

August 2002

The National Grid Company plc

Regulatory Accounting Guidelines

Working Paper

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Summary

This working paper sets out proposals for the Regulatory Accounting Guidelines (RAGs) of The National Grid Company plc (NGC).

The publication of this paper is the next step in the process of reforming regulatory accounts in the gas and electricity industries and follows on from Ofgem's August 2000 consultation paper and its November 2000 final proposals paper. It is hoped that the revised regulatory accounting arrangements for NGC will be effective for the regulatory accounts that will be prepared for 2002/03. If the proposed changes are not accepted by NGC, Ofgem would need to consider referring the matter to the Competition Commission.

This working paper is consistent with the approach of the inter-regulatory regulatory accounts working group, whose final proposals were published in April 2001. Where it is appropriate this paper is also consistent with the approach adopted in the electricity distribution RAGs, which were published in July 2001, and the Scottish Transmission RAGs, which will be published shortly.

NGC is the company that holds the transmission licence for England and Wales. This company carries out both the price controlled business of transmitting electricity over the English and Welsh transmission network (the transmission business) and the licensed, but not price controlled, business of the Scotland-England interconnector and the Anglo-French interconnector. At the last price control review the transmission business was treated as having two elements, namely the Transmission Owner (TO) activity and the System Operator (SO) activity.

The effects of these structural factors have been reflected in this paper and particularly in the draft template for the regulatory accounts of the transmission business and of the licensee contained in appendix 2. In NGC's RAG's the split between the TO and the SO reflects the definition of TO and SO at NGC's last price control review. However, this split may need to be reviewed to incorporate the effects of changes to the roles of TO and SO following the introduction of a deeper SO incentive scheme for NGC in April 2003 and the completion of any industry modifications related to transmission access.

As a separate issue, The Department of Trade and Industry (DTI) and Ofgem are developing proposals for the introduction of British Electricity Trading and Transmission Arrangements (BETTA). The reporting of regulatory accounting information by NGC may need to be reviewed to take into account changes to the respective roles of the transmission licensees (both the transmission owners and the GB system operator).

The development of RAGs will be an important step in understanding how the information in the regulatory accounts relates to the assumptions made during NGC's last price control review. The RAGs are a detailed framework of principles supported in certain areas by detailed rules, such as those for capitalisation policy.

In developing these proposals Ofgem has sought to avoid unnecessarily increasing the regulatory burden on NGC. Ofgem envisages that the proposals contained in this working paper would achieve that aim. If the proposed merger between NGC and Transco is completed then these RAGs may have to be revised to take account of any revised regulatory accounting requirements.

The main elements of this paper are summarised below:

- (a) A set of regulatory accounting policies.
 - ◆ The main issues involved in developing the RAGs concern compliance with UK Generally Accepted Accounting Practice (UK GAAP) and how prescriptive the RAGs should be. Both of these matters have been debated in the August 2000 consultation paper and the November 2000 final proposals paper. UK GAAP is designed to apply to the accounts of all UK companies and as such is a general framework of accounting principles, whereas RAGs are designed for the specific purpose of providing a set of accounting policies for the preparation of regulatory accounts.
 - ◆ At present the accounting policies included in these RAGs are consistent with UK GAAP. However as UK GAAP is changing, in the future there may be accounting policies included in the RAGs that do not comply 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 the review of regulatory accounts in the gas and electricity industries. In order to achieve these aims, if one of the RAGs does not comply with UK GAAP then the RAGs will take precedence. Where the RAGs do not cover an accounting issue then UK GAAP will apply. This is because RAGs will have been designed specifically to consider the regulatory accounting issues involved in the preparation of regulatory accounts.

- (b) A set of principles to be followed for accounting for cost attributions, cost allocations and inter-business recharges. The main principles are:
- ◆ Cost causality;
 - ◆ Objectivity;
 - ◆ Consistency; and
 - ◆ Transparency.
- (c) An activity analysis. The activities and services that the transmission business provides can be grouped together in the following manner:
- ◆ Transmission Owner (TO), which has the following activities:
 - network asset ownership;
 - network operation and maintenance;
 - asset management;
 - commercial; and
 - other activities.
 - ◆ System Operator (SO), which has the following activities:
 - daily operation and control of the transmission system;
 - information to Elexon;
 - electricity balancing;

- system balancing; and
 - transmission losses.
- (d) A draft template for the regulatory accounts of the transmission business and NGC. The main statements included in the template that are additional to the normal UK GAAP disclosures are a:
 - ◆ five year annual summary;
 - ◆ summary of the comparison to the price controls;
 - ◆ RAV statement;
 - ◆ detailed analysis of turnover;
 - ◆ detailed analysis of capital expenditure;
 - ◆ summary activity analysis; and
 - ◆ detailed analysis of each material related party transaction.
- (e) Proposals for the publication of information in the published version of NGC's regulatory accounts. It is Ofgem's intention that the large majority of items included in the draft template will be included in the published regulatory accounts. Nevertheless commercially sensitive items would not necessarily be published. NGC would have to make a convincing case to Ofgem that items are commercially sensitive and that their publication would not be in the interests of consumers.

1. Introduction

Background

- 1.1 This working paper sets out proposals for the Regulatory Accounting Guidelines (RAGs) of The National Grid Company plc (NGC). The review of regulatory accounts commenced in October 1998 with OFFER's publication of a consultation paper on regulatory accounts in the electricity industry. This paper follows on from the regulatory accounts consultation paper published in August 2000, the regulatory accounts final proposals paper published in November 2000 and the regulatory accounts working paper on electricity distribution businesses RAGs published in July 2001. The working paper for the RAGs of the Scottish transmission businesses is also planned to be published shortly.
- 1.2 It is hoped that the revised regulatory accounting arrangements for NGC contained in this working paper will be effective for the regulatory accounts that will be prepared for 2002/03. If the proposed changes are not accepted by NGC, Ofgem would need to consider referring the matter to the Competition Commission.
- 1.3 NGC is the company that holds the transmission licence for England and Wales. This company carries out both the price controlled business of transmitting electricity over the English and Welsh transmission network (the transmission business) and the licensed, but not price controlled, business of the Scotland-England interconnector and the Anglo-French interconnector. At the last price control review the transmission business was treated as having two elements, namely the Transmission Owner (TO) activity and the System Operator (SO) activity.
- 1.4 These structural factors have had a significant effect upon the template for the regulatory accounts of the transmission business and of the licensee contained in appendix 2. In order to perform its duties Ofgem would normally require more detail about the price controlled transmission business than it would for the Scotland-England interconnector business, the Anglo-French interconnector business and the licensee as a whole. The draft template in appendix 2 reflects these differing requirements. In NGC's RAG's the split between the TO and the SO reflects the definition of TO and SO at NGC's last price control review.

However, this split may need to be reviewed to incorporate the effects of changes to the roles of TO and SO following the introduction of a deeper SO incentive scheme for NGC in April 2003 and the completion of any industry modifications related to transmission access.

- 1.5 As a separate issue, The Department of Trade and Industry (DTI) and Ofgem are developing proposals for the introduction of British Electricity Trading and Transmission Arrangements (BETTA). The reporting of regulatory accounting information by NGC may need to be reviewed to take into account changes to the respective roles of the transmission licensees (both the transmission owners and the GB system operator).
- 1.6 In developing these proposals Ofgem has sought to avoid unnecessarily increasing the regulatory burden on NGC. Ofgem envisages that the proposals contained in this working paper would achieve that aim. If the proposed merger between NGC and Transco is completed then these RAGs may have to be revised to take account of any revised regulatory accounting requirements.
- 1.7 Regulatory accounts are the primary source of regular audited financial information about NGC. Good quality accounting information is important to the effective regulation of NGC and so helps ensure that customers' interests are properly protected. It is the purpose of this review to rationalise and improve NGC's regulatory accounts so that where appropriate they provide better information, which can be published each year in an appropriate format, that facilitates comparisons across time and across companies and with the assumptions underlying price controls.
- 1.8 This paper covers the following issues:
 - ◆ chapter 2 explains the accounting policies to be used for each aspect of regulatory accounting. In most cases these will entail the use of UK GAAP but in some cases, such as certain aspects of capitalisation policy, there will be a specific and more detailed policy. It also includes the principles to be followed in accounting for cost attributions, cost allocations and inter-business recharges;
 - ◆ chapter 3 contains a draft activity analysis;

- ◆ chapter 4 considers the level of detail that should be included in the regulatory accounts and publication issues;
- ◆ appendix 1 contains a draft set of RAGs for NGC; and
- ◆ appendix 2 contains a draft template of the regulatory accounts of the transmission business and the licensee.

