



# A2 - NGN RIIO-2

Business Plan Assurance

*together*  
**we are  
the network**

# Review of NGN's RII0-GD2 Business Plan Assurance

EY report for Northern Gas Networks

19<sup>th</sup> November 2019

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# Executive Summary

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## Introduction

In July 2017, Ofgem began the process for determining the RIIO-2 price control, which will run from April 2021 to March 2026. Northern Gas Networks (NGN) is currently in the process of preparing its Final Business Plan for submission to Ofgem in December 2019.

In this context, NGN has undertaken a range of activities to provide (or obtain in some instances) assurance that its business plan for its forthcoming gas distribution price control, RIIO-GD2, meets the criteria around accuracy, ambition, efficiency, and financeability of the Business Plan that Ofgem has set, which NGN has interpreted as a series of board assurance objectives.

To support these activities, NGN has commissioned EY to review two areas:

1. NGN's governance and assurance framework for its RIIO-GD2 Business Plan and its implementation:

The first part of our review considers whether NGN's RIIO-GD2 governance and assurance framework has been implemented as intended, as set out in NGN's RIIO-GD2 governance and assurance framework. In order to do this, we first reviewed the planned 'ways of working' to be adhered to during the course of the development of its RIIO-GD2 Business Plan. In our review, we focused our attention on: a) NGN's RIIO-GD2 Business Plan development governance structure; (b) the membership, roles and objectives of the different bodies within the governance structure; and (c) the planned assurance work.

We then examined available evidence of processes that have been followed, including attendance at meetings of the different bodies within the governance structure to evaluate whether the plan has been implemented as intended to achieve the objectives, and identify any areas where NGN had diverged from the plan.

2. The supporting evidence for each of NGN's RIIO-GD2 board assurance objectives:

NGN's RIIO-GD2 governance and assurance framework includes a list of NGN's RIIO-GD2 board assurance objectives, and we have assessed the evidence obtained for each in turn. Our assessment began with a review of assurance objectives, and then a study as to whether the combination of the pieces of evidence that NGN considers to support each board assurance objective do provide such support. To do this, we studied the scope and conclusion of each piece of evidence individually, and the evidence's key messages.

Following this, for each board assurance statement, we considered the conclusions of the supporting evidence collectively to determine whether they, together, objectively justified that each objective had been met. We also assessed whether there were any gaps or contradictions in the evidence, and where any additional evidence is required to support the board assurance objectives.

Our assessment was based on the assumption that the conclusions from each piece of evidence is a fair representation of, and consistent with, the work that was conducted to produce it; hence the conclusions can be used to enable us to consider the above.

The aim of our review is to consider whether NGN's actions have been consistent with its governance and assurance framework and assurance activities, and to assess if NGN's RIIO-GD2 board assurance objectives are supported by the evidence NGN has compiled during the development of its RIIO-GD2 Business Plan.

# Executive Summary

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## *Limitations of our scope*

Our review has been limited to the information that NGN has provided to us. A list of the documents we have received from NGN, and assessed as part of our review, is set out in the appendix.

The focus of our review has been whether NGN has adhered to its governance and assurance plan, and whether NGN has presented evidence to support the assurance objectives it had set itself. Our review does not consider Ofgem's forthcoming assessment of NGN's RIIO-GD2 Business Plan and how NGN has developed it.

Our scope of work did not include an assessment of whether NGN's governance and assurance framework, assurance objectives and associated definitions, or assurance activities were appropriate or comprehensive, or consideration of its quality.

Furthermore, our assessment did not consider the robustness of the pieces of evidence, i.e. it was assumed that an appropriate methodology had been used and correctly applied, and as such the conclusion stated was an appropriate reflection of the intended work.

## Assessment of NGN's RIIO-GD2 governance and assurance framework and its implementation

### *NGN's RIIO-GD2 governance and assurance framework*

NGN's RIIO-GD2 governance and assurance framework was approved in 2018, and set out planned 'ways of working' to be adhered to during the course of the development of its RIIO-GD2 Business Plan.

NGN's presentations for both its Board-Appointed RIIO2 Steering Group meeting and its Internal RIIO2 Steering Group meetings, and the minutes and action logs from these meetings, provide evidence that the governance structure has been adhered to throughout the period of development of the RIIO-GD2 Business Plan.

### *NGN's Board-Appointed RIIO2 Steering Group and NGN's internal RIIO2 Steering Group*

The RIIO-GD2 Governance & Assurance Framework & Objectives sets out the intended membership of NGN's Board-Appointed RIIO2 Steering Group and NGN's internal RIIO2 Steering Group, and their objectives.

NGN's presentations for its Board-Appointed RIIO2 Steering Group and Internal RIIO2 Steering Group, and their minutes and action logs from these meetings, provide evidence that the intended members of the group have attended meetings, and that the topics discussed at the meetings aligned with the stated objectives.

### *Internal and external assurance of NGN's RIIO-GD2 Business Plan*

In September 2019, NGN's Board-Appointed RIIO2 Steering Group discussed the internal and external assurance of NGN's RIIO-GD2 Business Plan. NGN has presented evidence that indicates that all of the assurance activities discussed have been conducted, or are in the process of being conducted (as of 19<sup>th</sup> November 2019) by internal teams or external parties.

# Executive Summary

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## Assessment of the supporting evidence for each of NGN's RIIO-GD2 board assurance objectives

NGN's RIIO-GD2 board assurance objectives are set out below, along with our conclusions following our review of the combination of the pieces of evidence that NGN considers to support each board assurance objective.

Our conclusions are based on the evidence that we have viewed (as set out in the Appendix) as of 19<sup>th</sup> November 2019, and therefore is based on draft versions of documents (such as the NGN's RIIO-GD2 Business Plan) and scopes of work yet to be completed (such as the Internal Audit team's work on assurance and the RIIO-GD2 team's assurance of the cost confidence work).

*Assurance objective 1: The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG [Customer Engagement Group] about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan*

Taken together the evidence indicates that NGN has provided evidence that its Business Plan has been informed by customer engagement and by feedback from its CEG about the quality of that customer engagement and how this has been incorporated into its plan.

*Assurance objective 2: The outcomes and output commitments made within the plan are deliverable*

Taken together the evidence indicates that NGN has presented evidence of its relatively strong past performance (compared to its peers), and its commitment to delivering outcomes included in its Business Plan, in accordance with the elements included in Ofgem's definition of 'deliverable'.

*Assurance objective 3: Outcomes, performance commitments and ODIs reflect customer needs and preferences and are ambitious*

Taken together the evidence indicates that NGN has presented evidence that the outcomes, performance commitments and ODIs reflect feedback it has received from customers, and is consistent with its definition of ambitious.

*Assurance objective 4: Is built on expenditure forecasts which have been produced using a robust and efficient process*

Taken together the evidence indicates that NGN has provided evidence that its approach to developing its expenditure forecasts is consistent with its definition of a robust and efficient process.

*Assurance objective 5: Is financeable on both the notional and actual capital structure based on our [NGN's] proposed financial parameters*

Taken together the evidence indicates NGN has provided evidence that the projected performance of the business over the RIIO-GD2 period on both a notional and actual capital structure basis is financeable, based upon NGN's proposed financial parameters and using the financeability tests that NGN considers appropriate.

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2. Assessment of NGN's RIIO-GD2 governance and assurance framework and assurance activities
3. Assessment of the supporting evidence for NGN's RIIO-GD2 board assurance objectives
- A1. Appendix: Evidence reviewed

# Section 1: Introduction



# Introduction

In July 2017, Ofgem began the process for determining the RIIO-2 price control, which will run from April 2021 to March 2026. Northern Gas Networks (NGN) is currently in the process of preparing its Final Business Plan for submission to Ofgem in December 2019, following a sustained period of engagement on its draft Business Plan and consultation with stakeholders and the Ofgem-appointed Challenge Group.



Ofgem has published successive versions of its RIIO-2 Business Plan Guidance in which it sets out its expectations of what should be presented in energy network companies' business plans. In the latest guidance Ofgem states that:

*"the Business Plan should set out the level of assurance that has been provided by sufficiently independent directors that the plan and associated costs have been tested for accuracy, ambition and efficiency"*<sup>1</sup>

And in further information provided by Ofgem on financeability, Ofgem stated that [it expects]:

*"licensees to provide board assurance that the licensee is financeable on both a notional and actual basis"*<sup>2</sup>

In this context, NGN has undertaken a range of activities to provide (or, in some instances obtain) assurance that its business plan for its forthcoming gas distribution price control, RIIO-GD2, meets the criteria that Ofgem has set, which NGN has interpreted as a series of board assurance objectives. These activities have included internal and external assurance activities, and close involvement of NGN's RIIO-GD2 steering groups throughout the development of the business plan.

To support these activities, NGN has commissioned EY to review the body of evidence it has collated on: (1) how it has governed the process to develop its RIIO-GD2 Business Plan; and (2) the assurance activities that it has undertaken. Our review focused on two areas:

1. NGN's governance and assurance framework for its RIIO-GD2 Business Plan and its implementation; and
2. The supporting evidence for each of NGN's RIIO-GD2 board assurance objectives.

The aim of our review is to consider whether NGN's actions have been consistent with its governance and assurance framework and assurance activities, and to assess if NGN's RIIO-GD2 board assurance objectives are supported by the evidence NGN has compiled during the development of its RIIO-GD2 Business Plan.

## Notes:

1 Ofgem (September 2019) [https://www.ofgem.gov.uk/system/files/docs/2019/09/riio-2\\_business\\_plans\\_guidance\\_september\\_2019\\_-\\_published\\_redline\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/09/riio-2_business_plans_guidance_september_2019_-_published_redline_0.pdf)

2 Ofgem (March 2019) [https://www.ofgem.gov.uk/system/files/docs/2019/03/financeability\\_assessment\\_for\\_riio2\\_further\\_information\\_20190326.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/03/financeability_assessment_for_riio2_further_information_20190326.pdf)

# Approach

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The approach we have taken to our review is as follows:

## **Assessment of NGN's RIIO-GD2 governance and assurance framework and its implementation**

The first part of our review was to consider whether NGN's RIIO-GD2 governance and assurance framework has been implemented as intended as set out in NGN's RIIO-GD2 governance and assurance framework.

In order to assess NGN's RIIO-GD2 governance and assurance framework, we first reviewed the planned 'ways of working' to be adhered to during the course of the development of its RIIO-GD2 Business Plan. In our review, we focused our attention on: (a) NGN's RIIO-GD2 Business Plan development governance structure; (b) the membership, roles and objectives of the different bodies within the governance structure; and (c) the planned assurance work.

We then examined available evidence of processes that have been followed, including attendance at meetings of the different bodies within the governance structure to evaluate whether the plan has been implemented as intended to achieve the objectives, and identify any areas where NGN had diverged from the plan.

## **Assessment of the supporting evidence for each of NGN's RIIO-GD2 board assurance objectives**

NGN's RIIO-GD2 governance and assurance framework includes a list of assurance objectives, and we have assessed the evidence obtained for each in turn.

