, which will include the disclosure of the company's estimate of its RAV;
  - ◆ requiring a reconciliation to the company's statutory accounts; and
  - ◆ permitting some revaluations of fixed assets where the use of HCA is impractical as discussed in paragraph 3.15.
- 3.13 In addition, if the companies want to they can prepare and publish additional information about their regulated activities. So for example Transco is free to prepare and publish additional information on a MHCA basis.
- 3.14 To summarise, regulatory accounts should be prepared on a HCA basis and should also include reconciliations both to the assumptions underlying the price control (which will include the disclosure of the company's estimate of its RAV) and its statutory accounts.
- 3.15 Many companies in the UK have revalued some of their fixed assets although in most cases the basis of preparation is described as being HCA rather than MHCA, usually because these revaluations are insignificant. In order to adopt a broadly consistent approach to the basis of preparation across the gas and electricity industries, while avoiding unnecessary changes, it is intended that as regulatory accounts will be prepared on a HCA basis, any revaluations of fixed assets for those accounts would require Ofgem's consent. It would be Ofgem's intention only to give consent to the inclusion of revalued fixed assets in the regulatory accounts where any difference between the revalued amount and the HCA amount would be insignificant and where it would be difficult to provide equivalent HCA values.

### ***Regulatory Accounting Guidelines***

#### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 3.16 The paper said that a detailed framework of principles would be the most appropriate approach to establishing a set of RAGs. If appropriate these

principles would be supported in certain areas by detailed rules for specific aspects of the RAGs, such as capitalisation policy.

- 3.17 The paper also said that it was necessary to consider how RAGs should relate to more general accounting standards. It concluded that the RAGs should take precedence over other accounting standards in the preparation of regulatory accounts. Where the RAGs did not cover an accounting issue then UK GAAP would be used.
- 3.18 Respondents generally agreed with this view, although some respondents said that UK GAAP should take precedence over the RAGs. Some respondents also pointed out that in the electricity industry, following the separation of the PES distribution and supply businesses into separate legal entities, these companies will prepare and publish statutory accounts, and suggested that this should limit the requirement for additional regulatory accounting information.

#### **Assessment and Proposals**

- 3.19 It is likely that the majority of accounting policies included in the RAGs will be consistent with UK GAAP. Greater consistency between the regulatory accounts of the companies concerned and appropriate comparisons with the assumptions underlying the price control are important aims of this review. In order to achieve these aims in situations where the RAGs do not comply with UK GAAP, then the RAGs will take precedence. Where the RAGs do not cover an accounting issue then UK GAAP will be used. This is because the RAGs will have been designed specifically to consider the regulatory accounting issues involved in the preparation of regulatory accounts.
- 3.20 In practice most differences between the accounting policies of the companies required to prepare regulatory accounts will probably appear at a more detailed level than addressed by UK GAAP. UK GAAP is designed to apply to the accounts of all UK companies and as such is a framework of accounting principles, whereas the RAGs will be designed for the specific purpose of providing accounting information for one type of company. This distinction allows the RAGs to be as detailed as required whereas UK GAAP has to be more general. This means that by having detailed rules in certain specific areas the application of those rules will ensure that there is more consistency between the

regulatory accounts of the companies concerned than would be achieved by just complying with UK GAAP. For example, a typical accounting policy for the capitalisation of cable repairs in electricity distribution would use the length of the cable repaired to determine whether the expenditure is capital or operating expenditure. At present one electricity distribution business capitalises all cable repairs over 2 metres whereas another electricity distribution business only capitalises cable repairs when more than 50 metres of cable is repaired. Both of these treatments comply with UK GAAP, but clearly do not produce consistent results.

3.21 In future it will be important to introduce more consistency into regulatory accounts and understand how capitalisation policy relates to the assumptions made during the last price control review. For the reasons discussed above it is proposed that a detailed framework of principles would be the most appropriate approach to establishing a set of RAGs. This would be supported in certain areas by detailed rules for certain aspects of the RAGs such as on capitalisation policy. Ofgem has appointed Deloitte & Touche to assist in developing RAGs for electricity distribution, which it is hoped will take effect for the financial year commencing April 2001.