Timetable

- 1.9 It is intended that the proposed revised regulatory accounts licence condition for NGC will be published for consultation shortly. This revised licence condition will incorporate the proposals made in the regulatory accounts final proposals paper that was published in November 2000 and will require that NGC's regulatory accounts will be prepared in accordance with NGC's RAGs. Similar RAGs have been developed for the electricity distribution businesses and are being developed for the Scottish electricity transmission businesses and Transco's transportation business.
- 1.10 The working paper on the RAGs for the electricity distribution businesses was published in July 2001. A working paper for the Scottish electricity transmission businesses will also be published shortly. It is intended that a consultation paper on the RAGs for Transco's transportation business will be published in the autumn of 2002, followed by final proposals in the winter of 2002/03. It is hoped that the RAGs for each of NGC's transmission business and Transco's transportation business will take effect for the year commencing April 2002. The timetable for the introduction of the RAG's for the Scottish electricity transmission businesses is being discussed with those companies at the moment.

Responding to this document

- 1.11 It would be helpful to hear from all those with an interest in the issues raised in this paper, including consumers, their consumer representatives and companies. The responses will be published by placing them in Ofgem's library and on Ofgem's website. Respondents should clearly mark as confidential any part of their response (or the whole response if applicable) that the respondent wants to be confidential, where possible respondents should consign any confidential material to appendices.

1.12 Responses should be sent (preferably by e-mail) to Ofgem by 9 September 2002, addressed to:

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2. Regulatory Accounting Policies

Introduction

- 2.1 Ofgem's November 2000 final proposals paper indicated that a set of RAGs will be prepared for those businesses that will be required to prepare regulatory accounts in the future. This working paper is consistent with the approach adopted by the inter-regulatory regulatory accounts working group. Their final proposals were published in April 2001. Where it is appropriate this paper is also consistent with the approach adopted in the electricity distribution RAGs, which were published in July 2001, and the Scottish Transmission RAGs, which will be published shortly.
- 2.2 The development of RAGs will be an important step in understanding how the information in the regulatory accounts relates to the assumptions made during NGC's last price control review. The RAGs are a detailed framework of principles supported in certain areas by detailed rules, such as those for capitalisation policy.
- 2.3 The main issues involved in developing the RAGs concern compliance with UK Generally Accepted Accounting Practice (UK GAAP) and how prescriptive the RAGs should be. Both of these matters have been debated in the August 2000 consultation paper and the November 2000 final proposals paper. UK GAAP is designed to apply to the accounts of all UK companies and as such is a general framework of accounting principles, whereas RAGs are designed for the specific purpose of providing a set of accounting policies for the preparation of regulatory accounts.
- 2.4 At present the accounting policies included in these RAGs are consistent with UK GAAP. However as UK GAAP is changing, in the future there may be accounting policies included in the RAGs that do not comply with UK GAAP.
- 2.5 Greater consistency between the regulatory accounts of the companies concerned and appropriate comparisons with the assumptions underlying the price control are important aims of the review of regulatory accounts in the gas and electricity industries. In order to achieve these aims, if one of the RAGs does not comply with UK GAAP then the RAGs will take precedence. Where

the RAGs do not cover an accounting issue then UK GAAP will apply. This is because RAGs will have been designed specifically to consider the regulatory accounting issues involved in the preparation of regulatory accounts.

General accounting policies

2.6 The main accounting policies contained in the RAGs relate to:

- ◆ capitalisation of line and cable work;
- ◆ capitalisation of small tools and equipment;
- ◆ capital contributions;
- ◆ capitalised interest; and
- ◆ revaluations of fixed assets, which will have to be approved by Ofgem.

2.7 The RAGs will allow the transmission business less discretion in its selection of accounting policies than UK GAAP. At present the main areas where Ofgem will be prescriptive are:

- ◆ the length of cable and lines replaced or repaired should not be used as a criteria for deciding whether the expenditure should be treated as an operating cost or as capital expenditure;
- ◆ there will be no use of renewals accounting;
- ◆ there will be no capitalisation of interest;
- ◆ any revaluation of assets will require the consent of Ofgem; and
- ◆ definition and disclosure of exceptional items.

2.8 The present regulatory accounts licence condition requires the licensee to obtain Ofgem's approval before changing an accounting policy used in the preparation of regulatory accounts. This requirement will remain and it is expected that Ofgem will meet with NGC each year, before the regulatory accounts are prepared, to agree on the accounting policies that will be used in the regulatory accounts for that year.

2.9 In setting the present NGC price controls a number of adjustments were made to the base accounting data. Some of these calculations and assumptions were not consistent with standard accounting treatments or with UK GAAP. In order to reconcile the results of the transmission business calculated on a statutory basis to the basis used in the price control a number of adjustments will be required. These are summarised below.

Capitalisation adjustments:

- ◆ non-operational capital expenditure; and
- ◆ other capitalisation adjustments.

Other adjustments:

- ◆ depreciation;
- ◆ margin on recharges;
- ◆ over-recovery of income;
- ◆ provisions on a cash basis;
- ◆ other costs on a cash basis;
- ◆ adjustment for stranded asset disposals;
- ◆ network rates;
- ◆ Ofgem licence fee;
- ◆ cost of de-minimis activities; and
- ◆ other other adjustments.

Cost attribution, cost allocation and inter-business recharging principles

2.10 The November 2000 final proposals paper said that attributions, allocations and inter-business recharging of costs should be based on a set of principles, the main ones being:

- ◆ Cost causality;
- ◆ Objectivity;
- ◆ Consistency; and
- ◆ Transparency.

2.11 The set of principles listed in paragraph 2.10 will apply unless Ofgem and NGC agree that in a particular situation other principles should apply or take precedence.

2.12 In addition more detailed guidance is appropriate in respect of inter-business recharging. NGC will be required to demonstrate:

- ◆ the basis of arm's length trading;
- ◆ that no cross-subsidy exists; and
- ◆ that services are provided at no extra cost than if they were provided from within the transmission business.

At a minimum this will involve:

- ◆ the transmission business paying reasonable prices for products and services;
- ◆ transfer prices for transactions between the transmission business and associate or associated companies being based on market prices or less, where no market exists these transfer prices should be based on cost plus an appropriate rate of return on capital employed¹;

¹ At present a typical real rate of return would be 6.25 per cent.

- ◆ market testing to establish market prices for supplies, works and services provided to the transmission business;
- ◆ where market testing is not available, transfer prices charged should be based on cost plus an appropriate rate of return on capital employed²;
- ◆ costs being attributed, allocated and recharged in relation to the way resources are consumed; and
- ◆ information should be provided on the margins associated with any recharges.

2.13 It will be part of the audit process to check that the above principles have been applied to the attribution, allocation and inter-business recharging of costs within the transmission business.

² At present a typical real rate of return would be 6.25 per cent.

3. Activity Analysis

Introduction

- 3.1 The August 2000 consultation paper suggested that an activity analysis would be required to supplement more traditional accounting disclosures. Over the years since privatisation there have been a number of structural changes to the organisation of NGC. Certain activities are now outsourced to related group companies. It is possible that there will be further similar developments. As a result of all these changes and other factors it is necessary to supplement the traditional analysis of costs by inputs with more functional or activity based analysis. This activity analysis should facilitate the understanding of the transmission business's costs.

Activities

- 3.2 The activities and services that the transmission business provides should be grouped together in the following manner.

1. Transmission Operator (TO).

The TO owns and maintains the high-voltage transmission network in England and Wales and undertakes the longer term development of, and investment in, the transmission system. The TO includes new connections to the electricity transmission system. The activities include:

A. Network asset ownership

- ◆ network assets including electrical lines and electrical plant, protection and control including telecontrol and SCADA etc;
- ◆ reinforcement; and
- ◆ replacement.