Our assessment for this part of the review began with a review of NGN's RIIO-GD2 board assurance objectives, and then a study as to whether the combination of the pieces of evidence that NGN considers to support each board assurance objective do provide such support. To do this, we studied the scope and conclusion of each piece of evidence individually to determine whether the conclusion was aligned with the scope, and the evidence's key messages.

Following this, for each board assurance statement, we considered the conclusions of the supporting evidence collectively to determine whether they, together, objectively justified that each objective had been met. We also assessed whether there were any gaps or contradictions in the evidence, and where any additional evidence or amendments to existing pieces of evidence, are required in order to support the board assurance objectives. Our assessment was based on the assumption that the conclusions from each piece of evidence is a fair representation of, and consistent with, the work that was conducted to produce it; hence the conclusions can be used to enable us to consider the above.

# Approach

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## **Limitations of our scope**

Our review has been limited to the information that NGN has provided to us. A list of the documents we have received from NGN, and assessed as part of our review, is set out in the appendix.

The focus of our review has been whether NGN has adhered to its governance and assurance plan, and whether NGN has presented evidence to support the assurance objectives it had set itself. Our review does not consider Ofgem's assessment of NGN's RIIO-GD2 Business Plan and how it has developed it.

Our scope of work did not include an assessment of whether NGN's governance and assurance framework and assurance activities were appropriate or comprehensive, or consideration of its quality.

Furthermore, our assessment did not consider the robustness of the pieces of evidence against each assurance objective, i.e. it was assumed that an appropriate methodology had been used, it had been correctly applied, and based on this the conclusion stated in the piece of evidence was an appropriate reflection of the intended work.

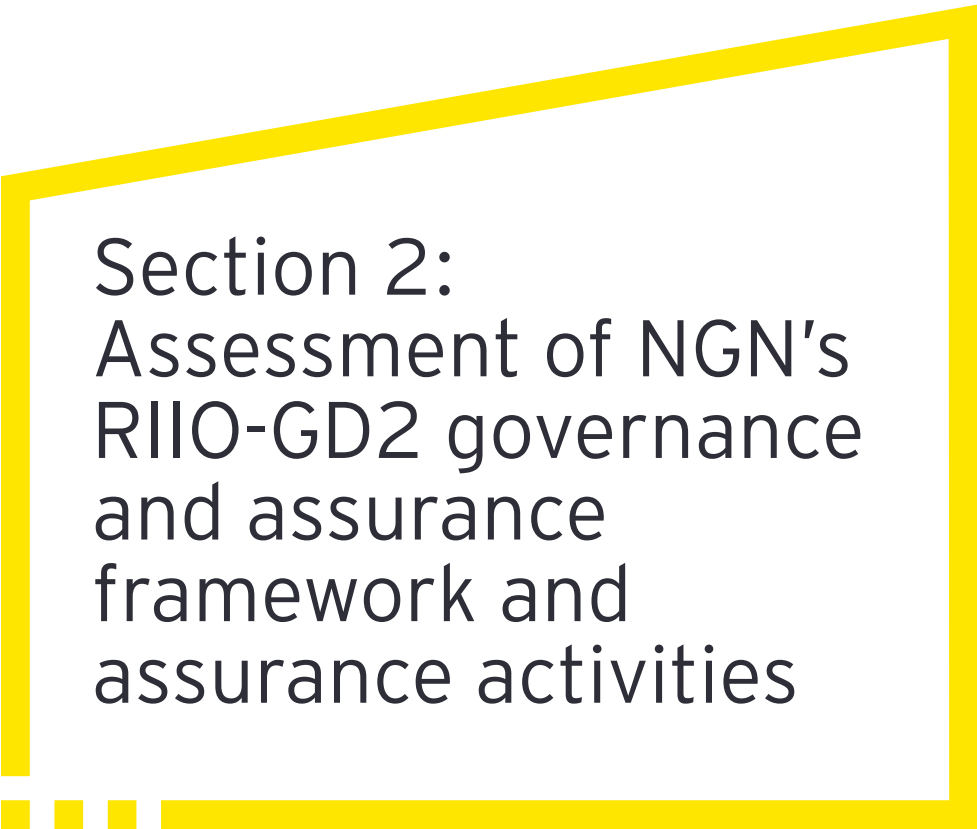
# Report structure

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The remainder of the report is structured as follows:

- ▶ Section 2 presents the findings from our assessment of NGN's RIIO-GD2 governance and assurance framework and its implementation and assurance activities; and
- ▶ Section 3 presents the findings from our assessment of the supporting evidence for NGN's RIIO-GD2 board assurance objectives.

Appendix 1 sets out the evidence that has been reviewed and provides more information on our assessment of the supporting evidence for the board assurance objectives.

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## Section 2: Assessment of NGN's RIIO-GD2 governance and assurance framework and assurance activities

# NGN's RIIO-GD2 governance and assurance framework

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NGN's RIIO-GD2 governance and assurance framework was approved in 2018, and covered:

- NGN's RIIO-GD2 Business Plan development governance structure;
- the membership of NGN's Board-Appointed RIIO2 Steering Group (also referred to as the Executive Steering Group), and the steering group's role and objectives;
- the membership of NGN's internal RIIO2 Steering Group (also referred to as the Internal Steering Group), and the steering group's role and objectives; and
- NGN's RIIO-GD2 board assurance objectives.

NGN's RIIO-GD2 governance and assurance framework does not explicitly comment on NGN's planned assurance activities, instead the Executive Steering Group meeting packs have been reviewed to understand NGN's approach in this area.

The following slides summarise our assessment of the governance and assurance elements set out below, comparing what the plan was and what happened:

- NGN's RIIO-GD2 governance framework;
- NGN's Board-Appointed RIIO2 Steering Group;
- NGN's internal RIIO2 Steering Group; and
- NGN's assurance activities.

NGN's RIIO-GD2 board assurance objectives are discussed in Section 3.

# Assessment of NGN's RIIO-GD2 governance framework

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## **NGN's RIIO-GD2 Business Plan development governance structure**

NGN's RIIO-GD2 Governance & Assurance Framework & Objectives document, dated December 2018, states that NGN's governance structure for the development of its RIIO-GD2 Business Plan was setup with the NGN Board of Directors as the most senior body in the structure, and the following reporting structure:

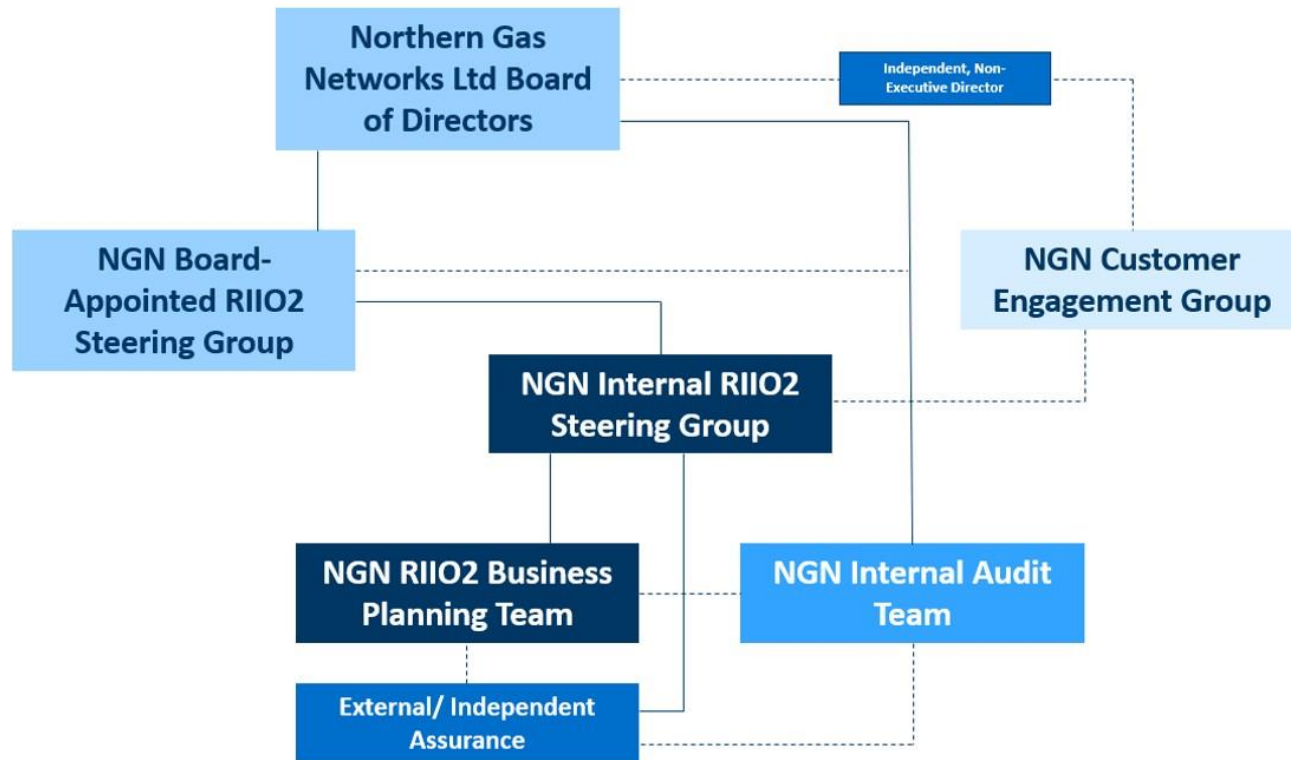
- assurance undertaken internally and/or provided by a third party was overseen by the NGN RIIO2 Business Planning team, which would report to the NGN Internal RIIO2 Steering Group;
- the NGN Internal RIIO2 Steering Group was set up to report to the NGN Board-Appointed RIIO2 Steering Group, and the NGN Customer Engagement Group (CEG);
- the NGN Board-Appointed RIIO2 Steering Group was established to report to the NGN Board of Directors;
- the NGN CEG was also established to report to the NGN Board of Directors, however it was to do that through the Independent Non-Executive Director; and
- during the development of the RIIO-GD2 Business Plan, the NGN Internal Audit team were to work alongside the NGN RIIO2 Business Planning team, providing internal assurance, and reporting to the NGN Board-Appointed RIIO2 Steering Group and the NGN Board of Directors.

NGN provided further commentary on the governance structure, stating that the NGN Board were the ultimate approval body for all of the elements of the Business Plan. The NGN Board will be the body that will sanction/approve the Business Plan for submission to Ofgem and provide the NGN CEO with the authority to submit on its behalf. All key strategic decisions on the Business Plan were taken to the NGN Board either directly at Board meetings, via the Board Appointed RIIO-GD2 Steering Group, or direct discussion with the Chairman of the NGN Board. The commissioning of assurance work was carried out at the Board Appointed RIIO-GD2 Steering Group level, either as a direct request from the Group or a recommendation taken to the Group from NGN directly for agreement.