3.22 In summary the RAGs that will be published in January 2001 will mainly cover the following issues:

- ◆ the level of detail that will be included in the regulatory accounts;
- ◆ the accounting policies to be used for each aspect of regulatory accounting. In most cases this will entail a reference to UK GAAP but in some cases such as capitalisation policy there will probably be a specific detailed policy;
- ◆ the principles to be followed for accounting for cost attributions, cost allocations and inter-business recharges. In particular examining Service Level Agreements and how these types of charges can be verified; and
- ◆ definition of the activity analysis structure and how that will be incorporated into the regulatory accounts.

## ***Arrangements for the monitoring and enforcement of the RAGs***

### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 3.23 The paper said that it would be necessary to develop a suitable approach to enforcing the RAGs. This would need to include consideration of the procedures and processes for monitoring regulatory accounts, investigating difficulties and developing and enforcing suitable remedies. Issues relating to audit arrangements are dealt with in chapter 4.
- 3.24 Respondents did not comment directly on this issue although they did comment on audit issues which are discussed in chapter 4.

### **Assessment and Proposals**

- 3.25 The provision of an appropriate audit will resolve some of the issues relating to monitoring and enforcement. However, there will still be a need for Ofgem to closely monitor and review regulatory accounts, the regulatory accounting framework and RAGs in order to ensure that regulatory accounts provide information which is reasonably consistent, useful and of good quality.

## ***Reporting periods***

### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 3.26 The paper said that in both the electricity and gas industries price controls are based on reporting periods ending 31 March, so having all regulatory accounts prepared with this year end would aid consistency and transparency. The paper also noted that this would be a new requirement for gas companies.
- 3.27 The majority of respondents agreed with this view, although two respondents noted that, with regulatory accounts being required to be published between April and July, companies with a December year end would probably also publish their own interim accounts during the July to September. These interim accounts will cover a part of the period included in the regulatory accounts. This will mean that those companies would have to consider the relevant Stock Exchange requirements governing such disclosures.

## **Assessment and Proposals**

- 3.28 All of the gas and electricity price control years run from 1 April to 31 March. The companies that have to prepare regulatory accounts use either a 31 March year end or a 31 December year end for statutory accounting purposes. It is therefore not possible to be consistent both with price control year ends and with all of the companies' statutory accounting year ends. Given that the main purpose of regulatory accounts is to monitor performance against price controls and to inform future price control reviews Ofgem proposes that a 31 March year end should be used for the preparation of regulatory accounts. In relation to the issue of the timing of the publication of regulatory accounts and interim accounts for those companies with December year ends, it is the responsibility of the companies concerned to ensure that they comply with the relevant legal, Stock Exchange and regulatory requirements.

### ***The format of regulatory accounts***

#### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 3.29 The paper said that a template for the regulatory accounts will be developed that will lead to a more consistent presentation of information in the regulatory accounts that will provide clear comparisons with the assumptions underlying the price control.
- 3.30 Respondents generally agreed on the need for a standard template. The regulated companies in particular were concerned with the level of detail contained in the draft that was included in the paper. Their main concern was over the activity analysis and the amount of commentary.

## **Assessment and Proposals**

- 3.31 The level of detail for activity based analysis may need to be reduced from that shown in the August 2000 consultation paper so that it is practicable for the electricity distribution businesses to complete the template on a reasonably consistent basis. A revised template which will show the level of detail required for the activity based analysis will be included in the electricity distribution business RAGs. Similarly templates for NGC's transmission business, the Scottish electricity transmission businesses and Transco's transportation business



will be included in the RAGs for those businesses. All of these RAGs will be published in accordance with the timetable set out in paragraphs 1.9 and 1.10.