B. Network operation and maintenance

- ◆ repair and maintenance of network assets including electrical lines and electrical plant, operational buildings, protection and control including telecontrol and SCADA etc;
- ◆ asset monitoring and inspection;
- ◆ monitoring faults; and
- ◆ communications.

C. Asset management

- ◆ planning e.g. future loads, economic trends;
- ◆ simulation analysis;
- ◆ analysis and interpretation of asset condition data;
- ◆ wayleaves;
- ◆ research and development; and
- ◆ documentation e.g. asset register.

D. Commercial

Excluded services. These mainly include:

- ◆ Post Vesting connection charges, including:
 - charges for established post vesting sites; and
 - charges for post vesting assets at established pre-vesting sites.

- ◆ Provision of services to third parties, including:
 - charges for relocation of electrical lines and plant;
 - one off charges;
 - Energis infrastructure fee; and
 - other services to third parties.

- ◆ Other excluded services.

De-minimis activities. These may include:

- ◆ telecommunications; and
- ◆ other de-minimis activities.

E. Other activities

- ◆ provision of information to the electricity distribution businesses and suppliers;
- ◆ Ofgem licence fee;
- ◆ network rates; and
- ◆ corporate costs, these are the corporate costs that are not practicable to allocate to the main activities, in general these costs will be relatively small e.g. the maintenance of the listed entity's share register.

2. System Operator (SO)

The SO undertakes the short term activities necessary to operate the high voltage transmission network in England and Wales safely and efficiently. This involves NGC buying and selling electricity and contracts for balancing services in order to keep the electricity system in balance (electricity balancing) and maintain the quality and security of supplies (system balancing). This includes:

- ◆ daily operation and control of the transmission system;
- ◆ information to Elexon;
- ◆ electricity balancing;
- ◆ system balancing; and
- ◆ transmission losses.

3.3 The above split between the TO and the SO reflects the definition of TO and SO at NGC's last price control review. However, this split may need to be reviewed to incorporate the effects of changes to the roles of TO and SO following the introduction of a deeper SO incentive scheme for NGC in April 2003 and the completion of any industry modifications related to transmission access. As a separate issue, The DTI and Ofgem are developing proposals for the introduction of BETTA. The reporting of regulatory accounting information by NGC may need to be reviewed to take into account changes to the respective

roles of the transmission licensees (both the transmission owners and the GB system operator).

- 3.4 The above list of examples of the activities within each activity centre is not meant to be exhaustive and is provided as an illustration of the activities that each activity centre would perform. It is not intended to have a separate analysis of the individual activities within each activity centre.
- 3.5 The indications from meetings with NGC are that it is possible for this analysis to be completed. The activity analysis will allow Ofgem to better understand the operations of the transmission businesses. At present it is not Ofgem's intention to be more prescriptive in defining the basis of the activity analysis.

4. Template and Publication Issues

- 4.1 Appendix 2 contains the draft template for the regulatory accounts of the transmission businesses and the licensee. This draft template is based on the draft template included in the August 2000 consultation paper and the template included in the electricity distribution businesses RAGs published in July 2001. The main purpose of regulatory accounts for NGC is to monitor actual performance against the present price control and inform future price control reviews. In order to perform this role the regulatory accounts will need to focus on comparisons with the price controls and be prepared in a greater level of detail than a normal set of statutory accounts.
- 4.2 The amount of detail that should appear in the published version of the regulatory accounts has been discussed in the November 2000 proposals paper and with NGC. Appendix 2 contains the proposed information that will be included in the published version of the regulatory accounts. It is also necessary to decide whether the published version of the regulatory accounts should be published as a stand alone document or in the statutory accounts of NGC. The choice between these two approaches should be driven by the requirements of the users of regulatory accounts. Where the differences between the regulatory accounts and the statutory accounts are not great then it may be possible for the statutory accounts to include the additional regulatory accounting disclosures in them. The main issue is to ensure that the regulatory accounting disclosures are transparent to users. At the moment NGC's regulatory accounts are published as a stand alone document and NGC have indicated to Ofgem that they would like to continue publishing their regulatory accounts as a stand alone document, this would also be Ofgem's preference.
- 4.3 The issue of publication has been discussed in the earlier consultation, working and final proposals papers. The large majority of items included in the draft template will be included in the published regulatory accounts. Nevertheless commercially sensitive items would not necessarily be published. NGC would have to make a convincing case to Ofgem that items are commercially sensitive and that their publication would not be in the interests of consumers.

Appendix 1 NGC RAGs

- 1.1 This appendix sets out draft RAGs for NGC. These RAGs will apply to the regulatory accounts of the transmission business. It is hoped that the RAGs will be effective for regulatory accounting periods ending on or after 1 April 2002.

Main Accounting Policies

- 1.2 The following paragraphs identify some of the main accounting policies that are used in the preparation of regulatory accounts or regulatory accounting information by NGC.
- 1.3 The financial statements should be prepared in accordance with these RAGs. Where the RAGs do not cover an accounting issue then UK GAAP will apply. If one of these RAGs does not comply with UK GAAP then the RAGs will take precedence.

Accounting Convention

- 1.4 The financial statements should be largely prepared under the historical cost convention and in accordance with applicable RAGs which means that in certain cases revaluations will have been made, in some financial statements there will be use of Regulatory Asset Values (RAVs) and some of the information should be calculated on a regulatory basis. After changes to the RAGs comparative figures should be restated.

Tangible fixed assets

- 1.5 At present the following restrictions will apply:
- ◆ the length of cable and lines replaced or repaired should not be used as a criteria for deciding whether the expenditure should be treated as an operating cost or as capital expenditure;
 - ◆ there will be no use of renewals accounting;
 - ◆ there will be no capitalisation of interest; and
 - ◆ revaluation of fixed assets will only be allowed on a case by case basis with the consent of Ofgem.

- 1.6 Any third party revenue or contribution should be offset against the gross cost of the asset. The net asset value should be depreciated over the life of the asset.
- 1.7 Where there has been a change in the asset life of any asset with a net book value greater than £2,000,000 at 1 April of the regulatory year concerned, the estimated financial effect of the changes in the current period must be reflected in the regulatory accounts for that period.

Guideline on capitalising line and cable work

- 1.8 All capital work that meets the definition of FRS 15 on underground cables and all overhead lines of any length should be capitalised. The length of cable and lines replaced or repaired will not be used as a criteria for deciding whether the expenditure should be treated as an operating cost or as capital expenditure.

Guideline on small tools and equipment

- 1.9 All small tools and equipment with a value greater than £2,000 should be capitalised.

Wayleaves

- 1.10 All expenditure on wayleaves should be expensed as incurred.

Easements

- 1.11 All 'one-off' payments to obtain easements should be capitalised and be treated as operational capital expenditure and not be depreciated.

One-offs, provisions and exceptional items

- 1.12 In the regulatory accounts, all special items such as provisions should be isolated, identified and a separate annotation made in the notes to the accounts as per the guidelines in FRS 12. All provisions with a balance at 1 April in the year concerned of greater than £500,000 should be separately disclosed.

1.13 With regard to one-off and other special items:

- ◆ exceptional items should be disclosed separately;
- ◆ any sales of land or associated assets with either a net book value greater than £2,000,000 or proceeds greater than £2,000,000 should be included in the regulatory accounts along with separate explanatory notes; and
- ◆ a separate schedule should be included in the regulatory accounts for 'other income' and 'other operating costs' for all items greater than 0.5 per cent of the turnover of the transmission business.

1.14 Exceptional items are those that need to be disclosed by virtue of their size or incidence. Such items are shown separately on the face of the profit and loss account, or included under the profit and loss heading to which they relate and separately disclosed in the notes to the accounts. No exceptional items should be included in the regulatory accounts unless Ofgem has approved the treatment and has agreed how they should be disclosed.

Cost Allocation, Cost Attribution and Inter-Business Recharging

1.15 The following paragraphs set out a draft set of principles for the attribution, allocation and inter-business recharging of costs in the transmission business. These principles will apply unless Ofgem and NGC agree that in a particular situation other principles should apply or take precedence.