A schematic of NGN's RIIO-GD2 Business Plan Development Governance Structure is presented on the following slide.

# Assessment of NGN's RIIO-GD2 governance framework

## RIIO-GD2 Business Plan Development Governance Structure<sup>1</sup>



Source:

1 NGN (December 2018), RIIO-GD2 Governance & Assurance Framework & Objectives



# Assessment of NGN's RIIO-GD2 governance framework

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## Assessment of evidence

NGN's presentations for both its Board-Appointed RIIO2 Steering Group meeting and its Internal RIIO2 Steering Group steering group meetings, and the minutes and action logs from these meetings, provide evidence that the governance structure has been adhered to throughout the period of development of the RIIO-GD2 Business Plan.

- ▶ The NGN Board-Appointed RIIO2 Steering Group met regularly dated December 2018 to September 2019<sup>1</sup>, with an action log and minutes of its meetings being recorded. At the beginning of each meeting, the action log from the previous meeting was reviewed to ensure actions were being progressed and completed. Minutes from the RIIO2 Executive Steering Group indicate that members of the NGN Internal RIIO2 Steering Group presented to the RIIO-2 Executive Steering Group on key topics related to the development of NGN's RIIO-GD2 Business Plan such as the financial strategy, Ofgem working groups, updates from Ofgem's Challenge Group, and assurance work. The decisions that the NGN Board of Directors has made in relation to NGN's RIIO-GD2 Business Plan since December 2018 have been recorded.
- ▶ The NGN Internal RIIO2 Steering Group met regularly from October 2018 to October 2019, with an action log from its meetings being recorded. At the beginning of each meeting, the action log from the previous meeting was reviewed to ensure actions were being progressed and completed. Presentations for the NGN Internal RIIO2 Steering Group meetings indicate that topics such as progress on the Business Plan, outputs, and stakeholder engagement were discussed, as well as progress on actions to be delivered for NGN Board-Appointed RIIO2 Steering Group.
- ▶ The NGN Internal RIIO2 Steering Group is recorded as having discussed the plan for obtaining internal and external assurance of its development of the RIIO-GD2 Business Plan.

The NGN Board-Appointed RIIO2 Steering Group, the NGN Internal RIIO2 Steering Group, and NGN's assurance activities are discussed further on the next slides.

## Notes:

<sup>1</sup> The NGN Board-Appointed RIIO2 Steering Group met again in early November, but we have not reviewed the material related to that meeting

# Assessment of NGN's Board-Appointed RII02 Steering Group

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## **NGN's Board-Appointed RII02 Steering Group**

The RII0-GD2 Governance & Assurance Framework & Objectives, dated December 2018, sets out the intended membership and objectives for the NGN Board-Appointed RII02 Steering Group.

The Board-Appointed RII02 Steering Group was comprised of NGN's CEO, the Independent Non-Executive Director, a Non-Executive Director, three alternate Non-Executive Directors, the Finance Director, and the Corporate Regulatory and Governance Director.

The Board-Appointed RII02 Steering Group's stated objectives were to:

- ▶ oversee the strategic development of the RII0-GD2 Business Plan;
- ▶ review, challenge and approve the key strategic and policy positions;
- ▶ ensure that the key assurance objectives are met;
- ▶ ensure the NGN Board of Directors are briefed and aware of key strategic and policy positions included within the RII0-GD2 Business Plan; and
- ▶ meet on a schedule agreed between the Chairperson and Group Members.

## Assessment of evidence

NGN's presentations for its Board-Appointed RII02 Steering Group, and the minutes and action logs from these meetings, provide evidence that the intended members of the group have attended meetings, and that the topics discussed at the meetings aligned with the stated objectives.

- ▶ Meeting minutes indicate that the members of the Board-appointed RII02 Steering Group regularly attended the meetings;
- ▶ The Board-Appointed RII02 Steering Group met six times between December 2018 and September 2019. All the meeting minutes show that during the meetings, forecasts, delivery strategy and financial strategy of the RII0-GD2 business plan are consistently topics of discussion, which suggests that the group is consistently overseeing the strategic development of the plan;
- ▶ Meeting presentations and minutes also show that NGN's Board-Appointed RII02 Steering Group also regularly reviewed, challenged and approved the feedback and risks and mitigation log, as well as the group's action log to confirm that actions were being completed. At every meeting, the progress of the business plan was evaluated, to ensure that appropriate progress is being made; and
- ▶ Members of the steering group also updated the NGN Board of Directors on the progress of the plan and ensured that the NGN Board were briefed and aware of key positions within the business plan.

# Assessment of NGN's Internal RII02 Steering Group

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## NGN's Internal RII02 Steering Group

The RII0-GD2 Governance & Assurance Framework & Objectives, dated December 2018, sets out the intended membership and objectives for NGN's Internal RII02 Steering Group.

NGN's Internal RII02 Steering Group was comprised of NGN's CEO, the Corporate Regulatory and Governance Director, the Finance Director, the Regulation and Strategic Planning Director, the Head of RII0-GD2, the Head of Stakeholder Relations, and the RII0-GD2 Project Manager.

The Internal RII02 Steering Group's stated objectives were to:

- ▶ deliver a quality RII0-GD2 Business Plan;
- ▶ provide recommendations to the NGN Board-Appointed RII02 Steering Group on;
  - ▶ Strategic Position
  - ▶ Key Policy Decisions
  - ▶ Compliance with Ofgem Requirements
  - ▶ Assurance Objectives
- ▶ direct and guide the RII0-GD2 Business Plan team to deliver desired outcomes.

## Assessment of evidence

NGN's presentations for its Internal RII02 Steering Group, and the minutes and action logs from these meetings, provide evidence that the intended members of the group have attended meetings, and that the topics discussed at the meetings aligned with the stated objectives.

- ▶ Meeting minutes indicate that the members of the Board-appointed RII02 Steering Group regularly attended the meetings.
- ▶ The Internal RII02 Steering Group met 13 times during the period covering October 2018 to September 2019. The group reviewed its actions and tracked its progress on the RII0-GD2 Business Plan with the aim of delivering a high quality plan. The Steering Group identified challenges to its aim and decided on actions to be taken, for example:
  - ▶ at the January 2019 meeting, the steering group discussed Ofgem's business plan guidance to ensure that all members are aware of the requirements and take steps to achieve the desired customer outputs; and
  - ▶ in the August 2019 meeting, the steering group discussed and agreed how to respond to feedback from the Ofgem-appointed Challenge Group.

# Assessment of NGN's assurance activities

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## Internal and external assurance of NGN's RIIO-GD2 Business Plan

In September 2019, NGN's Board-Appointed RIIO2 Steering Group discussed the following internal and external assurance of NGN's RIIO-GD2 Business Plan:

- ▶ Internal assurance
  - ▶ Compliance with requirements of the Data Assurance Guidance (DAG) for forecast data;
  - ▶ Data Validation over historic data within the data tables; and
  - ▶ Review of key models used for forecast data.
- ▶ External assurance
  - ▶ Financial model assessment;
  - ▶ Business support costs assessment; and
  - ▶ Cost confidence plan.

## Assessment of evidence

The following pieces of work have been, or are in the process of being, completed to assure elements of NGN's RIIO-GD2 Business Plan:

- ▶ Internal assurance
  - ▶ The scope for the Internal Audit team's work relating to NGN's RIIO-GD2 Business Plan includes a review of processes and controls implemented by business departments and the RIIO-GD2 team for the compilation, review, checking and sign off of expenditure forecasts, and justification for any expenditure forecasts which differ significantly from historical trends, in NGN's RIIO-GD2 Business Plan. The work is currently being carried out.
- ▶ External assurance (see the appendix for more information on these pieces of evidence)
  - ▶ NGN commissioned the consultancy Oxera to conduct a peer review of NGN's financial model for the notional company for RIIO-GD2 to provide an independent assessment of whether NGN's conclusions were reasonable at the time the report was finalised; and
  - ▶ As set out in the presentation for NGN's Board-Appointed RIIO2 Steering Group's meeting in September 2019, NGN's financial model "has been independently reviewed by KPMG. Specifically, KPMG's review included "testing the logical integrity of the arithmetical operations in the Model formulae and calculations under the assumptions and input data for the base case". KPMG has found that "the Model has been constructed so as to materially achieve the purpose which it was designed to meet, insofar as its logical integrity under the base case assumptions and input data is concerned".
  - ▶ KPMG was also commissioned to undertake an assessment of business support costs to provide clarity and confidence in the current and forecasted business support costs in NGN's RIIO-GD2 Business Plan, according to the presentation for the NGN's Board-Appointed RIIO2 Steering Group's meeting in September 2019.

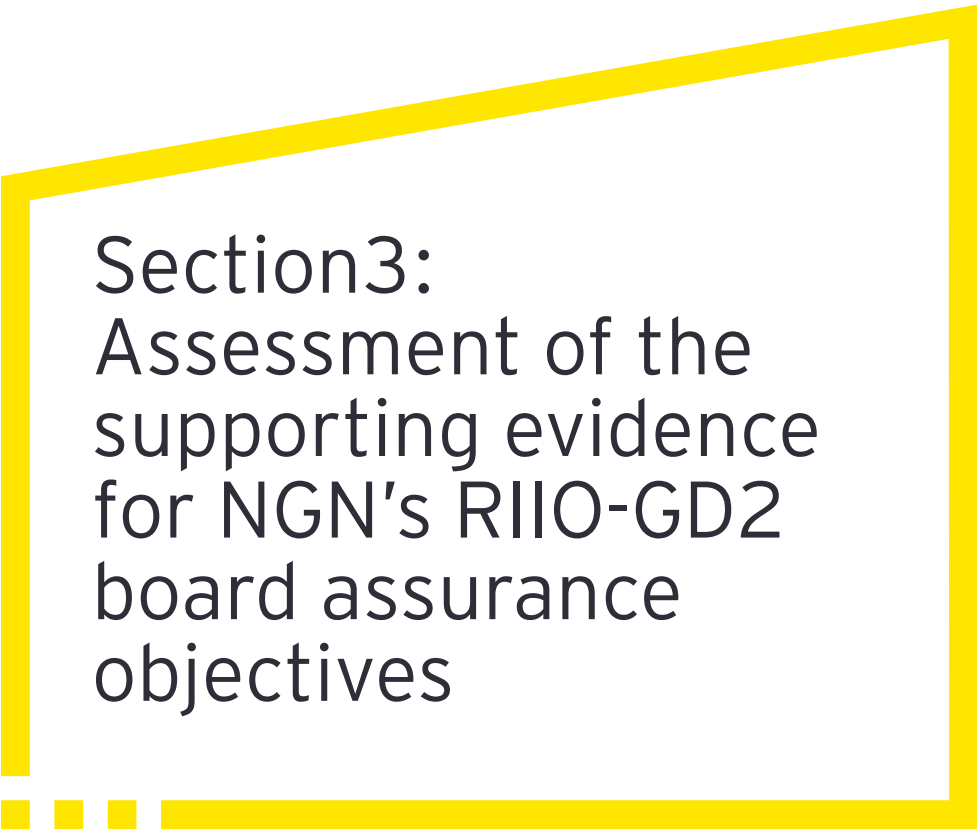
# Assessment of NGN's assurance activities

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## Assessment of evidence (cont.)