## 4. Audit Arrangements

4.1 This chapter considers the process by which regulatory accounts are audited. The audit of regulatory accounts is particularly important in ensuring that regulatory accounts are credible. Ofgem and The Inter-Regulatory Working Group on regulatory accounts are discussing these issues with a working group from the Institute of Chartered Accountants in England and Wales (ICAEW). The main issues considered are:

- ◆ the appointment of the auditors;
- ◆ the duty of care owed to Ofgem by the auditor;
- ◆ the materiality levels used by the auditors;
- ◆ the audit opinion; and
- ◆ the engagement letter.

4.2 Generally respondents agreed that audit arrangements needed clarifying, although a number of them said that they did not want Ofgem to appoint the auditors of the regulatory accounts or to set materiality levels. The majority of the respondents recognised that the auditor should owe a duty of care to Ofgem.

### *Who should perform the regulatory accounts audit?*

#### **Summary of the August 2000 Consultation Paper and Respondents' Views**

4.3 The paper said that it is for consideration whether a company's statutory accounts auditors should be allowed to perform the audit of its regulatory accounts. If the audit of the regulatory accounts were to be carried out on a basis independent of the statutory accounts audit this might improve the quality, objectivity and credibility of the regulatory accounts. It might also make it possible for the same firm to audit the regulatory accounts of all the companies in the gas and electricity industries so enhancing the consistency of regulatory accounting information. However, appointing such auditors might unduly increase the costs of the audit if the auditors of the regulatory accounts duplicated some of the work associated with the statutory accounts audit.

- 4.4 All of the respondents agreed that it would be appropriate for a company's statutory accounts auditors also to audit its regulatory accounts. They claimed that it would be impractical, costly and slow to have one firm of auditors audit the regulatory accounts of all the relevant licensees in the gas and electricity industries.

### **Assessment and Proposals**

- 4.5 While there could be merit in requiring a separate audit of the statutory accounts from that of the regulatory accounts and there could also be merit in having the same firm of auditors audit the regulatory accounts of all companies operating in a particular sector of the gas and electricity industries, at present the costs and benefits of these approaches are hard to quantify. A better approach would be to use reserve powers as a means of ensuring that the audit of the regulatory accounts meets Ofgem's requirements.
- 4.6 It is proposed that the following reserve powers should be granted to Ofgem in order to ensure that the audit of the regulatory accounts meets its requirements. If necessary Ofgem should be able to require:
- ◆ the appointment of a different auditor if the existing audit arrangements prove unsatisfactory;
  - ◆ a second audit by the licensee's auditors;
  - ◆ a second audit by a different auditor; and
  - ◆ a second audit of specific areas of concern, perhaps with the same auditors reporting on a number of different companies.
- 4.7 At present it is envisaged that these reserve powers will be included in a new licence condition. The introduction of the new licence condition will be discussed with the companies concerned and the criteria for assessing the audit will be determined in discussions with the companies concerned and the ICAEW.

## ***Auditors remuneration***

### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 4.8 The paper said that if Ofgem were going to require the appointment of a particular firm of auditors it would also be necessary to consider whether they should be remunerated by Ofgem or the licensee.
- 4.9 In the situation where Ofgem has appointed the auditor, some respondents said that Ofgem should remunerate the auditor whereas other respondents said that the licensee should remunerate the auditor.

### **Assessment and Proposals**

- 4.10 The costs of the audit of the regulatory accounts will be paid for by the company and will be taken into account in the review of its price control.

## ***Duty of care***

### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 4.11 The paper said that at present auditors have a duty of care to the regulated company and that it is not clear whether auditors also have a duty of care to Ofgem. Given that Ofgem relies upon the audit report, the auditor should also owe a duty of care to Ofgem so the existing arrangements need to be clarified.
- 4.12 The large majority of respondents agreed that the auditor should also owe a duty of care to Ofgem. In addition, some respondents said that auditors already have a duty of care to Ofgem.