High-level Principles

- ◆ Cost causality. Revenues, costs, assets and liabilities should be attributed in accordance with the activities which cause the revenues to be earned, costs to be incurred, the assets to be acquired or the liabilities to be incurred;
- ◆ Objectivity. With attributions, allocations and inter-business recharging of costs performed on an objective basis and not unduly benefiting the regulated company or any other company or organisation;

- ◆ Consistency. Where practicable all attributions, allocations and inter-business recharging of costs should be consistent from year to year, where there are changes to the RAGs NGC should restate the previous years regulatory accounts; and
- ◆ Transparency. All the methods used in the attribution, allocation and inter-business recharging of costs should be transparent and the revenues, costs (including showing depreciation separately), profits, assets and liabilities separately distinguishable from each other.

Further guidance

1.16 In addition to the above, more detailed guidance is appropriate in respect of inter-business recharges. The transmission business will be required to demonstrate:

- ◆ the basis of arm's length trading;
- ◆ that no cross-subsidy exists; and
- ◆ that services are provided at no extra cost than if they were provided from within the transmission business.

1.17 At a minimum this will involve:

- ◆ the transmission business paying reasonable prices for products and services;
- ◆ transfer prices for transactions between the transmission business and associate or associated companies being based on market prices or less, where no market exists these transfer prices should be based on cost plus an appropriate rate of return on capital employed³;
- ◆ market testing to establish market prices for supplies, works and services provided to the transmission business;
- ◆ where market testing is not available, transfer prices charged should be based on cost plus an appropriate rate of return on capital employed³;

³ At present a typical real rate of return would be 6.25 per cent.

- ◆ costs being attributed, allocated and recharged in relation to the way resources are consumed; and
- ◆ information should be provided on the margins associated with any recharges.

Market testing

- 1.18 FRS 8 does not provide explicit guidance on market testing to determine that an arm's length transaction is taking place, except to say internal recharges should be based on market prices.
- 1.19 Supporting documentation should transparently demonstrate the arm's length basis of the contract, that no cross-subsidy has been received or given and that services are provided at no extra cost than if they were provided from within the transmission business. The requirement not to give or receive any cross-subsidy is also included in NGC's standard licence condition 12.
- 1.20 Where no market exists for particular supplies, works or a service, the transfer price should be based on cost and the cost allocation guidelines followed. Where cost is used, the appointed company should have access to the costs of that associate and should conduct validation exercises to ensure that transfer prices are charged at cost.
- 1.21 The following are examples of market testing techniques that can be used. They have been presented showing the most desirable method at the top.

Type of tender	Detail
Wide market tender	Unlimited market exposures and conducted in accordance with EU procurement rules.
Selective market tender	Selective enquiry of known players who have a proven product or service in the market.
Benchmarking	Using published figures (including appropriate quantity discounts) to benchmark the relevant service providers.

Disclosures

1.22 The main principle is that the disclosure of related party transactions should be made under the auspices of FRS 8. However, for the purposes of the RAGs, FRS 8 has been adjusted in the following respects:

- ◆ if a company with which the transmission business has a business relationship or contract would be considered to be a related party of any company within the group then it shall be considered a related party of the transmission business. Therefore, if an associated company is considered to be a related party of the parent company but not directly an associate of the transmission business, it will still be considered a related party for regulatory reporting purposes;
- ◆ there will be no exemption for subsidiary undertakings 90 per cent or more of whose voting rights are controlled within the group;
- ◆ where the financial statements are consolidated, transactions or balances between group entities will still be required to be disclosed in the detail identified in transmission business tables 23 and 24 of appendix 2;
- ◆ although FRS 8 relates only to material transactions, additional disclosures will be required to allow Ofgem to conduct its duties. Such disclosures identified in tables 23 and 24 of appendix 2 will be required for all individual transactions or combined transactions which can be attributed to a service or contract, which exceed the following benchmarks:
 - ◆ total expected value of the individual contract is 0.25 per cent of the regulated businesses turnover for the year immediately preceding; or
 - ◆ £500,000.

1.23 The following information should also be disclosed:

- ◆ a detailed structure which identifies and explains all the material related party transactions;
- ◆ a breakdown of the charges to and from the related party showing a split between operating cost (excluding depreciation), depreciation and return on capital (see transmission business table 24 of appendix 2);
- ◆ a flowchart showing the business process used to allocate internal and related party transactions. This should include a summary of the procedures adopted by the directors to ensure they comply with the Companies Act 1989; and
- ◆ any other information about the related party transaction necessary for an understanding of the financial statements e.g. an indication that the transfer of an asset had taken place at an amount materially different from that obtainable on normal commercial terms, although this should not have happened.

1.24 FRS 8 identifies the following as related parties of the reporting entity:

- ◆ the reporting entity's ultimate and intermediate parent undertakings, subsidiary undertakings and fellow subsidiary undertakings;
- ◆ the reporting entity's associates and joint ventures;
- ◆ the investor or venturer in respect of which the reporting entity is an associate or a joint venture;
- ◆ directors of the reporting entity and the directors of its ultimate and intermediate parent undertakings (directors include shadow directors); and
- ◆ pension funds for the benefit of employees of the reporting entity or of any entity that is a related party of the reporting entity.

1.25 FRS 8 identifies the following as being presumed to be related parties of the reporting entity:

- ◆ key management (including close family) of the reporting entity and the parent undertaking or undertakings;
- ◆ a person (including close family) exercising control over 20 per cent of the reporting entities voting rights;
- ◆ each person (including close family) acting in concert and exercising control or influence;
- ◆ an entity managing or managed by the reporting entity under a management contract; and
- ◆ partnerships, companies, trusts or other entities in which any individual or member of the close family in the first three bullet points above has a controlling interest.

1.26 In addition any entity or person that Ofgem decides should be treated as a related party will be treated as a related party in the regulatory accounts. In particular for the purposes of these regulatory accounts the following parts of the licensee should be treated as related parties of each other:

- ◆ transmission business;
- ◆ interconnectors; and
- ◆ the other parts of the licensee.

Detail required to support arm's length arrangements

1.27 FRS 8 presents a number of disclosure requirements required for related party disclosures. Ofgem has built on such disclosures in tables 23 and 24 of the transmission business draft template included in appendix 2. These contain a summary for each related party that transacts with the company and a detailed table for each related party transaction as defined in paragraph 1.22.

Categorisation of related party transactions

1.28 Related party disclosures should be divided into the relevant transaction categories as identified under FRS 8. Each related party transaction should include a note explaining which of the following categories the transaction falls into:

- ◆ purchases or sales of goods (finished or unfinished);
- ◆ purchases or sales of property and other assets;
- ◆ rendering or receiving of services;
- ◆ agency arrangements;
- ◆ leasing arrangements;
- ◆ transfer of research and development;
- ◆ licence agreements;
- ◆ provision of finance (including loans and equity contributions in cash or in kind);
- ◆ guarantees and the provision of collateral security; and
- ◆ management contracts.

Regulatory terms

1.29 The following paragraphs define the regulatory terms that are included in the RAGs.

Transmission business TO turnover on the basis used in the price control

- 1.30 Transmission business TO turnover on the basis used in the price control is defined as:

Total transmission business TO turnover
Less:
Transmission business TO de-minimis turnover

Transmission business operating costs on the price control basis

- 1.31 Transmission business operating costs on the basis used in the price control is defined as:

Total operating costs for the transmission business per table 9
Adjustments
Capitalisation adjustments:
Non-operational capital expenditure
Other capitalisation adjustments
Total capitalisation adjustments
Other adjustments:
Depreciation
Margin on recharges
Over-recovery of income
Provisions on a cash basis
Other costs on a cash basis
Adjustment for stranded asset disposals
Network rates
Ofgem licence fee
Cost of de-minimis activities
Other other adjustments
Total other adjustments
Transmission business operating costs on the basis used in the price control

Transmission business EBIT on the basis used in the price control

1.32 Transmission business EBIT on the basis used in the price control is defined as:

Total EBIT for the transmission business per table 9
Adjustments
Capitalisation adjustments:
Non-operational capital expenditure
Other capitalisation adjustments
Total capitalisation adjustments
Other adjustments:
Depreciation
Margin on recharges
Over-recovery of income
Provisions on a cash basis
Other costs on a cash basis
Adjustment for stranded asset disposals
Network rates
Ofgem licence fee
De-minimis EBIT (De-minimis turnover – cost of de-minimis activities)
Other other adjustments
Total other adjustments
Transmission business EBIT on the basis used in the price control