NGN informed us that, following the NGN's Board-Appointed RIIO2 Steering Group's meeting in September 2019, it was decided not to proceed with external assurance of the cost confidence plan. Instead, it was considered sufficient for NGN's RIIO-GD2 team to conduct internal self-assurance over these elements of the Business Plan. NGN told us that its RIIO-GD2 team was independent from the parts of the business which had developed the expenditure projections for its RIIO-GD2 Business Plan.

The evidence discussed above indicates that all of the assurance activities included in the presentation for the NGN's Board-Appointed RIIO2 Steering Group's meeting in September 2019 have been conducted, or are in the process of being conducted by either internal teams or external bodies.

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## Section3: Assessment of the supporting evidence for NGN's RIIO-GD2 board assurance objectives

# NGN's RIIO-GD2 board assurance objectives

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NGN's RIIO-GD2 board assurance objectives are set out in the table below.

## NGN's RIIO-GD2 board assurance objectives<sup>1</sup>

1.	The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan;
2.	The outcomes and output commitments made within the plan are deliverable;
3.	Outcomes, performance commitments and Output Delivery Incentives (ODIs) reflect customer needs and preferences and are ambitious;
4.	Is built on expenditure forecasts which have been produced using a robust and efficient process;
5.	Is financeable on both the notional and actual capital structure based on our [NGN's] proposed financial parameters.

The following slides summarise the findings from EY's assessment of the combination of all of the evidence against each board assurance objective. More information can be found in the Appendix.

Our conclusions are based on the evidence that we have viewed (as set out in the Appendix) as of 19<sup>th</sup> November 2019, and therefore is based on draft versions of documents (such as the NGN's RIIO-GD2 Business Plan) and scopes of work yet to be completed (such as the Internal Audit team's work on assurance and the RIIO-GD2 team's assurance of the cost confidence work).

### Note:

<sup>1</sup> NGN (November 2019), RIIO-GD2 NGN Board Statement & Assurance. The NGN's RIIO-GD2 board assurance objectives were originally set out in the RIIO-GD2 Governance & Assurance Framework & Objectives in December 2018

# Assurance objective 1

**Assurance objective: The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG [Customer Engagement Group] about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan**

The findings from our assessment are as follows:

**Overview of evidence** (see slides 35 to 43 in the Appendix for more detail on the evidence)

- ▶ There are six pieces of evidence which support this assurance objective, in addition to relevant sections of NGN's draft RIIO-2 Business Plan.

## **Assessment of the evidence**

- ▶ The evidence has been assessed by considering:
  - ▶ How has the business plan been informed by customer engagement?
  - ▶ How has the plan been informed by feedback from NGN's CEG about the quality of that customer engagement?
  - ▶ How has NGN incorporated this feedback into its Business Plan?
- ▶ Taken together the evidence indicates that:
  - ▶ NGN's RIIO-GD2 Business Plan has been informed by customer engagement
  - ▶ NGN has used an engagement programme to co-create its RIIO-GD2 Business Plan with customers and stakeholders.
  - ▶ NGN's stakeholder engagement approach is underpinned by NGN'S RIIO-GD1 stakeholder engagement strategy, which has been benchmarked and tested against the AA1000 Stakeholder Engagement Strategy<sup>1</sup>, and refreshed in consultation with the CEG for RIIO-GD2.
  - ▶ NGN adopted a range of different engagement mechanisms to engage with stakeholders, such as surveys, conversations with stakeholder groups, and willingness to pay research. NGN considered the target audience, the purpose and the method of engagement for each engagement mechanism. NGN gained a total of over 26,000 engagement inputs from customers and stakeholders through its engagement mechanism.
  - ▶ There is a related assurance programme. NGN used third party providers for stakeholder engagement and analysis (which was reported to NGN through tactical reports prepared by Impact, a consultancy), and reported back to stakeholders on its engagement.

### **Note:**

1 A framework for conducting stakeholder engagement



# Assurance objective 1

**Assurance objective: The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG [Customer Engagement Group] about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan**

- ▶ The plan been informed by feedback from NGN's CEG about the quality of that customer engagement
- ▶ NGN's approach stakeholder engagement assurance included NGN's establishment of the CEG as an independent group with a mandate to challenge whether NGN's Business Plan addresses the needs and preferences of consumers, and report its views on NGN's plan to Ofgem.
- ▶ During the development of NGN's RIIO-GD2 Business Plan, the CEG has provided challenge to NGN on its engagement approach and its draft plans, which NGN has responded to by adapting how they engage (for example accessing hard to reach customers) and amending its plan (for example increasing its hardship fund).
- ▶ The CEG's note to the Ofgem-appointed Challenge Group stated that "NGN have continued to engage positively and respond to the challenges we have set them".<sup>1</sup>
- ▶ The CEG established controls and processes to ensure effectiveness and independence, controls and processes to ensure effective scrutiny of the Business Plan, and processes to ensure effective scrutiny of stakeholder engagement.
- ▶ NGN has incorporated this feedback into its RIIO-GD2 Business Plan
- ▶ NGN's approach to customer engagement has allowed them to identify key insights from its stakeholders that have shaped its plan, specifically relating to:
  - ▶ providing an affordable and acceptable plan;
  - ▶ meeting the needs of customers and network users;
  - ▶ maintain a safe and resilient network;
  - ▶ delivering an environmentally sustainable network;
  - ▶ enabling whole systems solutions; and
  - ▶ driving efficiency through innovation and competition.
- ▶ Customer acceptability ranged from 85% to 91% for NGN's promises relating to reliability, customer service, social issues and vulnerable customers. Acceptability was below 100% as some customers wanted NGN to go further on promises, such as wanting the usual level of support provided by NGN to be maintained when a large-scale unplanned incident occurs.

Source:

<sup>1</sup> CEG (October 2019), CEG report to CCG 15 October 2019

# Assurance objective 1

**Assurance objective: The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG [Customer Engagement Group] about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan**

- ▶ NGN has incorporated this feedback into its RIIO-GD2 Business Plan (cont.)
- ▶ Insights from stakeholders have driven the development of NGN's RIIO-GD2 Business Plan. For example in relation to:
  - ▶ Increasing its commitment on Fuel Poor Connections from 1,000 to 2,000 connections per annum;
  - ▶ increasing its commitment to financially supporting customers and communities who are facing issues linked to poverty and/or find themselves in vulnerable situations;
  - ▶ Increasing its workload in metallic mains replacement to improve the safety, reliability and environmental performance of the network;
  - ▶ changing its vehicle replacement policy to directly address environmental issues (carbon and air quality) and significantly increase its commitment to deploy ultra-low emission vehicles; and
  - ▶ bills not being higher than absolutely necessary and NGN services should be affordable for all; NGN's plan will result in a reduced average annual domestic customer bill over RIIO-GD2.

- ▶ In conclusion, NGN has provided evidence that its Business Plan has been informed by customer engagement and by feedback from its CEG about the quality of that customer engagement and how this has been incorporated into its plan.

# Assurance objective 2

**Assurance objective: The outcomes and output commitments made within the plan are deliverable**

The findings from our assessment are as follows:

**Overview of evidence** (see slides 44 to 47 in the Appendix for more detail on the evidence)

- ▶ The evidence for deliverability of the plan is presented in NGN's draft RIIO-GD2 Business Plan, and NGN's analysis of its historical performance against its peers.

## **Assessment of the evidence**

- ▶ The evidence has been assessed by considering:
  - ▶ Has the term 'deliverable' been clearly defined? Is the definition justified?
  - ▶ How has NGN satisfied itself that the outcomes and output commitments made within the Business Plan are deliverable?
- ▶ Taken together the evidence indicates that:
  - ▶ Ofgem has defined 'deliverable' in the context of RIIO-2 Business Plans
  - ▶ Ofgem's updated RIIO-2 Business Plan Guidance published in September 2019 states that it will consider the deliverability of plans "in the context of past performance and the level of commitment provided for delivering the outcomes set out in the plan".<sup>1</sup>
  - ▶ NGN has determined that the outcomes and output commitments made within its RIIO-GD2 Business Plan are deliverable
  - ▶ NGN has presented evidence that historically it has performed well when compared to its peers, and does so consistently.
  - ▶ NGN is on course to meet or exceed all 51 RIIO-GD1 performance targets, covering safety, reliability, connections, customer services, social obligations and environmental targets.
  - ▶ NGN has made a number of improvements to its delivery model since the beginning of RIIO-GD1, such as implementing a new delivery model for its pipe replacement work and modernising its workforce with new terms and conditions. Some of these initiatives have meant that NGN has consistently been ranked as the most efficient GDN by Ofgem's comparative efficiency toolkit during RIIO-GD1, while the benefits of others are expected to be realised in the RIIO-GD2 period. These initiatives have also resulted in a reduction in average bills over the RIIO-GD1 period to date.

### **Notes:**

<sup>1</sup> Ofgem (September 2019) [https://www.ofgem.gov.uk/system/files/docs/2019/09/riio-2\\_business\\_plans\\_guidance\\_september\\_2019\\_-\\_published\\_redline\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/09/riio-2_business_plans_guidance_september_2019_-_published_redline_0.pdf)

# Assurance objective 2

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## **Assurance objective: The outcomes and output commitments made within the plan are deliverable**

- ▶ NGN has determined that the outcomes and output commitments made within its RIIO-GD2 Business Plan are deliverable (cont.)
- ▶ During RIIO-GD2, NGN is proposing to deliver 62 output commitments in order to deliver outcomes related to: meeting the needs of consumers and network users; gas where its needed; and helping those that need it most.
- ▶ It is NGN's view that its performance during RIIO-GD1 to date and the initiatives it has put in place mean that it is in a strong position to deliver bill reductions while continuing to improve levels of service, as stated in its RIIO-GD2 Business Plan.

- ▶ NGN has presented evidence of its relatively strong past performance (compared to its peers), and its commitment for delivering outcomes included in its Business Plan, in accordance with the elements included in Ofgem's definition of 'deliverable'.

# Assurance objective 3

**Assurance objective: Outcomes, performance commitments and ODIs reflect customer needs and preferences and are ambitious**

The findings from our assessment are as follows:

**Overview of evidence** (see slides 48 to 54 in the Appendix for more detail on the evidence)

- ▶ There are four pieces of evidence which support this assurance objective, in addition to the relevant sections of NGN's draft RIIO-2 Business Plan.