### **Assessment and Proposals**

- 4.13 It is clear that the auditor should have a duty of care to Ofgem and this should be made explicit in the engagement letter.

## ***Materiality levels***

### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 4.14 The paper said that at present the materiality level used for the audit of group level statutory accounts might also be used as the materiality level for the audit of the regulatory accounts. For some companies the group may be significantly larger than its regulated activities. In these circumstances the appropriate level for an issue to be material to the audit of the group may be significantly in excess of the appropriate materiality level for a regulated activity or business. Therefore, it may be more appropriate for Ofgem either to set or to approve the materiality levels for the audit of the regulatory accounts. Transparency could also be improved by disclosing either in the audit opinion or on the face of each accounting statement the materiality level used in the audit.
- 4.15 The large majority of respondents said that the auditor should set materiality levels.

### **Assessment and Proposals**

- 4.16 While the level of materiality is an accounting and auditing issue, it is clear that it should relate directly to the regulated business. In addition as the regulatory accounts are prepared at the direct request of Ofgem it would be reasonable for Ofgem to have a reserve power to set materiality levels where Ofgem decided that the approach adopted by the auditor was not appropriate. In addition it would be useful for other users of the accounts to gain an appreciation of the approach that has been taken to materiality by including an explanation of materiality in the audit report. This is one of the matters that will be dealt with in the regulatory accounts engagement letter.

## ***Audit opinion***

### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 4.17 The paper suggested that if RAGs were going to take precedence over UK GAAP then it might be appropriate to use "presents fairly in accordance with" rather than "true and fair view" in the audit opinion. Not many respondents addressed this issue. Of those that did respond the regulated companies generally

preferred the use of “true and fair view” and the auditing organisations preferred the use of “presents fairly in accordance with” or “properly prepared in accordance with”.

### **Assessment and Proposals**

- 4.18 Given that the RAGs are going to take precedence over UK GAAP and they would contain principles that may not comply with UK GAAP, then it is not appropriate to use “true and fair view” in the audit opinion. The audit opinion “properly prepared in accordance with” is relatively mechanistic and does not allow the use of judgement on issues not covered by the RAGs. So it is proposed that the audit opinion for regulatory accounts would be “presents fairly in accordance with” which is also used in some other similar regulatory situations.

### ***Form and content of engagement letters***

#### **Summary of the August 2000 Consultation Paper and Respondents’ Views**

- 4.19 The paper said that the audit issues that are of interest to Ofgem, could be dealt with either by including Ofgem in the engagement letter between the regulated company and the auditor or by having a separate engagement letter between Ofgem and the auditor. The intention would be to place the relationships between all three parties on a more formal basis and the engagement letter could include:
- ◆ the duty of care owed by the auditor to Ofgem and liability levels;
  - ◆ the disclosure of sensitive information to Ofgem;
  - ◆ the process for holding tri-partite meetings and written communication between the auditor, regulated company and Ofgem and bi-lateral communications between the auditor and Ofgem; and
  - ◆ materiality levels.
- 4.20 Respondents generally agreed with this view.

## **Assessment and Proposals**

- 4.21 There is general agreement that the approach described above is correct so the proposal is that there will be a tripartite engagement letter between Ofgem, the regulated company and the auditors covering the issues discussed above.

## 5. Other Matters

- 5.1 This chapter mainly considers matters relating to the publication of regulatory accounts such as:
- ◆ how regulatory accounts should be published;
  - ◆ what information the published regulatory accounts should contain; and
  - ◆ when regulatory accounts should be published.
- 5.2 In general the respondents agreed with the suggestions made in the August 2000 consultation paper, although most of the PESs were reluctant to publish detailed narrative and information about cost allocations, cost attributions and inter-business recharges as they said that this information was commercially sensitive.