Return on the RAV of the transmission business

1.33 Return on the transmission business RAV is defined as:

Transmission business EBIT on the basis used in the price control
divided by
Average transmission business RAV

Regulatory Asset Value (RAV)

1.34 For the purposes of regulatory accounts RAV is defined as:

Opening RAV balance (A)
Add: inflation adjustment
Add: fixed asset additions on a RAV basis
Less: fixed asset disposals on a RAV basis
Less: regulatory depreciation
Closing RAV balance (B)
Average RAV = (A + B) / 2
Where:
Fixed asset additions are equal to:
Additions included in the transmission businesses tangible fixed assets note
Adjustments onto a RAV basis:
Non-operational capital expenditure
Other adjustments
Less: de-minimis additions
Fixed asset additions on a RAV basis
Fixed asset disposals are equal to:
Disposals included in the transmission businesses tangible fixed assets note
Adjustments onto a RAV basis:
Non-operational capital expenditure
Adjustment for stranded asset disposals
Other adjustments
Less : de-minimis disposals
Fixed asset disposals on a RAV basis
Inflation adjustment Index

Appendix 2 Template

Introduction

- 2.1 This appendix sets out the template for the regulatory accounts of NGC. The aim of the template is to facilitate reasonably straightforward comparisons across time and between companies, with the assumptions underlying the price control and where necessary with the statutory accounts of NGC and to inform the analysis of the licensed, but not price controlled, elements of NGC.
- 2.2 Generally, the tables in the template are consistent with UK GAAP for a company listed on the London Stock Exchange, but certain tables will require the provision of additional information. In particular it will be important to be able to compare the actual costs of running the company with the assumptions underlying the price control and gain a better understanding of any variances.
- 2.3 The additional information and tables that have been included are:
- ◆ most of the Five Year Annual Summary;
 - ◆ reconciliation to the TO Price Control basis;
 - ◆ reconciliation to the SO Price Control basis;
 - ◆ summary of the Comparison to the TO price control;
 - ◆ summary of the Comparison to the SO price control;
 - ◆ summary of the Comparison to the Total Transmission Business Price Control;
 - ◆ some parts of the Review of the Year are additional;
 - ◆ RAV Statement;
 - ◆ detailed analysis of turnover;
 - ◆ summary analysis of turnover compared to the price control;
 - ◆ analysis of repair and maintenance costs;

- ◆ detailed analysis of capital expenditure;
- ◆ five year summary of cumulative capital expenditure;
- ◆ five year summary of major capital schemes
- ◆ analysis of provisions;
- ◆ summary activity analysis;
- ◆ SO cost of sales analysis;
- ◆ source of costs summary;
- ◆ summary of related party transactions;
- ◆ detailed analysis of each related party transaction as defined in paragraphs 1.22 and 1.23 of appendix 1;
- ◆ licence condition compliance statement; and
- ◆ extra information on accounting policies than would be required by UK GAAP, including a detailed statement of the basis of preparation, a detailed statement of the capitalisation policy, a detailed statement of the principles involved in cost attribution, cost allocation, inter-business recharging and a detailed statement of the principles involved in the preparation of the activity analysis; and
- ◆ reconciliation of the transmission business to the total business of the licensee, this includes:
 - some of the Five Year Annual Summary of the licensee;
 - Profit and Loss Account;
 - Statement of Total Recognised Gains and Losses;
 - Balance Sheet; and
 - Cash Flow Statement

2.4 In terms of publication, it is envisaged that all of the tables included in the template with the exception of the tables disclosing the detailed analysis of turnover (transmission business tables 13), five year summary of major capital schemes (transmission business table 17), items 5-9 of the summary of related party transactions (transmission business table 23) and the detailed analysis of each material related party transaction (transmission business table 24), will be published.

2.5 The tables should be read in conjunction with the following notes:

- ◆ the following tables are primary financial statements:
 - ◆ Five Year Annual Summary;
 - ◆ Reconciliation to the Price Control Basis;
 - ◆ Summary of the Comparison to the Price Control;
 - ◆ RAV Statement;
 - ◆ Profit and Loss Account;
 - ◆ Statement of Total Recognised Gains and Losses;
 - ◆ Balance Sheet; and
 - ◆ Cash Flow Statement.
- ◆ unless stated, numbers are for the transmission business as a whole and not for the TO and SO elements;
- ◆ the commentary required in each of the tables in appendix 2 should provide sufficient detail so that users of the regulatory accounts can use the tables in appendix 2 to assist them in assessing for themselves the regulatory performance, financial position, financial performance and cash flows of the business;
- ◆ the RAV numbers in the regulatory accounts will be NGC's estimate of its RAV;

- ◆ information that is not presently provided in the regulatory accounts is marked with a hash sign;
- ◆ in the analysis of the source of costs, external costs mean those costs that are charged to the transmission business from companies that are not related parties of the company as defined in appendix 1;
- ◆ the activities will be as defined in chapter 3;
- ◆ staff in post numbers will be calculated using average full time equivalents for the year;
- ◆ the price control numbers in transmission business tables 4, 5, 6, 8, 14, 17 and 21 are on a nominal basis and will be inflated from the 1999/00 price levels that were used in the last NGC price control review, using the inflation adjustment index in transmission business table 8;
- ◆ unless stated, prices are on a nominal basis;
- ◆ where possible, throughout the tables actuals will be compared to the assumptions underlying the price control;
- ◆ health and safety and environmental costs will only be separately identified if Ofgem and NGC can agree upon a suitable definition of them; and
- ◆ for transmission business table 16 the following terms have the following meanings:
 - ◆ Dem means demand;
 - ◆ Gen means generation;
 - ◆ Net means transmission network capacity which is the improvement of the existing capacity of the network;
 - ◆ Tot means total;
 - ◆ Env means environment;
 - ◆ Rep means replacement; and
 - ◆ Non-op means non-operational.

Draft Template for the transmission business

Transmission business

Contents List

1. Five Year Annual Summary
2. Reconciliation to the TO Price Control Basis
3. Reconciliation to the SO Price Control Basis
4. Summary of the Comparison to the TO Price Control
5. Summary of the Comparison to the SO Price Control
6. Summary of the Comparison to the Total Transmission Business Price Control
7. Review of the year
8. RAV Statement
9. Profit and Loss Account
10. Statement of Total Recognised Gains and Losses
11. Balance Sheet
12. Cash Flow Statement
13. Detailed analysis of turnover
14. Summary analysis of turnover compared to the price control
15. Analysis of repair and maintenance costs
16. Detailed analysis of capital expenditure
17. Five year summary of cumulative capital expenditure
18. Five year summary of major capital schemes
19. Analysis of provisions
20. Summary activity analysis
21. SO cost of sales analysis;
22. Source of costs summary;
23. Summary of related party transactions
24. Detailed analysis of each material related party transaction

25. Auditors report
26. Directors responsibility statement
27. Corporate governance (in accordance with the combined code together with a licence condition compliance statement e.g. that no cross-subsidy exists)
28. Director's report
29. Directors remuneration
30. Accounting policies (including a detailed statement of the basis of preparation, a detailed statement of the capitalisation policy, a detailed statement of the principles involved in cost attribution, cost allocation, inter-business recharging and a detailed statement of the principles involved in the preparation of the activity analysis)
31. Other UK GAAP notes to the accounts e.g. an analysis of exceptional items and a five year summary

Reconciliation of the transmission business to the total business of the licensee

1. Five Year Annual Summary of the licensee
2. Review of the year
3. Profit and Loss Account
4. Statement of Total Recognised Gains and Losses
5. Balance Sheet
6. Cash Flow Statement

Transmission business

1. Five Year Annual Summary

Commentary

Containing a high-level review of the last five years.