## **Assessment of the evidence**

- ▶ The evidence has been assessed by considering:
  - ▶ How has NGN determined customer needs and preferences?
  - ▶ Has NGN interpreted customer needs and preferences correctly?
  - ▶ Has the term 'ambitious' been clearly defined? Is the definition justified?
  - ▶ How has NGN satisfied itself that the outcomes, performance commitments and ODIs are ambitious?
- ▶ Taken together the evidence indicates that:
  - ▶ NGN has interpreted customer needs and preferences
  - ▶ NGN has used an engagement programme to co-create its RIIO-GD2 Business Plan with customers and stakeholders.
  - ▶ Insights from stakeholders have informed the development of NGN's RIIO-GD2 Business Plan. For example, in relation to bills not being higher than absolutely necessary and NGN services should be affordable for all, NGN's plan will result in a reduced average annual domestic customer bill over RIIO-GD2.
  - ▶ NGN has ensured that it has interpreted customer needs and preferences correctly
  - ▶ There is an assurance programme governing NGN's stakeholder engagement. NGN used third party providers for stakeholder engagement and analysis, and reported back to stakeholders on its engagement.
  - ▶ NGN presented on RIIO-GD2 outputs to the CEG a number of times during the course of the development of NGN's Business Plan. The CEG raised challenges and NGN accepted actions from the CEG relating to outputs.
  - ▶ For each output, NGN has referenced the specific insight that it received from customers to inform and evidence the requirement to deliver each output.

# Assurance objective 3

**Assurance objective: Outcomes, performance commitments and ODIs reflect customer needs and preferences and are ambitious**

- ▶ NGN has defined 'ambition' in relation to its board assurance objective
- ▶ NGN has informed us that the Board define 'ambition' as NGN being well placed to 'take a step further' on cost efficiency, outcomes and outputs and financial efficiency in RIIO-GD2 compared to RIIO-GD1.
- ▶ NGN has determined that the outcomes, performance commitments and ODIs are ambitious
- ▶ NGN has highlighted where it has proposed bespoke outcomes (a total of 14), which are not common across GDNs.
- ▶ For example NGN has proposed a bespoke output relating to a non-regulated customer satisfaction survey, i.e. in addition to the existing RIIO customer satisfaction survey based on Customer Insight 18 in the Customer Insight Appendix – customers recognise our strong customer service throughout RIIO-1 and want to ensure that existing levels of performance are at least maintained in RIIO-2, and on feedback from Customer and Reinstatement Pioneer Survey in 2019

- ▶ NGN has presented evidence that the outcomes, performance commitments and ODIs reflect feedback it has received from customers, and is consistent with its definition of ambitious.

# Assurance objective 4

**Assurance objective: Is built on expenditure forecasts which have been produced using a robust and efficient process**

The findings from our assessment are as follows:

**Overview of evidence** (see slides 55 to 59 in the Appendix for more detail on the evidence)

- ▶ There are four pieces of evidence which support this assurance objective, in addition to the relevant sections of NGN's draft RIIO-2 Business Plan.

## **Assessment of the evidence**

- ▶ The evidence has been assessed by considering:
  - ▶ How has NGN developed its expenditure forecasts?
  - ▶ Have the terms 'robust' and 'efficient' been clearly defined? Are the definitions justified?
  - ▶ How has the process to develop expenditure forecasts been determined to be robust and efficient?
- ▶ Taken together the evidence indicates that:
  - ▶ NGN has developed its expenditure forecasts in a considered manner
  - ▶ NGN's expenditure plans reflect the outcomes and outputs its stakeholders identified as key priorities to be delivered by NGN in RIIO-GD2.
  - ▶ Other drivers of NGN's expenditure forecasts for the RIIO-GD2 period include improving the resilience of the its network to address changes in the climate and environment, managing its ageing asset population, changes to the mains replacement programme to manage safety risks, and the completion of the gas holder removal programme to improved reliability and reduce costs.
  - ▶ NGN has developed a definition of 'a robust and efficient process' in its board assurance objective
  - ▶ NGN has told us that it defines a robust and efficient process as one that starts with an assessment of its cost efficiency compared its peers, and then challenges itself to not only maintain at least this level in RIIO-GD2, but also identify whether there are further cost efficiencies that could be delivered in RIIO-GD2 that are prudent and appropriate.

# Assurance objective 4

**Assurance objective: Is built on expenditure forecasts which have been produced using a robust and efficient process**

- ▶ NGN has determined that its expenditure forecasts have been developed using a robust and efficient process
- ▶ A combination of approaches have been used to develop robust and efficient forecasts:
  - ▶ NGN's use of its established regulatory reporting policy;
  - ▶ KPMG was commissioned to conduct an independent review to assess the adequacy of the design of the NGN's Data Assurance Guidance (DAG) processes used for all regulatory reporting (not specifically related to the development of NGN's RIIO-GD2 Business Plan), including an assessment as to whether these processes are being adhered to in practice;
  - ▶ NGN is using internal assurance to review processes and controls implemented by business departments and the RIIO-GD2 team for the compilation, review, checking and sign off of expenditure forecasts, and justification for any expenditure forecasts which differ significantly from historical trends, in NGN's RIIO-GD2 Business Plan;
  - ▶ NGN has considered its projected expenditure and carried out cost-benefit analysis of its proposed interventions; and
  - ▶ NGN's proposed efficiency challenge for the RIIO-GD2 period has been informed by the report on frontier productivity growth by First Economics, a consultancy (see evidence aligned to assurance objective 3 in the Appendix for more information).

- ▶ NGN has provided evidence that its approach to developing its expenditure forecasts is consistent with its definition of a robust and efficient process.



# Assurance objective 5

**Assurance objective: Is financeable on both the notional and actual capital structure based on our [NGN's] proposed financial parameters**

The findings from our assessment are as follows:

**Overview of evidence** (see slides 60 to 65 in the Appendix for more detail on the evidence)

- ▶ There are four pieces of evidence which support this assurance objective, in addition to the relevant sections of NGN's draft RIIO-2 Business Plan. The four pieces of evidence have been produced by independent third parties, and cover financeability issues, assurance of NGN's financial model and target credit ratings.

## **Assessment of the evidence**

- ▶ The evidence has been assessed by considering:
  - ▶ Has the term 'financeable' been clearly defined? Is the definition justified?
  - ▶ How has NGN satisfied itself that the Business Plan meets the definition of 'financeable'?
- ▶ Considered together, the evidence indicates that:
  - ▶ NGN has developed a definition of 'financeable'
  - ▶ NGN has a clear and reasonable definition of financeable. NGN defines financeable as maintaining its existing investment-grade credit ratings of BBB+ (S&P) and Baa1 (Moody's), as stated in its Business Plan v3. This definition is supported by the Frontier Economics report on the appropriate credit rating target for NGN for RIIO-GD2.
  - ▶ NGN has demonstrated that it is financeable based upon NGN's proposed financial parameters
  - ▶ Based on this definition of financeable, NGN demonstrated that its RIIO-GD2 Business Plan is expected to be financeable on a notional and actual capital structure using its proposed financial parameters, by presenting projected financial ratios used by the credit rating agencies, which are above the threshold S&P and Moody's set for BBB+ and Baa1 ratings, respectively.
  - ▶ The results of NGN's financeability assessment is supported by Oxera's and KPMG's assurance of the NGN financial model<sup>1</sup> (which has been used as part of NGN's financeability assessment), and the conclusions of KPMG's financeability assessment.
  - ▶ We understand from NGN that the Ofgem RIIO-2 licence model (LiMo) was not finalised until 31 October 2019, and therefore NGN has not sought to assure this model. Ofgem has commissioned an independent audit of the LiMo, but the results are not currently available. NGN has used the results from its own financial model to sense-check the outputs from the LiMo and to help with the identification of errors and inconsistencies contained in its draft versions.

### **Source:**

<sup>1</sup> Oxera's and KPMG's assurance was carried out on different versions of NGN's model; Oxera completed its review in March 2019, and KPMG completed its review of the model in July 2019. KPMG's financeability assessment was completed in November 2019

# Assurance objective 5

**Assurance objective: Is financeable on both the notional and actual capital structure based on our [NGN's] proposed financial parameters**

- ▶ NGN has demonstrated that it is financeable based upon NGN's proposed financial parameters (cont.)
- ▶ NGN developed its own financial parameters, but their development has been informed by work by Oxera on the potential negative impact of stopping or decreasing dividends, and by Frontier Economics which considered issues such the lack of supporting evidence for the inclusion of Ofgem's proposed outperformance wedge in analysis of the cost of equity.
- ▶ In addition, NGN engaged with stakeholders on financeability issues, and in some instances NGN included stakeholders' proposals within its financial package, as described in the Business Plan.

- ▶ In conclusion, NGN has provided evidence that the projected performance of the business over the RIIO-GD2 period on both a notional and actual capital structure basis is financeable, based upon NGN's proposed financial parameters and using the financeability tests that NGN considers appropriate.

# Appendix: Evidence reviewed

# Appendix: Evidence reviewed for assurance objective 1

# Assurance objective 1

**Assurance objective: The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
RIIO-GD2 Business Plan Draft version 3  (4 <sup>th</sup> November 2019)	Part 3 of the Business Plan is titled 'Giving Customers a Stronger Voice' and covers: <ul style="list-style-type: none"> <li>• How NGN has co-created its plan with customers and stakeholders, and what it will deliver;</li> <li>• How NGN has worked with the Customer Engagement Group (CEG) and responded to challenge;</li> <li>• The view of NGN's stakeholders, and how they have shaped its plan; and</li> <li>• NGN's approach to stakeholder engagement for the RIIO-GD2 period and how it will ensure its plan is inclusive, insightful and evolving</li> </ul>	<p>NGN have used an extensive, inclusive, high quality engagement programme to put customers and stakeholders to co-create its RIIO-2 business plan.</p> <p>During the development of NGN's RIIO-GD2 Business Plan, the CEG has provided challenge to NGN on its engagement approach and its draft plans, which NGN has responded to by adapting how they engage (for example accessing hard to reach customers) and amending its plan (for example increasing its hardship fund).</p> <p>NGN's approach to customer engagement has allowed them to identify key insights from its stakeholders that have shaped its plan, specifically relating to providing an affordable and acceptable plan, meeting the needs of customers and network users, maintain a safe and resilient network, delivering an environmentally sustainable network, enabling whole systems solutions, and driving efficiency through innovation and competition. Customer acceptability ranged from 85% to 91% for of NGN's promises relating to reliability, customer service, social issues and vulnerable customers. Acceptability wasn't 100% as some customers wanted NGN to go further on promises, such as wanting the usual level of support provided by NGN to be maintained when a large-scale unplanned incident occurs.</p>