### *Publication issues*

#### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 5.3 The paper said that it would seem appropriate that in future all companies that are required to prepare regulatory accounts in the electricity and gas industries should be required to publish their regulatory accounts and make them available on the Internet. The paper also said that it will be important that the published version of the regulatory accounts contains a full range of information including a statement of cost attributions, cost allocations and inter-business recharges.
- 5.4 Respondents generally agreed with the view contained in the paper, although as noted earlier there were concerns about the level of detail to be included in the published regulatory accounts. In particular the respondents who produce regulatory accounts did not see the value of having detailed disclosures about cost attributions, cost allocations and inter-business recharges. Some other respondents said that cost attributions, cost allocations and inter-business recharges should be made more transparent.



## **Assessment and Proposals**

- 5.5 It is clear that a version of the regulatory accounts should be published and there would be advantages in making it available on the Internet. If there is commercially sensitive information in the regulatory accounts then Ofgem will consider whether it should be excluded from the published version of the regulatory accounts. Generally, despite an increase in the use of contractors and external services, electricity transmission, electricity distribution and gas transportation remain monopoly businesses subject to price control. It is important that the costs of these businesses are transparent. Ofgem proposes that the published version of the regulatory accounts should contain a statement of cost attributions, cost allocations and inter-business recharges. The level of detail to be included in the published version of the regulatory accounts will be shown in the templates that will be part of the RAGs. The RAGs for the electricity distribution businesses, NGC's transmission business, the Scottish transmission businesses and Transco's transportation business will be published in accordance with the timetable set out in paragraphs 1.9 and 1.10.

### ***Disclosure of other information in the published regulatory accounts***

#### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 5.6 The paper said that the other information that might need to be contained in the published regulatory accounts included:
- ◆ a note setting out the licensee's estimate of its regulatory asset value;
  - ◆ the additional information normally only required as part of a listed company's statutory accounts;
  - ◆ information on financial structure (tax, interest and dividends);
  - ◆ a reconciliation between the information in the regulatory accounts and other relevant information, such as the statutory accounts or data on capital expenditure contained in quality of supply reports; and
  - ◆ a detailed narrative.

- 5.7 Respondents generally agreed with this view, although there were differences of opinion over the level of detail to be included in the narrative section. Some respondents said that some of the narrative required may be commercially sensitive.

### **Assessment and Proposals**

- 5.8 The main area of discussion was over the level of detail to be included in the published version of the regulatory accounts. This issue will be addressed in the templates that will be included in the RAGs. The RAGs for the electricity distribution businesses, NGC's transmission business, the Scottish transmission business and Transco's transportation business will be published in accordance with the timetable set out in paragraphs 1.9 and 1.10. Nevertheless, it is proposed that in broad terms the published regulatory accounts will contain the information set out above.

### ***Publication timetable***

#### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 5.9 The paper said that at present regulatory accounts are sent to Ofgem up to 6 months after the regulatory accounting year end. The companies that presently produce regulatory accounts in the electricity and gas industries usually publish their statutory accounts substantially earlier. The paper suggested that a more suitable timetable for the regulatory accounts to be published might be within 4 months of the regulatory accounting year end.
- 5.10 The large majority of respondents agreed with the view contained in the August 2000 consultation paper. The only ones who did not agree said that as the regulatory accounts may be more detailed, more work may be required to produce them.

### **Assessment and Proposals**

- 5.11 While recognising that there may be more work required to produce the regulatory accounts because they will become more detailed, it should be noted that for NGC and the electricity distribution businesses the preparation of regulatory accounts will also be made simpler following the removal of the requirement to produce the regulatory accounts on a CCA basis. Therefore it is reasonable to propose a timetable that will require the preparation and publication of regulatory accounts within 4 months of the year end.

### ***Interim regulatory accounts***

#### **Summary of the August 2000 Consultation Paper and Respondents' Views**

- 5.12 The paper said that at present interim regulatory accounts are prepared on a half-yearly basis by certain electricity and gas licensees. In general these interim accounts contain little information and add relatively little to the information contained in the annual regulatory accounts. The paper concluded that in the light of these factors it might be appropriate to remove the requirements on licensees to produce interim regulatory accounts. Only one respondent disagreed with the view contained in this paper.