Key Information	Actual 02/03 £m	Actual 01/02 £m	Actual 00/01 £m	Actual 99/00 £m	Actual 98/99 £m
Profitability					
Turnover					
Operating costs					
EBIT					
Profit/(loss) before tax	n/a	n/a	n/a	n/a	n/a
Profit/(loss) after tax	n/a	n/a	n/a	n/a	n/a
Dividends	n/a	n/a	n/a	n/a	n/a
Retained profit/(loss)	n/a	n/a	n/a	n/a	n/a
Earnings per share #	n/a	n/a	n/a	n/a	n/a
Dividends per share #	n/a	n/a	n/a	n/a	n/a
Return on a price control basis - separately for both the TO, SO and total transmission business					
Turnover #					
Operating costs #					
Controllable operating costs #					
EBIT #					
EBIT/Average RAV #					
Profit/(loss) before tax/Average RAV #	n/a	n/a	n/a	n/a	n/a
Profit/(loss) after tax/Average RAV #	n/a	n/a	n/a	n/a	n/a
Note: All numbers in this section are on a price control basis and a reconciliation should be provided between the numbers on a price control basis and for the business in total.					
Financial indicators					
EBIT interest coverage #	n/a	n/a	n/a	n/a	n/a
EBITDA interest coverage #	n/a	n/a	n/a	n/a	n/a
FFO interest coverage #	n/a	n/a	n/a	n/a	n/a
FFO to net debt #	n/a	n/a	n/a	n/a	n/a
(FFO – non load operational capex)/net debt	n/a	n/a	n/a	n/a	n/a
Gearing (net debt / net debt + equity)	n/a	n/a	n/a	n/a	n/a
Other key information					
Average RAV #					
Capital expenditure					
Total costs (operating and capital) #					
Disposals of fixed assets					
Net assets					
Net debt	n/a	n/a	n/a	n/a	n/a
Dividend Cover #	n/a	n/a	n/a	n/a	n/a
Effective tax rate #	n/a	n/a	n/a	n/a	n/a
Other statistics					
Staff in post					

2. Reconciliation to the TO Price Control Basis

Reconciliation to the TO Price Control Basis for the year ended 31 March 2003	Operating costs £m	EBIT £m	PBT £m	PAT £m
TO				
Per table 9				
Adjustments				
Capitalisation adjustments:				
Non-operational capital expenditure				
Other capitalisation adjustments				
Total capitalisation adjustments				
Other adjustments:				
Depreciation				
Margin on recharges				
Over-recovery of income				
Provisions on a cash basis				
Other costs on a cash basis				
Adjustment for stranded asset disposals				
Network rates				
Ofgem licence fee				
Cost of de-minimis activities				
Other other adjustments				
Total other adjustments				
TO results on the basis used in the price control				

Commentary

3. Reconciliation to the SO Price Control Basis

Reconciliation to the SO Price Control Basis for the year ended 31 March 2003	Operating costs £m	EBIT £m	PBT £m	PAT £m
SO				
Per table 9				
Adjustments				
Capitalisation adjustments:				
Non-operational capital expenditure				
Other capitalisation adjustments				
Total capitalisation adjustments				
Other adjustments:				
Depreciation				
Margin on recharges				
Over-recovery of income				
Provisions on a cash basis				
Other costs on a cash basis				
Network rates				
Ofgem licence fee				
Cost of de-minimis activities				
Other other adjustments				
Total other adjustments				
SO results on the basis used in the price control				
Total transmission business results on the basis used in the price control (TO and SO)				

Commentary

4. Summary of the Comparison to the TO Price Control

Summary of the Comparison to the TO Price Control for the year ended 31 March 2003	Actual (A) 02/03 £m	Price control (B) # 02/03 £m	Var (A-B) 02/03 £m
Operating costs			
Own staff costs			
Contractors, materials and consumables			
IT			
Professional fees			
MVAC supplies			
Non salary staff costs (including T&S)			
Communications			
Internal purchases – premises			
Internal purchases – other			
Other operating costs			
Controllable operating costs			
Line diversions and one-off costs			
Depreciation			
Network rates			
Transmission licence fee			
Pension surplus/(liability)			
Total operating costs			
Capital expenditure			
Load related operational expenditure			
Demand			
Generation			
Capital contributions			
Other load related			
Total load related operational expenditure			
Total non load related operational expenditure			

Commentary

Note:

1. The price control numbers will be inflated from the 1999/00 price level that was used in the last NGC price control review, using the inflation adjustment index in table 8.
2. It is intended that after the next NGC price control review the above analysis of capital expenditure will be more aligned with the analysis in table 16.

5. Summary of the Comparison to the SO Price Control

Summary of the Comparison to the SO Price Control for the year ended 31 March 2003	Actual (A) 02/03 £m	Price control (B) # 02/03 £m	Var (A-B) 02/03 £m
Operating costs			
Cost of sales			
Other operating costs			
Own staff costs			
Contractors, materials and consumables			
IT			
Professional fees			
Depreciation			
MVAC supplies			
Non salary staff costs (including T&S)			
Communications			
Internal purchases – premises			
Internal purchases – other			
Other operating costs			
Total operating costs			
Capital expenditure			
SO Transmission Services Scheme (TSS)			
IT			
Other			
Total capital expenditure			

Commentary

Note:

1. The price control numbers will be inflated from the 1999/00 price level that was used in the last NGC price control review, using the inflation adjustment index in table 8.
2. It is expected that the capital expenditure on the SO Transmission Services Scheme (TSS) will be transferred to the TO RAV on 1 April 2006.

6. Summary of the Comparison to the Total Transmission Business Price Control #

Summary of the Comparison to the Total Transmission Business Price Control for the year ended 31 March 2003	Actual (A) 02/03 £m	Price control (B) # 02/03 £m	Var (A-B) 02/03 £m
Operating costs			
SO Cost of sales			
Other operating costs			
Own staff costs			
Contractors, materials and consumables			
IT			
Professional fees			
MVAC supplies			
Non salary staff costs (including T&S)			
Communications			
Internal purchases – premises			
Internal purchases – other			
Other operating costs			
Controllable operating costs			
Line diversions and one-off costs			
Depreciation			
Network rates			
Transmission licence fee			
Pension surplus/(liability)			
Total operating costs			
Capital expenditure			
Load related operational expenditure			
Demand			
Generation			
Capital contributions			
Other load related			
Total load related operational expenditure			
Non load related operational expenditure			
Transformers			
Switchgear			
Other Substation			
Overhead lines			
Underground cables			
Non-rechargeable diversions			
Telecontrol, SCADA, Energy management			
SO Transmission Services Scheme			
Other non load related			
Total non load related operational expenditure			

Commentary

Note:

1. The price control numbers will be inflated from the 1999/00 price level that was used in the last NGC price control review, using the inflation adjustment index in table 8.
2. It is expected that the capital expenditure on the SO Transmission Services Scheme will be transferred to the TO RAV on 1 April 2006.
3. It is intended that after the next NGC price control review the above analysis of capital expenditure will be more aligned with the analysis in table 16.

7. **Review of the year #**

Introduction

The aim of the review of the year is to give users of the accounts a better understanding of the company's position and performance. The future prospects of the company will also be discussed (see below for the details). It will also allow key issues to be identified e.g. risks to the business. Generally it will be prepared along the lines of an operating and financial review but with some additional disclosures.

Typical contents of the review of the year would be:

Operational

- ◆ Key factors affecting the business
- ◆ Management of risks
- ◆ Projects
- ◆ Use of resources
- ◆ People
- ◆ Environment
- ◆ Health and safety

Financial

- ◆ Capital structure *
- ◆ Treasury policy *
- ◆ Interest policy *
- ◆ Dividend policy *
- ◆ Generation and use of cash resources *
- ◆ Liquidity and maintenance of investment grade credit rating *

Comparison to the TO, SO and total transmission business price control

- ◆ Allowed revenue
- ◆ Operating costs
- ◆ Interest *
- ◆ Taxation *
- ◆ Dividends *
- ◆ Capital expenditure
- ◆ Balance sheet *
- ◆ Operational performance
- ◆ Operation of the SO incentive scheme
- ◆ New generation capital expenditure adjustment mechanism

Prospects for the following year

- ◆ Cost reduction programmes
- ◆ Capital expenditure programmes
- ◆ Financing requirements *
- ◆ Organisational structure and manpower

* These items will be discussed in the review of the year in the reconciliation of the transmission business to the total business of the licensee section of the transmission business regulatory accounts.