# Assurance objective 1

**Assurance objective: The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
Stakeholder Engagement Assurance  assurance presentation	<p>The document provides:</p> <ul style="list-style-type: none"> <li>• an overview of roles, responsibilities of, and relationships between NGN, the Customer Engagement Group (CEG) for NGN, Ofgem, the Challenge Group, and NGN stakeholders;</li> <li>• an overview of roles, responsibilities of, and relationships between NGN's Head of Stakeholder Relations, NGN's business leads, research by Impact (a consultancy) and third party service providers;</li> <li>• information on role of the CEG and how it should operate;</li> <li>• information on delivering the engagement programme, specifically covering the process to ensure effective planning and the controls in place to avoid 'capture' of stakeholders; and</li> <li>• information on how independent analysis and reporting of all results from the stakeholder engagement, and the review and sign-off procedure</li> </ul>	<p>NGN had a clear view of its responsibilities with regards to stakeholder engagement:</p> <ul style="list-style-type: none"> <li>• NGN was responsible for managing and implementing the stakeholder engagement programme, providing Secretariat support to the CEG and refining the Business Plan in response to stakeholder input;</li> <li>• NGN was to share its stakeholder engagement strategy and reporting with Ofgem, alongside its Business Plan;</li> <li>• NGN's Head of Stakeholder Relations was responsible for NGN assurance of the results from stakeholder engagement and dissemination to the business; and</li> <li>• NGN's business leads were responsible for designing engagement that test its key proposals and refining its proposals in response to results</li> </ul> <p>NGN established the CEG as an independent group with a mandate to challenge whether NGN's Business Plan addresses the needs and preferences of consumers, and report its views on NGN's plan to Ofgem.</p> <p>The CEG put in place controls and processes to ensure effectiveness and independence, controls and processes to ensure effective scrutiny of the Business Plan, and processes to ensure effective scrutiny of stakeholder engagement.</p> <p>NGN used third party providers for stakeholder engagement and its analysis, reported back to stakeholders on its engagement, and had CEG members check engagement reporting in order to avoid 'capture' of stakeholders</p>

# Assurance objective 1

**Assurance objective: The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
Appendix to NGN Business Plan v3 Stakeholder Engagement Strategy & Approach	<p>The appendix to the NGN Business Plan sets out the methodology used by NGN to build and deliver an extensive, inclusive and high-quality engagement programme.</p> <p>The appendix covers:</p> <ul style="list-style-type: none"> <li>• NGN's stakeholder engagement strategy</li> <li>• NGN's approach to ensure engagement is meaningful;</li> <li>• NGN's approach to ensure engagement is inclusive;</li> <li>• NGN's integrated and iterative approach to engagement;</li> <li>• Detailed methodology for each engagement mechanism;</li> <li>• The overall summary of input gained; and</li> <li>• How the main messages from the stakeholder engagement have been applied to the Business Plan</li> </ul>	<p>NGN's stakeholder engagement approach is underpinned by NGN'S RIIO-GD1 stakeholder engagement strategy, which has been benchmarked and tested against the AA1000 Stakeholder Engagement Strategy, and refreshed in consultation with the CEG for RIIO-GD2.</p> <p>The objective of NGN's engagement strategy is that business planning and change is driven by insight into customer and stakeholders' values, preferences and ideas.</p> <p>NGN adopted a range of different engagement mechanisms to engage with stakeholders, such as surveys, conversations with stakeholder groups, willingness to pay research. NGN considered the target audience, the purpose and the method of engagement of each engagement mechanism.</p> <p>NGN gained a total of over 26,000 engagement inputs from customers and stakeholders through its engagement mechanism.</p>

# Assurance objective 1

**Assurance objective: The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
Appendix to NGN Business Plan v3 Stakeholder Insights	<p>The appendix to the NGN Business Plan summarises what NGN's stakeholders communicated was important to them and how that has shaped NGN's plan.</p> <p>The appendix covers stakeholder insights on the following topics:</p> <ul style="list-style-type: none"> <li>• affordability and overall business plan acceptability;</li> <li>• giving consumers a stronger voice;</li> <li>• meeting the needs of customers and network users</li> <li>• maintaining a safe and resilient network;</li> <li>• delivering an environmentally sustainable network;</li> <li>• enabling whole systems energy solutions</li> <li>• driving efficiency through innovation and competition</li> </ul>	<p>NGN captured 63 stakeholder insights including:</p> <ul style="list-style-type: none"> <li>• Bills should be not higher than absolutely necessary and NGN services should be affordable for all;</li> <li>• NGN's focus should be on minimising disruption to customers' normal daily activities by reducing the average duration of supply interruptions;</li> <li>• Customers showed, in principle, support for an accelerated programme of pipe replacement, in order to achieve improved safety and reliability, and reduced environmental impacts;</li> <li>• Stakeholders consider that it is imperative that NGN act against climate change by reducing both shrinkage and non-shrinkage emissions to reduce carbon emissions</li> <li>• NGN customers and stakeholders consider that gas of some type should remain part of the UK energy mix; and</li> <li>• Stakeholders are concerned about the impact of changes to Network Innovation Allowance funding and want to see continued commitment to investment in innovation</li> </ul> <p>NGN have understood what customers have told them, including nuances in views between different groups and ultimately. Insights from stakeholder have driven the development of NGN's RIIO-GD2 Business Plan. For example in relation to bills not being higher than absolutely necessary and NGN services should be affordable for all, NGN's plan will result in a reduced average annual domestic customer bill over RIIO-GD2.</p>



# Assurance objective 1

**Assurance objective: The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
An example of, Stakeholder Engagement Tactical programme evaluation Impact (June 2019)	<p>Stakeholder Engagement Tactical programme evaluation report by Impact, a consultancy, critically evaluates the delivery, outputs and emerging outcomes of the NGN stakeholder engagement programme.</p> <p>The report covers:</p> <ul style="list-style-type: none"> <li>• emerging stakeholder insights;</li> <li>• the engagement delivered during June 2019;</li> <li>• modifications to the planned approach;</li> <li>• the stakeholders that have been engaged;</li> <li>• seldom heard stakeholders that have been engaged;</li> <li>• stakeholder feedback;</li> <li>• lessons learned for future engagement;</li> <li>• triangulation of relevant secondary data sources; and</li> <li>• programme risk management</li> </ul>	In accordance with NGN's plans for assurance of stakeholder engagement as part of the development process for its RIIO-GD2 Business Plan, NGN has used an independent third party provider (Impact) for its stakeholder engagement and analysis.

# Assurance objective 1

**Assurance objective: The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
An example of, Sign off to confirm data review and accuracy (of work by Impact) (October 2019)	Impact's declaration confirming that the data in the Business Plan Appendix - Stakeholder Insights has been checked back and is accurate, and that the procedures, assumptions and interpretations used have been documented. The Head of Stakeholder Relations' declaration that the process followed to compile and check the Business Plan Appendix - Stakeholder Insights is compliant with the control requirements outlined in the NGN Regulatory Reporting Policy and all mandatory data assurance activities have been performed	In accordance with NGN's plans for assurance of stakeholder engagement as part of the development process for its RIIO-GD2 Business Plan, NGN's Head of Stakeholder Relations is assuring the results from stakeholder engagement.

# Assurance objective 1

**Assurance objective: The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
CEG note to CCG (October 2019)	<p>The CEG note to CCG covers:</p> <ul style="list-style-type: none"> <li>• key points on the progress of the CEG's work;</li> <li>• suggested RAG ratings for the completeness of each section of NGN's Business Plan;</li> <li>• what the CEG considers to be the key remaining challenges in NGN's Business Plan; and</li> <li>• what the CEG expect to see before the v3 Business Plan is signed-off</li> </ul>	<p>NGN has continuously engaged positively with the CEG and responded to challenges.</p> <p>In accordance with NGN's plans for assurance of stakeholder engagement as part of the development process for its RIIO-GD2 Business Plan, the CEG has challenged whether NGN's Business Plan addresses the needs and preferences of consumers, and will report its views on NGN's plan to the Ofgem appointed CCG.</p>
Feedback on your 1 October draft Business Plan for RIIO-2 CCG (October 2019)	<p>Feedback letter from the Chair of the RIIO-2 Challenge Group to the CEO on NGN's October draft Business Plan for RIIO-GD2.</p> <p>The letter includes an annex in which the CCG sets out its evaluation of 12 areas of the draft Business Plan using criteria relating to ambition, stakeholder input, cost-effectiveness, and deliverability, and highlights what it considered to be remaining key issues.</p>	<p>NGN's October draft Business Plan was an improvement from its July draft.</p> <p>NGN's presentation and discussion of its track record, and stakeholder engagement in its October draft Business Plan received a green rating from the CCG.</p>

# Assurance objective 1

**Assurance objective: The business plan has been informed by customer engagement and by feedback from our [NGN's] CEG about the quality of that customer engagement and how this has been incorporated into our [NGN's] plan**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
You said, we did...	NGN's report to the CCG on how it responded to each of the challenges on the first version of its Business Plan from the CCG, in the second version of its Business Plan	NGN has considered each of the CCG's challenges and directly responded to each and highlighted where they has made resulting changes in the second version of the Business Plan

# Appendix: Evidence reviewed for assurance objective 2

# Assurance objective 2

**Assurance objective: The outcomes and output commitments made within the plan are deliverable**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
RIIO-GD2 Business Plan Draft version 3	NGN has set out the outcomes and output commitments that it proposes to deliver in RIIO-GD2	<p>NGN proposes to deliver the following outcomes and associated groups of output commitments in RIIO-GD2:</p> <p><u>Meeting the needs of consumers and network users</u></p> <ul style="list-style-type: none"> <li>• Outcome: A truly great customer experience for everyone - 6 outputs split across: <ul style="list-style-type: none"> <li>• A new, non-regulated customer survey</li> <li>• Implementing an enhanced complaints metric</li> <li>• Improving the way NGN work with market service customers</li> <li>• An enhanced connections service</li> <li>• Efficient and effective response for emergencies and repair</li> <li>• Minimising customer inconvenience when gas is interrupted</li> </ul> </li> <li>• Outcome: Has where you need it - 29 outputs</li> <li>• Outcome: Help for those that need it most - 11 outputs split across: <ul style="list-style-type: none"> <li>• Facilitating fuel poor connections</li> <li>• Improving vulnerable customer support</li> <li>• NGN's delivery plan to make best use of the 'use it or lose' it allowance</li> </ul> </li> </ul> <p><u>Maintaining a safe and resilient network</u></p> <ul style="list-style-type: none"> <li>• Outcome: Safe and sound service - 7 outputs split across: <ul style="list-style-type: none"> <li>• Network Asset Risk Metric</li> <li>• Delivering our statutory pipe replacement commitments</li> <li>• Booking NTS offtake capacity efficiently</li> <li>• Removal of remaining Gas Holders on our network</li> <li>• Improving Cyber Resilience and IT Business Security</li> <li>• Workforce Resilience</li> <li>• Maintaining effective records of our Multi Occupancy Buildings</li> </ul> </li> </ul>