### **Assessment and Proposals**

- 5.13 The reasoning set out in the August 2000 consultation paper remains valid so it is proposed that interim regulatory accounts will no longer be required.

# Appendix 1: Summary of the Responses to the August 2000 Consultation Paper

- 1.1 Ofgem received 31 responses to the August 2000 consultation paper on regulatory accounts. Responses were received from a range of interested parties, including 11 PESs, NGC, 4 generators, 3 consumer organisations, 2 Public Gas Transporters, 3 audit firms, the Auditing Practices Board (APB), the ICAEW and 5 other respondents. Some of the responses for companies that are part of a group that operates in more than one sector of the gas and electricity industries were submitted from the parent company. This means that although the above list only includes 11 PESs, the views of all 14 PESs are included in this final proposals paper. A full list of respondents is provided below.

## Overview

- 1.2 All respondents agreed that regulatory accounting in the gas and electricity industries should be reformed broadly along the lines suggested in the August 2000 consultation paper. Most of the PESs concerns related to audit and the publication of information that they regard as being commercially sensitive. Most of the respondents supported the use of HCA as the basis of preparation for regulatory accounts although some respondents preferred the use of MHCA or RAV as the basis of preparation. There was also widespread support for a detailed narrative and for publication of the regulatory accounts via the internet.

## Summary of Responses by Group

### PESs

- 1.3 The majority of PESs said that the proposed implementation date of April 2001 was ambitious as sufficient time needs to be allowed to make any necessary changes to the companies financial systems and procedures.
- 1.4 Most PESs agreed that the main purpose of regulatory accounts was to inform the regulation of companies subject to price control, provided an appropriate balance could be maintained between the volume of information, its usefulness and the cost of providing it. Nevertheless PESs said that commercially sensitive

information should not be disclosed to the public. One PES said that the IIP should be used to monitor performance.

- 1.5 The PESs suggested that regulatory accounting requirements should be removed for non-price controlled businesses such as generation and supply.
- 1.6 The large majority of PESs supported the use of HCA as the basis of preparation and most of them also said that the disclosure of information about the RAV was also important. Two PESs said that CCA information should also be included in the regulatory accounts. There was general support for a framework of principles to be used as the basis for the RAGs rather than a detailed set of rules. This was said to be a more flexible and appropriate approach. Most PESs also said that UK GAAP should take precedence over RAGs in the preparation of regulatory accounts.
- 1.7 Most PESs agreed that regulatory accounts should be prepared using a 31 March year end. One PES said that as most PESs have a December year end for their statutory accounts, it would be more appropriate to use a December year end for the regulatory accounts year end, although it recognised the problems this would cause when comparisons are made to the assumptions underlying the price control.
- 1.8 All PESs said that the regulatory accounts should be audited by the auditor that also audits their statutory accounts. This was said to be the most cost-effective solution and avoids duplication of work. Most PESs agreed that the auditors of the regulatory accounts should have a duty of care to Ofgem and some of them said that the auditors already had a duty of care to Ofgem. All PESs suggested that materiality levels should be set by auditors as part of their normal approach to an audit. Generally the PESs preferred the use of "true and fair view" in the audit opinion. Most PESs also suggested that engagement letters could include other issues relating to the audit process such as duty of care.
- 1.9 Most PESs generally supported the publication of regulatory accounts on the Internet and they also agreed that it would be appropriate to produce regulatory accounts within four months of the end of the regulatory accounting year.

- 1.10 The majority of the PESs supported the requirements for additional information, particularly on capital structure, the reconciliation between statutory and regulatory accounts and publication of a detailed narrative. However, the publication of detailed information on cost allocations, cost attributions and inter-business recharges was not supported as this might expose commercially sensitive information to competitors. In addition the PESs were reluctant for forecast information to be included in the regulatory accounts. All PESs agreed that it would be sensible to discontinue the production of interim regulatory accounts.