8. RAV Statement #

RAV Statement for the year ended 31 March 2003	Actual 02/03			Actual 01/02		
	TO £m	SO £m	Total £m	TO £m	SO £m	Total £m
Opening RAV balance						
Inflation adjustment						
RAV additions						
Fixed asset additions included in the transmission business tangible fixed assets note						
Adjustments onto a RAV basis:						
Non-operational capital expenditure						
Other adjustments						
Less: de-minimis additions						
Net RAV Additions						
RAV disposals						
Fixed asset disposals included in the transmission business tangible fixed assets note						
Adjustments onto a RAV basis:						
Non-operational capital expenditure						
Adjustment for stranded asset disposals						
Other adjustments						
Less: de-minimis disposals						
Net RAV disposals						
Regulatory depreciation						
Closing RAV Balance						

Price control assumptions (nominal prices)						
Opening RAV balance						
RAV additions						
RAV disposals						
Regulatory depreciation						
Closing RAV balance						

Inflation adjustment index						

Commentary

9. Profit and Loss Account

The profit and loss account for both the TO, SO and the whole of the transmission business will be based on normal statutory disclosures. The operating and financial review will include a detailed commentary including an explanation of the variances between the results of this year and the results of the previous year. The format of the profit and loss account will be agreed with NGC at the same time as the accounting policies for that year's regulatory accounts are agreed with them.

10. Statement of Total Recognised Gains and Losses

The statement of total recognised gains and losses for both the TO, SO and the whole of the transmission business will be based on normal statutory disclosures. The operating and financial review will include a detailed commentary including an explanation of the variances between the results of this year and the results of the previous year. The format of the statement of total recognised gains and losses will be agreed with NGC at the same time as the accounting policies for that year's regulatory accounts are agreed with them.

11. Balance Sheet

The balance sheet for both the TO, SO and the whole of the transmission business will be based on normal statutory disclosures. The operating and financial review will include a detailed commentary including an explanation of the variances between the results of this year and the results of the previous year. The format of the balance sheet will be agreed with NGC at the same time as the accounting policies for that year's regulatory accounts are agreed with them.

12. Cash Flow Statement

The cash flow statement for both the TO, SO and the whole of the transmission business will be based on normal statutory disclosures. The operating and financial review will include a detailed commentary including an explanation of the variances between the results of this year and the results of the previous year. The format of the cash flow statement will be agreed with NGC at the same time as the accounting policies for that year's regulatory accounts are agreed with them.

13. Detailed analysis of turnover

Detailed analysis of turnover for the year ended 31 March 2003	Actual (A) 02/03 £m	Actual (B) 01/02 £m
TO		
Price controlled turnover		
Demand TNUoS charges HH Tariff		
Demand TNUoS charges NHH Tariff		
Generation TNUoS charges		
Pre-vesting connection charges		
Other price controlled turnover		
Under/over recovery of price controlled income		
Total price controlled turnover		
Excluded services turnover		
Post vesting connection charges		
- charges for established post vesting sites		
- charges for post vesting assets at established pre vesting sites		
- total post vesting connection charges		
Provision of services to third parties		
- charges for relocation of electrical lines and plant		
- one off charges		
- Energis infrastructure fee		
- other services to third parties		
- total provision of services to third parties		
Other excluded services		
Total excluded services turnover		
De-minimis turnover		
Telecommunications		
Other de-minimis activities		
Total de-minimis turnover		
Total TO turnover		
SO		
Internal recovery		
External recovery		
Total		
Total transmission business turnover		

Commentary

Note:

1. Additional analysis of TNUoS charges and connection charges is provided confidentially to Ofgem by NGC on a voluntary basis.

14. Summary analysis of turnover compared to the price control #

Summary analysis of turnover compared to the price control for the year ended 31 March 2003	Actual (A) 02/03 £m	Actual (B) 01/02 £m	Price control (C) # 02/03 £m	Var (A-C) 02/03 £m
TO				
Total price controlled turnover				
Excluded services turnover				
Energis infrastructure fee				
Other excluded services turnover				
Total excluded services turnover				
De-minimis turnover				
Total TO turnover				
SO				
Internal recovery				
Target				
Incentive				
Total				
External recovery				
Target				
Incentive				
Total				
Total SO turnover				
Target				
Incentive				
Total SO turnover				
Total turnover				

Commentary

Note:

1. The price control numbers will be inflated from the 1999/00 price level that was used in the last NGC price control review, using the inflation adjustment index in table 8.

15. Analysis of repair and maintenance costs #

Analysis of repair and maintenance costs for the year ended 31 March 2003	Actual 02/03 £m	Actual 01/02 £m
Substations		
Overhead lines		
Underground cables		
Protection and control		
SO		
Transmission Services Scheme		
IT		
Other		
Total		
Non-operational		
IT		
Administrative land & buildings		
Vehicles		
Other		
Total non-operational		
Other		
Total repair and maintenance costs		

Commentary

Note:

1. Repairs and maintenance costs will include direct costs (including salaries) and overheads. For the purposes of this table overheads will be allocated to repairs and maintenance costs on the same basis as if the repairs and maintenance expenditure had been capital expenditure under FRS 15.
2. Protection and control includes telecontrol and SCADA.

16. Detailed analysis of capital expenditure

	Capital expenditure for the year ended 31 March 2003												
	Load related operational					Non load related operational						Non op	Tot
	Dem	Gen	Net	Transfer	Tot	Rep	Safety	Env	Other	Transfer	Tot		
	Act	Act	Act	Act	Act	Act	Act	Act	Act	Act	Act	Act	Act
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Work in progress													
Substations													
Transformers													
Switchgear													
Protection and control													
Auxiliary systems and plant													
Other substation													
Total substations													
Overhead lines													
Underground cables													
Protection and control													
SO													
TSS													
IT													
Other													
Total													
Total operational capital expenditure													
Non-operational													
IT													
Admin land & buildings													
Vehicles													
Other													
Total non-operational													
Other													
Total capital expenditure													

Commentary

Note:

1. Non load related operational replacement capital expenditure means all capital expenditure that is incurred to keep the transmission business network in its present condition.
2. Work in progress represents all transmission assets whether load or non load that cannot at the moment be separately analysed into the relevant asset categories.
3. Transfers represent movements of transmission assets from work in progress to the relevant asset categories.
4. Protection and control includes telecontrol and SCADA.
5. Work in progress will include some Transmission Services Scheme expenditure.
6. See paragraph 2 of appendix 2 for the definitions of dem, gen, net, tot, rep, env and non op capital expenditure.

17. Five year summary of cumulative capital expenditure #

Five year summary of cumulative capital expenditure (from start of price control to date)	Actual (A) 01/02 - 05/06 £m	Price control (B) 01/02 - 05/06 £m	Variance (A-B) 01/02 - 05/06 £m
Capital expenditure			
Operational			
Load related			
Demand			
Generation			
Capital contributions			
Other load related			
Total load related			
Non load related			
Transformers			
Switchgear			
Other Substation			
Overhead lines			
Underground cables			
Non-rechargeable diversions			
Telecontrol, SCADA, Energy management			
SO Transmission Services Scheme			
Other non load related			
Total non load related			
Non operational			
Total capital expenditure			

Commentary

Note:

1. The price control numbers will be inflated from the 1999/00 price level that was used in the last NGC price control review, using the inflation adjustment index in table 8.
2. The commentary will contain a high-level cumulative review of capital expenditure over the five year period of the NGC price control.
3. The above numbers are cumulative from the beginning of the price control to the end of the present year that the regulatory accounts have been prepared for.

19. Analysis of provisions #

Analysis of provisions for the year ended 31 March 2003	Actual (A) 02/03 £m	Actual (B) 01/02 £m
TO		
Provision 1 etc		
Opening balance		
Charge to profit and loss account		
Credited to profit and loss account		
Provisions utilised		
Closing balance		
Total TO		
Opening balance		
Charge to profit and loss account		
Credited to profit and loss account		
Provisions utilised		
Closing balance		
SO		
Provision 1 etc		
Opening balance		
Charge to profit and loss account		
Credited to profit and loss account		
Provisions utilised		
Closing balance		
Total SO		
Opening balance		
Charge to profit and loss account		
Credited to profit and loss account		
Provisions utilised		
Closing balance		
Total transmission business		
Opening balance		
Charge to profit and loss account		
Credited to profit and loss account		
Provisions utilised		
Closing balance		

Commentary

20. Summary activity analysis

Summary activity analysis For the year ended 31 March 2003	TO			SO	Total
	Activity 1 £m	Activity 2 etc £m	Total £m	£m	£m
Operating costs					
Cost of sales (see table 21 for extra detail)					
Other operating costs					
Own staff costs					
Contractors, materials and consumables					
Premises					
IT					
Insurance					
Advertising and marketing					
Professional fees					
Bad debts					
Health and safety					
Environmental					
Network rates					
Wayleaves					
Licence fees					
Depreciation					
MVAC supplies					
Communications					
Other operating costs					
Total operating costs					
Capital expenditure					
Load related operational					
Non load related operational					
Capital contributions					
Non operational					
Total capital expenditure					
Total costs					

Commentary

Note:

1. All the activities as defined in chapter 3 will be included in the above table.
2. Own staff costs will include all staff costs.
3. Only the SO has cost of sales.