# Assurance objective 2

**Assurance objective: The outcomes and output commitments made within the plan are deliverable**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
RIIO-GD2 Business Plan Draft version 3  (cont. from previous slide)		<u>Delivering an environmentally sustainable network</u> <ul style="list-style-type: none"><li>• Outcome: Protecting the environment - 4 outputs split across:<ul style="list-style-type: none"><li>• A new Environmental Action Plan for RIIO-2</li><li>• Improving Air Quality</li><li>• Using Resources Responsibly</li><li>• Enhancing life on land</li></ul></li><li>• Outcome: Supporting a move to a zero-carbon future - 5 outputs split across:<ul style="list-style-type: none"><li>• Reducing Our Gas Shrinkage</li><li>• Reducing Our Business Carbon Emissions</li><li>• Enabling Green Gas</li></ul></li></ul> <p>NGN presented its proposed level of commitment ('NGN' target) for each output commitment in its plan, and some of these are proposed ODIs</p>

# Assurance objective 2

**Assurance objective: The outcomes and output commitments made within the plan are deliverable**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
GDN Performance comparison 2018 (September 2018)	NGN prepared analysis on the performance of the eight GDNs. The analysis provides a comparison of gas delivery networks in terms of its key output metrics (safety, reliability, customer service, environmental, social and connections), cost drivers, incentive performance and cost comparison by category, i.e. Totex, Opex, Capex and Repex. Further, it provides NGN's spend and efficiency rankings in the following areas: work management, emergency, repairs, maintenance, connections and mains reinforcement.	<p>NGN performs well when compared to its peers, and does so consistently. Results of the analysis presented includes:</p> <ul style="list-style-type: none"> <li>• In 2017/18, NGN outperformed its totex allowance by 12% (5% below the GDN average), and ranked first in shrinkage, leakage and network innovation, second in stakeholder and third in customer in relation to incentive performance;</li> <li>• NGN's efficiency rankings over the 2008/09 - 2017/18 period, on a cumulative basis, as follows: <ul style="list-style-type: none"> <li>• the top performing GDN in totex</li> <li>• fourth in opex</li> <li>• third in capex</li> <li>• the top performing GDN in repex</li> <li>• the top performing GDN in work management</li> <li>• third in emergency efficiency</li> <li>• fifth in repairs</li> <li>• the top performing GDN in maintenance</li> <li>• second in connections</li> <li>• fourth in mains reinforcement</li> </ul> </li> </ul>



# Appendix: Evidence reviewed for assurance objective 3

# Assurance objective 3

**Assurance objective: Outcomes, performance commitments and ODIs reflect customer needs and preferences and are ambitious**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
RIIO-GD2 Business Plan Draft version 3	NGN has set out the outcomes and output commitments that it proposes to deliver in RIIO-GD2	See slides 45 to 46
Frontier Productivity Growth, A report prepared for the Energy Networks Association First Economics (February 2019)	<p>First Economics considers the rate of frontier productivity growth that GDNs should be factoring into its cost projections for the RIIO-GD2, based on historical rates of productivity growth in industries with similar characteristics to GDNs, Bank of England's (BoE) estimates of the annual total factor productivity (TFP) growth, and Ofgem's views on the same and the electricity distribution networks' average annual TFP growth over the past periods of price control.</p> <p>On that basis, they carry out an analysis looking into the reasonably attainable levels of TFP improvements by the energy networks that should be considered for the RIIO -2.</p>	First Economics point out that estimating productivity growth for RIIO-GD2 is challenging due to the post-2008 fall in productivity growth in the UK. Given the uncertainty, First Economics suggest that GDNs could include RIIO-GD1 annual productivity growth rates (although these costs reduction targets may be challenging), or reducing the annual productivity growth rates in the plans based on the BoE's and Office of Budget Responsibility judgement that productivity rates in the short-to-medium term will be lower than pre-2008, and state that halving potential productivity growth would not be unreasonable.

# Assurance objective 3

**Assurance objective: Outcomes, performance commitments and ODIs reflect customer needs and preferences and are ambitious**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
Outputs Appendix NGN RIIO-GD2 Business Plan v3	<p>The Outputs appendix sets out:</p> <ul style="list-style-type: none"> <li>• how NGN designed its RIIO-2 outputs, covering defining outputs, setting stretching targets, proposals for targets and outcomes and incorporate feedback from the CEG; and</li> <li>• NGN's RIIO-2 commitments meeting the needs of customers and network users, maintaining a safe and resilient network, and delivering an environmentally sustainable network.</li> </ul>	<p>The outputs that NGN plan to deliver over the RIIO-GD2 period are aimed at:</p> <ul style="list-style-type: none"> <li>• meeting the needs of consumers and network users;</li> <li>• maintaining a safe and resilient network; and</li> <li>• delivering an environmentally sustainable network</li> </ul> <p>NGN developed and implemented a meaningful, iterative and inclusive process to develop its outputs, involving:</p> <ul style="list-style-type: none"> <li>• a review of its historic performance combined with aspirations for RIIO-GD2;</li> <li>• business workshops comparing historic performance and targets;</li> <li>• establishing notional outputs and targets;</li> <li>• testing outputs with its stakeholders and CEG; and</li> <li>• Iterative business workshops to review and refine outputs and targets and acceptability testing with its stakeholders and CEG before the outputs and targets are finalised</li> </ul> <p>The CEG, in particular the Engagement Deep Dive Group, has provided rigor and challenge to NGN's engagement with stakeholders and customers. The CEG's feedback directly impacted NGN's engagement programme relating to the development of outputs, for example stakeholders becoming more involved in decision making on NGN's innovation programme.</p>

# Assurance objective 3

**Assurance objective: Outcomes, performance commitments and ODIs reflect customer needs and preferences and are ambitious**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
Outputs, Innovation and Incentives workshop (January 2018)	<p>The purpose of the workshop was to:</p> <ul style="list-style-type: none"><li>• Create awareness of what GD2 Business Planning is about;</li><li>• Understand the challenges the GD2 Business Plan needs to address</li><li>• Think about new Customer Outcomes for GD2; and</li><li>• Create a wider NGN team.</li></ul> <p>The session covered:</p> <ul style="list-style-type: none"><li>• Factors impact the Business Plan, including challenges from Ofgem such as delivering the right outputs</li><li>• Customers in GD2 focusing on feedback and research</li></ul>	From early in the development of its RIIO-GD2 Business Plan, NGN considered the outputs in conjunction with customer outcomes

# Assurance objective 3

**Assurance objective: Outcomes, performance commitments and ODIs reflect customer needs and preferences and are ambitious**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
Outputs Challenge Meeting presentations	A set of output challenge meetings  GD2 1st Challenge Meeting (June 2018) An internal NGN meeting discussing: <ul style="list-style-type: none"><li>• safety and reliability outputs;</li><li>• Environmental outputs and social obligations;</li><li>• customer service; and</li><li>• connections outputs</li></ul>	NGN considered the outputs it would target in RIIO-GD2, taking into account what they want to achieve, the delivery plan, business impact, current status, and anticipated benefits to customers for each area.

# Assurance objective 3

**Assurance objective: Outcomes, performance commitments and ODIs reflect customer needs and preferences and are ambitious**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
Outputs Challenge Meeting presentations  (cont.)	<p>A set of output challenge meetings</p> <p>GD2 Outputs Challenge Meeting (October 2010)</p> <p>An internal NGN meeting covering:</p> <ul style="list-style-type: none"> <li>• Roadworks performance;</li> <li>• Safety and efficiency improvements;</li> <li>• Market service standards;</li> <li>• PE pipe waste reduction</li> <li>• Mains replacement</li> <li>• Supply restoration</li> <li>• Reducing the environmental impact of gas pre-heating</li> <li>• Reinstatement performance</li> <li>• Customer surveys, complaints and enquiries handling, and major incident performance</li> <li>• Connections</li> <li>• Attending gas escapes</li> <li>• Technical facilitation of distributed network entry and large load exit demand</li> <li>• E&amp;R call handling</li> <li>• BCF, use of virgin aggregate, air quality improvement</li> <li>• Supply restoration - unplanned work</li> <li>• Safety in multi-occupancy buildings</li> <li>• 12-hour repair target</li> <li>• Affordability, additional services delivered by colleagues, education, sharing best practice</li> </ul>	<p>NGN considered the outputs it would target in RIIO-GD2, taking into account what they want to achieve, the delivery plan, business impact, current status, and anticipated benefits to customers for each area.</p>

# Assurance objective 3

**Assurance objective: Outcomes, performance commitments and ODIs reflect customer needs and preferences and are ambitious**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
CEG meeting minutes	<p>A set minutes from CEG meetings</p> <p>CEG Meeting (October 2018) Attendees discussion included:</p> <ul style="list-style-type: none"> <li>• Introduction to the output framework;</li> <li>• Safety outputs; and</li> <li>• Customer service outputs</li> </ul> <p>CEG Meeting (November 2018) Attendees discussion included:</p> <ul style="list-style-type: none"> <li>• Feedback from Ofgem CCG meeting; and</li> <li>• Outcome &amp; Output commitments relating to reliability, social outputs, connections and environment</li> </ul> <p>CEG Meeting (April 2019) Attendees discussion included:</p> <ul style="list-style-type: none"> <li>• Stakeholder engagement;</li> <li>• GSOP research;</li> <li>• Business Plan outputs;</li> <li>• Meeting the needs of consumers and network users; and</li> <li>• Maintaining a safe and resilient network</li> </ul> <p>In each meeting minutes, actions and the challenge log from previous meetings were reviewed, and new actions and challenges were raised.</p>	<p>NGN presented on RIIO-GD2 outputs to the CEG a number of times during the course of the development of NGN's Business Plan. The CEG raised challenges and NGN accepted actions from the CEG relating to outputs.</p>

# Appendix: Evidence reviewed for assurance objective 4



# Assurance objective 4

**Assurance objective: Is built on expenditure forecasts which have been produced using a robust and efficient process**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
RIIO-GD2 Business Plan Draft version 3	Part 6 of the Business Plan is titled 'Delivering Value for Money' and covers: <ul style="list-style-type: none"> <li>• key assumptions;</li> <li>• totex;</li> <li>• opex;</li> <li>• investment expenditure;</li> <li>• capex; and</li> <li>• repex</li> </ul>	<p>NGN's expenditure plans reflect the outcomes and outputs its stakeholders identified as key priorities to be delivered by NGN in RIIO-GD2.</p> <p>Other drivers of NGN's expenditure forecasts for the RIIO-GD2 period include improving the resilience of its network to address changes in the climate and environment, managing its ageing asset population, changes to the mains replacement programme to manage safety risks, and the completion of the gas holder removal programme to improve reliability and reduce costs.</p>
Customer Value Proposition (CVP) 10 V3 - Gas to appliances	The Excel file presents the projected benefits from improved performance in restoring interrupted gas supply to appliances for the RIIO-GD2 period.	NGN have considered its projected expenditure and carried out cost-benefit analysis of its proposed investments and initiatives that are expected to deliver value to customers.