### **Generators**

- 1.11 The generators suggested removing regulatory accounting requirements from businesses that were in competitive markets.
- 1.12 All of the generators supported the production of regulatory accounts on a HCA basis.
- 1.13 All generators said that the regulatory accounts should be audited by the auditor that audits the company's statutory accounts. This was believed to be the most cost-effective solution. Some of the generators also said that the issue of duty of care, both to the company and Ofgem, should be resolved by discussions with the relevant accountancy bodies.
- 1.14 One generator said that the decision whether to also publish regulatory accounts on the Internet should be left to the companies concerned. Most generators agreed that regulatory accounts should be produced within 4 months of the regulatory accounting year end. There was also general agreement that it would be sensible to discontinue the production of interim regulatory accounts. The requirement to provide a reconciliation between the regulatory accounts and statutory accounts was also supported by the generators.

### **Consumer organisations**

- 1.15 Generally the consumer organisations said that the timetable for implementation was tight. They agreed that the main purpose of regulatory accounts was to inform price control reviews and monitor company performance between

reviews. They also did not want to over-burden the companies by including any requirements that meant information was published in unnecessary detail.

- 1.16 One consumer organisation suggested that the requirement to produce regulatory accounts should be retained for suppliers while they remained price-controlled and before the requirement is removed the regulator should satisfy itself that it is able to monitor the financial viability of any supplier. One consumer organisation also said that the generators should continue to produce regulatory accounts until NETA is established.
- 1.17 The use of HCA as the basis of preparation for regulatory accounts was generally supported. One consumer organisation said that as some revaluations of fixed assets, usually relating to land and buildings, will have been included in the statutory accounts of most licensees, then technically MHCA should be the basis of preparation. They also supported the development of a framework of principles for the RAGs.
- 1.18 Most consumer organisations also supported the use of a 31 March year end for the regulatory accounts. One consumer organisation suggested that as many licensees are subsidiaries of companies listed in the US and have 31 December year ends, then 31 December should be used as the year end for all regulatory accounts.
- 1.19 Consumer organisations also suggested that companies should appoint their own auditors. They also supported the view that auditors of regulatory accounts should have a duty of care to Ofgem. One of the consumer representatives said that this issue would be best dealt with in a Statement of Recommended Practice (SORP).
- 1.20 Some of the consumer organisations recommended that differences between RAGs and UK GAAP should be discussed with the relevant accounting bodies.
- 1.21 The publication of regulatory accounts on the Internet was supported by the consumer organisations. They also suggested that accounts should be published within 3 months of the financial year.
- 1.22 There was general support for a number of the other proposed changes, particularly the inclusion of additional information relating to capital structure,

the reconciliation to the statutory accounts and a detailed narrative. The only consumer organisation that responded on the issue of interim regulatory accounts agreed that they should be discontinued.

### **Auditing organisations**

- 1.23 Most of the auditing organisations said that the proposed timetable was ambitious given that major changes were under consideration and in particular sufficient time would need to be allowed for licensees to assess and implement any changes that may need to be made to their financial reporting systems.
- 1.24 Generally these respondents agreed that regulatory accounts should be prepared by businesses subject to ongoing price regulation. The use of HCA as the basis of preparation for the regulatory accounts was supported by most of the respondents and they also said that they preferred adopting a framework of principles for the RAGs and that these RAGs should be incorporated into a SORP. The only respondent that commented on the issue of RAGs and their relationship with UK GAAP agreed that the RAGs should take precedence over UK GAAP.
- 1.25 All of these respondents said that the regulatory accounts should be audited by the auditor that audits the company's statutory accounts. This was said to be the most cost-effective solution.
- 1.26 The auditing organisations indicated that the current position regarding duty of care was unclear and agreed that the engagement letter should clearly identify the duty of care that the auditor owes Ofgem for regulatory accounting purposes.
- 1.27 All of these respondents said that the auditors should set materiality levels as this is solely an accounting and auditing concept. Generally the auditing organisations preferred the use of "presents fairly in accordance with" or "properly prepared in accordance with" in the audit opinion. The engagement letter would also clarify the position on other issues related to the audit eg liability.
- 1.28 Most of the auditors supported the publication of regulatory accounts via the Internet, provided they did not include any price sensitive information. The publication of regulatory accounts within 4 months of the year end was