21. SO cost of sales analysis #

SO cost of sales analysis for the year ended 31 March 2003	Actual (A) 02/03 £m	Price control (B) 02/03 £m	Var (A-B) 02/03 £m
Balancing mechanism (BM)			
BM Offers			
BM Bids			
Non-delivery			
Costs to SO of the balancing mechanism (CSOBM)			
Balancing services contracts (BSCC)			
Energy trading			
Reserve			
Frequency response			
Transmission constraints			
Black start			
Reactive power			
Other balancing services			
Total balancing services contracts costs			
Total SO accounting cost of sales			
Reconciliation to Incentivised Balancing Costs (IBC)			
CSOBM (from above)			
Less:			
Net imbalance adjustment			
Incentivised Balancing Mechanism Costs (IBMC)			
BSCC (from above)			
Transmission losses			
Other adjustments			
Incentivised Balancing Costs			

Commentary

Note:

1. This analysis may need to be revised in the future in accordance with Ofgem's proposals on transmission access and BETTA.
2. The first part of the above table provides details of the SO accounting cost of sales. The second part of the table provides a reconciliation from the SO accounting cost of sales to the SO cost of sales that NGC is incentivised upon.
3. The price control numbers for the CSOBM and balancing services contracts costs will probably not be able to be broken down into the detail shown in the above table.
4. The price control numbers will be inflated from the 1999/00 price level that was used in the last NGC price control review, using the inflation adjustment index in table 8.

22. Source of costs summary

Summary of the source of costs for the year ended 31 March 2003	External 02/03 £m	Recharged 02/03 £m	Allocated/ Attributed 02/03 £m	Total 02/03 £m
Operating costs				
TO				
Cost of sales				
Own staff costs				
Contractors, materials and consumables				
Premises				
IT				
Insurance				
Advertising and marketing				
Professional fees				
Bad debts				
Health and safety				
Environmental				
Network rates				
Wayleaves				
Licence fees				
Depreciation				
MVAC supplies				
Communications				
Other operating costs				
Total TO operating costs				
SO				
Internal				
External				
Total SO operating costs				
Total operating costs				
Capital expenditure				
TO				
Load related operational				
Non load related operational				
Capital contributions				
Non operational				
Total TO capital expenditure				
SO capital expenditure				
Total capital expenditure				
Total costs				
TO				
SO				
Total				

Commentary

Note:

1. External costs mean those costs that are charged to the transmission business from companies that are not related parties of the company as defined in appendix 1. Recharged costs are those costs that are charged into the transmission business from related parties of the company as defined in appendix 1. Allocated/attributed costs are those costs that are allocated/attributed from either within the transmission business or from related parties of the company as defined in appendix 1.
2. Own staff costs will include all staff costs.

23. Summary of related party transactions

	Type of Information	Notes
1	Company providing service.	Names of the transacting related parties including a description of the company structure and the relationship with the regulated company.
2	Service.	A summary of the assets transferred, services received or provided.
3	Terms of supply.	A summary of how prices were established e.g. by market tender.
4	Value.	Total aggregate value of assets transferred, service received or provided. Showing a breakdown of its component parts.
5	Number of contracts in existence at the balance sheet date.	
6	Percentage of contracts won by the related party that were let during the year.	Both in terms of value and number.
7	Number of other tenders for these contracts.	
8	State method of evaluation.	Summary of the evaluation method.
9	Category of transaction.	Identify the value of transactions by category.
10	Balance sheet.	Amounts due to or from the related party at the balance sheet date.
11	Amounts written off.	Amounts written off by the related party in respect of the contract including interest.

Note:

1. Items 5 – 9 will not have to be published but will be provided to Ofgem.

24. Detailed analysis of each material related party transaction #

	Type of information	Notes
1	Company providing service.	Names of the transacting related parties including a description of the company structure and the relationship with the regulated company.
2	Service.	A description of the assets transferred, service received or provided.
3	Terms of supply.	State how prices were established e.g. by market tender.
4	Value.	Value of asset transferred, service received or provided. Showing a breakdown of its component parts.
5	Date of contract and date of expiry.	Include details of any options to extend or renew.
6	Method of selection of appointee: with explanation of why the contract was awarded internally.	Include details of market tests conducted.
7	Details of advertisement of contract.	
8	Date of advertisement and number of respondents.	
9	Number of invitees to tender.	
10	Number of tenders submitted.	Basis for exclusion or withdrawal.
11	State method of evaluation.	Method and number of comparators with their ranking.
12	Category of transaction.	
13	Analysis of the price charged.	The related party transaction should be split between the operating cost (excluding depreciation), depreciation and return on capital.

Reconciliation of the transmission business to the total business of the licensee

1. Five Year Annual Summary of the licensee

Commentary

Containing a high-level review of the last five years.

Key Information	Actual 02/03 £m	Actual 01/02 £m	Actual 00/01 £m	Actual 99/00 £m	Actual 98/99 £m
Profitability					
Turnover (see note 1)					
Operating costs (see note 1)					
EBIT (see note 1)					
Profit/(loss) before tax (see note 1)					
Profit/(loss) after tax (see note 1)					
Dividends (see note 1)					
Retained profit/(loss) (see note 1)					
Earnings per share # (see note 1)					
Dividends per share # (see note 1)					
Financial indicators					
EBIT interest coverage #					
EBITDA interest coverage #					
FFO interest coverage #					
FFO to net debt #					
(FFO – non load operational capex)/net debt					
Gearing (net debt / net debt + equity)					
Other key information					
Net assets (see note 1)					
Net debt (see note 1)					
Dividend cover # (see note 1)					
Effective tax rate #					
Staff in post (see note 1)					

Note:

1. The requirement for the licensee to provide some of the above disclosures, can be satisfied by NGC including a copy of NGC's statutory accounts in NGC's regulatory accounts, if those items are also included in NGC's statutory accounts.
2. The above information and numbers are for the licensee.

2. Review of the year #

Introduction

The aim of the review of the year in the reconciliation of the transmission business to the total business of the licensee, is to give users of the accounts a better understanding of how the financial position, financial performance and cash flows of the transmission business are reconciled to the financial position, financial performance and cash flows of the total business of the licensee and how those aspects of the operation and financing of the transmission business that are carried out at the NGC level compare to the assumptions made during price control reviews.

Typical contents of the review of the year would be:

Operational

- ◆ Discussion of the performance of the non transmission business elements of NGC.

Financial

- ◆ Capital structure
- ◆ Treasury policy
- ◆ Interest policy
- ◆ Dividend policy
- ◆ Generation and use of cash resources
- ◆ Liquidity and maintenance of investment grade credit rating

Analysis of total NGC performance

- ◆ Interest
- ◆ Taxation
- ◆ Dividends
- ◆ Balance sheet

Prospects for the following year

- ◆ Financing requirements

Draft Template for the licensee

Contents List

Other disclosures required by the licensee in accordance with UK GAAP

1. Auditors report
2. Directors responsibility statement
3. Corporate governance (in accordance with the combined code)
4. Chairman's statement
5. Director's report
6. Directors remuneration
7. Accounting policies
8. Other UK GAAP notes to the accounts e.g. an analysis of exceptional items and a five year summary

Note:

The requirement for the licensee to provide the other disclosures as specified above or in the licensee's five year annual summary, can be satisfied by NGC including a copy of NGC's statutory accounts in NGC's regulatory accounts if those items specified above are also included in NGC's statutory accounts.