# Assurance objective 4

**Assurance objective: Is built on expenditure forecasts which have been produced using a robust and efficient process**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
Regulatory Reporting Policy (February 2019)	<p>The document sets out the policy and minimum standards for the compilation and submission of all Regulatory Reporting issued by NGN</p> <p>The document covers:</p> <ul style="list-style-type: none"><li>• regulatory submissions;</li><li>• roles and responsibilities;</li><li>• procedures for compiling regulatory reports;</li><li>• data validation and checking procedures;</li><li>• retention of data;</li><li>• sign off; and</li><li>• audit</li></ul>	NGN has established a regulatory reporting policy for all of its regulatory reporting processes (not specifically related to the development of NGN's RIIO-GD2 Business Plan) in order to manage the risks relating to the submission of complete and accurate regulatory reports.

# Assurance objective 4

**Assurance objective: Is built on expenditure forecasts which have been produced using a robust and efficient process**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
Project scope for Internal Audit's review relating to NGN's RIIO-GD2 Business Plan	<p>The scope document sets out the key aspects of the review NGN's Internal Audit will conduct relating to NGN's RIIO-GD2 final Business Plan.</p> <p>The review will cover:</p> <ul style="list-style-type: none"><li>• the processes and controls implemented for the compilation, review, checking and sign off of data, and content;</li><li>• evidence to confirm that input from stakeholder engagement has been incorporated into the Business Plan.</li><li>• the framework used for the cost confidence assessment; and</li><li>• justification for any forecast costs and outputs which differ significantly from historical trends.</li></ul>	NGN is using internal assurance to review processes and controls implemented by business departments and the RIIO-GD2 team for the compilation, review, checking and sign off of expenditure forecasts, and justification for any expenditure forecasts which differ significantly from historical trends, in NGN's RIIO-GD2 Business Plan.

# Assurance objective 4

**Assurance objective: Is built on expenditure forecasts which have been produced using a robust and efficient process**

The table below presents the scope and conclusions of the evidence aligned to the assurance objective

Evidence	Scope	Key conclusions from the evidence point
Final Report Data Assurance Guidance Process KPMG (November 2018)	<p>KPMG conducted an audit to assess the adequacy of the design of NGN's Data Assurance Guidance (DAG) processes used for all regulatory reporting (not specifically related to the development of NGN's RIIO-GD2 Business Plan), including an assessment as to whether these processes are being adhered to in practice.</p> <p>The audit focused on:</p> <ul style="list-style-type: none"><li>• the extent to which processes and controls are documented;</li><li>• the completion of risk assessments for all submissions in scope per the DAG;</li><li>• compliance of the risk assessment methodology applied with the DAG;</li><li>• whether the assurance activities determined by management are proportionate to the risk assessment;</li><li>• the extent to which controls are evidenced; and</li><li>• the appropriateness of checks and controls exists over the manual compilation processes.</li></ul>	<p>KPMG did not identify any instances of non-compliance based on the procedures it performed, but did make four minor observations to further enhance the efficiency and effectiveness of NGN's data assurance arrangements.</p>

# Appendix: Evidence reviewed for assurance objective 5

# Assurance objective 5

**Assurance objective: Is financeable on both the notional and actual capital structure based on our [NGN's] proposed financial parameters**

Evidence	Scope	Key conclusions from the evidence point
RIIO-GD2 Business Plan Draft version 3	<p>Part 7 of the Business Plan is titled 'Financing Our [NGN's] Plan' and covers:</p> <ul style="list-style-type: none"> <li>• assumptions;</li> <li>• assessment of Ofgem's 'Base case' (as per Ofgem's working assumption in the Sector Specific Methodology Decision);</li> <li>• options to address financeability;</li> <li>• NGN's proposal on revenues and financeability for RIIO-2; and</li> <li>• customer bills</li> </ul>	<p>NGN's proposed financial parameters are:</p> <ul style="list-style-type: none"> <li>• Indexation - a single-step, full transition from RPI to CPIH as the key measure of inflation with an inflation wedge of 1.05%;</li> <li>• Cost of Capital - a weighted average cost of capital of 3.44% (real, CPIH-deflated) over the period;</li> <li>• Cost of Equity - set at 5.00% (real, CPIH-deflated);</li> <li>• Cost of Debt - cost of debt indexation with a recalibration of the iBoxx index to be based upon a 14-18-year trombone, 2.40% (real, CPIH-deflated);</li> <li>• Notional Gearing - 60% in line with Ofgem's assessment (this assumption requires a notional equity injection of £118m, and NGN's plan assumes a further role for Equity);</li> <li>• Dividend Policy - a Dividend Payout ratio for Equity of 3.5%; and</li> <li>• Notional Company - The business plan is based upon the financing of the efficient notional company, and the fact that this structure is financeable in the short and longer term.</li> </ul> <p>During the development of the RIIO-GD2 Business Plan, NGN engaged with stakeholders on the subject of network Returns. NGN responded to technical challenges received from informed stakeholders on issues around financial proposals and financeability including Ofgem, the RIIO2 Challenge Group, Citizen's Advice and the wider investment community. There were a number of areas where NGN included stakeholders' proposals within its financial package.</p>

# Assurance objective 5

**Assurance objective: Is financeable on both the notional and actual capital structure based on our [NGN's] proposed financial parameters**

Evidence	Scope	Key conclusions from the evidence point
RIIO-GD2 Business Plan Draft version 3  (cont.)		NGN's financial objective is to retain its existing investment-grade credit ratings of BBB+ (S&P) and Baa1 (Moody's). NGN's plan meets the requirements for these ratings (demonstrated through the use comparison of financial ratios to thresholds set by S&P and Moody's), and therefore is considered financeable under both its actual capital structure and the notional capital structure prescribed by Ofgem under the RIIO-GD2 framework.

# Assurance objective 5

**Assurance objective: Is financeable on both the notional and actual capital structure based on our [NGN's] proposed financial parameters**

Evidence	Scope	Key conclusions from the evidence point
Review of NGN's financial analysis for RIIO-GD2 Oxera (March 2019)	<p>The report provides advice to NGN on financial projections for RIIO-GD2, specifically:</p> <ul style="list-style-type: none"> <li>a peer-review of NGN's financial model for the notional company for RIIO-GD2 to providing an independent assessment on whether NGN's conclusions are reasonable.</li> <li>Review of the potential impact from delaying or stopping dividends during RIIO-GD2. They have reviewed theory and empirical evidence on the costs of delaying investor cash flows and whether investors have preferences for dividend distributions.</li> </ul> <p>Oxera also reviewed NGN's financeability concerns with regards to Ofgem's RIIO-GD2 package (current at that time).</p>	<p>Oxera's peer review of NGN's financial model found that the calculations were correct and the assumptions made by NGN in relation to notional financial performance were reasonable.</p> <p>Oxera's review of the potential impact from delaying or stopping dividends during RIIO-GD2 find that such actions may result in a higher required return on equity from a theoretical point of view. In addition, Oxera reflect that if NGN were forced to reduce or delay dividends, then this may be in the context of an industry-wide trend of lower dividend yields by regulated networks. If investors expect high and consistent dividend yields, such reductions may reduce the relative attractiveness of UK regulated assets within the international market for capital.</p> <p>NGN has informed us that on the basis of the Oxera analysis of delaying or stopping dividends, they are not proposing to do so.</p>
Testing procedures on the GD2 financial model (the "Model"): report of findings KPMG (July 2019)	<p>A report of findings from testing procedures on NGN RIIO-GD2 financial model by KPMG. The procedures tested the logical integrity of the arithmetical operations in the formulae and calculation in NGN's financial model under the assumptions and input for the base case.</p>	<p>KPMG found that NGN's financial model had been constructed to materially achieve the purpose which it was designed to meet (i.e. generate projected profit and loss accounts, cash flow statements and financial ratios on both a notional and actual basis), within the scope of the testing.</p> <p>During the course of the work KPMG raised a number of assumption-related comments, which NGN responded to.</p>



# Assurance objective 5

**Assurance objective: Is financeable on both the notional and actual capital structure based on our [NGN's] proposed financial parameters**

Evidence	Scope	Key conclusions from the evidence point
<p>Review of NGN's RIIO-2 Business Plan Financeability KPMG (November 2019)</p> <p>Draft version</p>	<p>KPMG undertook a financeability assessment of NGN's RIIO-2 Business plan and financial projections on an actual and notional financing structure basis, using NGN's financial model and two different sets of assumptions:</p> <p>(1) Ofgem's base case financial Projections; and</p> <p>(2) NGN's Business Plan financial projections</p> <p>NGN's Business Plan was also stress-tested under a set of Ofgem-mandated macroeconomic and business risk scenarios, as well as a set of KPMG scenarios of potential macroeconomic risks and potential, plausible business downside risks considered by NGN</p>	<p>KPMG concluded that:</p> <ul style="list-style-type: none"> <li>financial projections for the notional company are broadly consistent with ratios required for a comfortable investment grade rating, which suggests that the notional company is unlikely to face a financeability challenge under Ofgem's base case financing assumptions, but the business is projected to face some pressure when stress-tested under both Ofgem-mandated as well as KPMG-modelled plausible downside scenarios;</li> <li>Under NGN's actual financing structure and Ofgem's base case financial assumptions a significant financeability challenge is implied as ratios are projected to fall below the Baa1 target rating and the company is projected to breach its bank covenants; and</li> <li>The financeability assessment of the Business Plan under NGN's financing assumptions implies that both the notional and actual financing achieve ratios consistent with comfortable investment grade of Baa1/BBB+ under the base case. However, for both the notional and actual financial structures with NGN's financing assumptions, the company would face pressure under certain high impact Ofgem-mandated and KPMG modelled scenarios of potential macroeconomic risks and potential, plausible business downside risks considered by NGN), which might result in a fall in ratios to Baa2/ Baa3 levels.</li> </ul>

# Assurance objective 5

**Assurance objective: Is financeable on both the notional and actual capital structure based on our [NGN's] proposed financial parameters**

Evidence	Scope	Key conclusions from the evidence point
<p>Assessment of Comfortable Investment Grade Credit Rating Frontier Economics (November 2019)</p> <p>Draft version</p>	<p>An independent study on the appropriate credit rating target for NGN for the RIIO-GD2 period</p>	<p>A “comfortable” investment grade rating is considered to be a BBB+ (Baa1) credit rating, in line with the minimum credit rating presupposed by Ofgem’s Cost of Debt allowance, and with general guidance that UK regulators have provided to regulated utilities in price controls in the past.</p> <p>Frontier Economics concludes that it will likely be in the best interest of NGN’s current and future customers to continue to target a comfortable investment grade credit rating for RIIO-GD2 because:</p> <ul style="list-style-type: none"> <li>• the customer benefit from lower allowed revenues which result in a downgrade from BBB+ to BBB would be more than offset by the higher future cost of debt (in present value terms);</li> <li>• NGN’s existing bank financial covenants<sup>2</sup> require the headroom provided broadly by the BBB+ rating metrics;</li> <li>• targeting BBB- as a steady-state credit rating in the long run would provide almost no headroom to accommodate such shocks, exposing NGN’s customers to an increased risk of a potentially catastrophic escalation of its financing costs; and</li> <li>• regulatory precedent in the UK and Ireland suggests that regulators favour targeting a credit rating of at least BBB+ or above.</li> </ul>

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