supported by a number of the respondents while others thought that it would cause difficulties for the businesses concerned.

- 1.29 A number of these respondents supported the provision of detailed information relating to cost attributions, cost allocations, inter-business recharges, capital structure, reconciliation to statutory accounts and detailed narrative. However, many felt that Ofgem should specify the level of detail, bearing in mind certain information would be commercially sensitive.

### **Other respondents**

- 1.30 These respondents generally agreed with the timetable proposed for the new arrangements to be put in place. They also generally agreed that the main purpose of regulatory accounts was to inform price control reviews and monitor company performance between reviews. Some of these respondents said that it would be a burden for supply businesses to revise their reporting requirements for the short period remaining before price controls are removed. Another respondent said IPGTs should not be required to produce regulatory accounts, as the costs would outweigh the benefits.
- 1.31 There were contrasting views on the basis of preparation of regulatory accounts. One respondent supported the use of HCA but added that the use of MHCA should be supported wherever possible, one respondent said that MHCA should be used, one respondent said that RAV should be used and another respondent said that CCA should be used. Most of them agreed that the regulatory accounts should be based upon a framework of principles and that RAGs should take precedence over UK GAAP.
- 1.32 Those other respondents that addressed the year end issue said that they preferred the regulatory year end to be the same as the company's year end for statutory accounting purposes.
- 1.33 All these respondents supported the use of a single auditor for the statutory and regulatory accounts on the grounds of efficiency and cost. Generally they also agreed that a duty of care should be owed to Ofgem. One respondent supported Ofgem setting the materiality levels where group materiality differed from that of the regulated business whereas another respondent said that the

issue of audit materiality was a matter for the auditor. One of these respondents said that Ofgem should not be included in an engagement letter with the auditors whereas another of these respondents said that Ofgem should be included in an engagement letter with the auditors.

1.34 These respondents generally supported the publication of regulatory accounts and their availability on the Internet. The publication of regulatory accounts within 4 months of the financial year was also generally supported. Generally the other respondents agreed with Ofgem's proposal to remove the requirement for certain licensees to produce interim regulatory accounts.

1.35 One of these other respondents supported the inclusion of detailed information in regulatory accounts provided the information was suitable for the public, would provide meaningful results and was not commercially sensitive. Also one of these respondents said that the regulatory accounts should focus more on outputs.

## LIST OF RESPONDENTS

Eastern Electricity (TXU Europe)  
London Electricity  
Midlands Electricity (GPU Power UK)  
Northern Electric  
Norweb  
Scottish Power (including the response of MANWEB)  
Scottish & Southern Energy  
Seeboard  
South Wales Electricity (Infralec)  
South Western Electricity (Western Power Distribution)  
Yorkshire Electricity – distribution business

BNFL (Magnox Electric plc)  
British Energy  
Innogy  
Powergen (including the response of East Midlands Electricity)

National Grid Company

East Midlands Pipelines Ltd  
Transco (Lattice Group plc)

Electricity Consumers' Committee East Midlands Region  
National Consumer Council  
National Electricity Consumers Council

Arthur Andersen  
Deloitte & Touche  
PricewaterhouseCoopers

The Auditing Practices Board  
The Institute of Chartered Accountants in England & Wales

BP Gas Marketing Limited  
British Gas Trading (Centrica)  
Centre for the study of Regulated Industries  
Thames Water Utilities  
Yorkshire Electricity – supply business