



National Audit Office

DEPARTMENTAL OVERVIEW

Overview of Ofgem 2011-12

NOVEMBER 2012

Our vision is to help the nation spend wisely.

We apply the unique perspective of public audit to help Parliament and government drive lasting improvement in public services.

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Amyas Morse, is an Officer of the House of Commons and leads the NAO, which employs some 860 staff. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively, and with economy. Our studies evaluate the value for money of public spending, nationally and locally. Our recommendations and reports on good practice help government improve public services, and our work led to audited savings of more than £1 billion in 2011.



National Audit Office

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Introduction

Aim and scope of this briefing

The primary purpose of this report is to provide the Energy and Climate Change Select Committee with an overview of Ofgem, based primarily on Ofgem's Annual Report and Accounts and National Audit Office work. The content of the report has been shared with Ofgem to ensure that the evidence presented is factually accurate.

Part One

About Ofgem

Ofgem's responsibilities

1 The Office of Gas and Electricity Markets (Ofgem), which was established in 2000 as a non-ministerial department, operates under the direction and governance of the Gas and Electricity Markets Authority (the Authority), which is independent of ministerial control, and is responsible for the economic regulation of the gas and electricity industries in Great Britain. The Authority determines Ofgem's strategy, sets policy priorities and takes decisions on a range of matters, including price controls and enforcement. In carrying out its functions, the Authority must have regard to guidance on social and environmental objectives issued by the Secretary of State.¹

2 Ofgem's principal objective is to protect the interests of existing and future consumers. Ofgem exercises functions on behalf of the Authority in accordance with its rules of procedure. Its key functions include:

- issuing, modifying, enforcing and revoking licences to operate in the gas or electricity markets;
- publishing advice and information to promote the interests of consumers;
- setting price controls for monopoly owners of gas distribution networks and electricity transmission and distribution networks;
- investigating and penalising those in breach of licence conditions; and
- implementing the EU's Third Package of energy reforms.

3 The Department of Energy and Climate Change (the Department) concluded in July 2011, following a review,² that Ofgem should continue to be the independent regulator of the gas and electricity markets, but there needed to be further clarity about the respective roles of the Department and Ofgem. The government's commitment to independent economic regulation was reinforced by the requirements of the EU Third Package. The review concluded that independence enables Ofgem to provide a stable long-term regulatory environment for investors. The Department committed to establishing a statutory 'Strategy and Policy Statement' to clarify respective responsibilities and provide context for Ofgem's independent regulatory role. The draft Energy Bill,³ published in May 2012, provides for the proposed Strategy and Policy Statement and is likely to be implemented in 2013. The Department's, the Authority's and Ofgem's respective roles are set out in **Figure 1** overleaf.

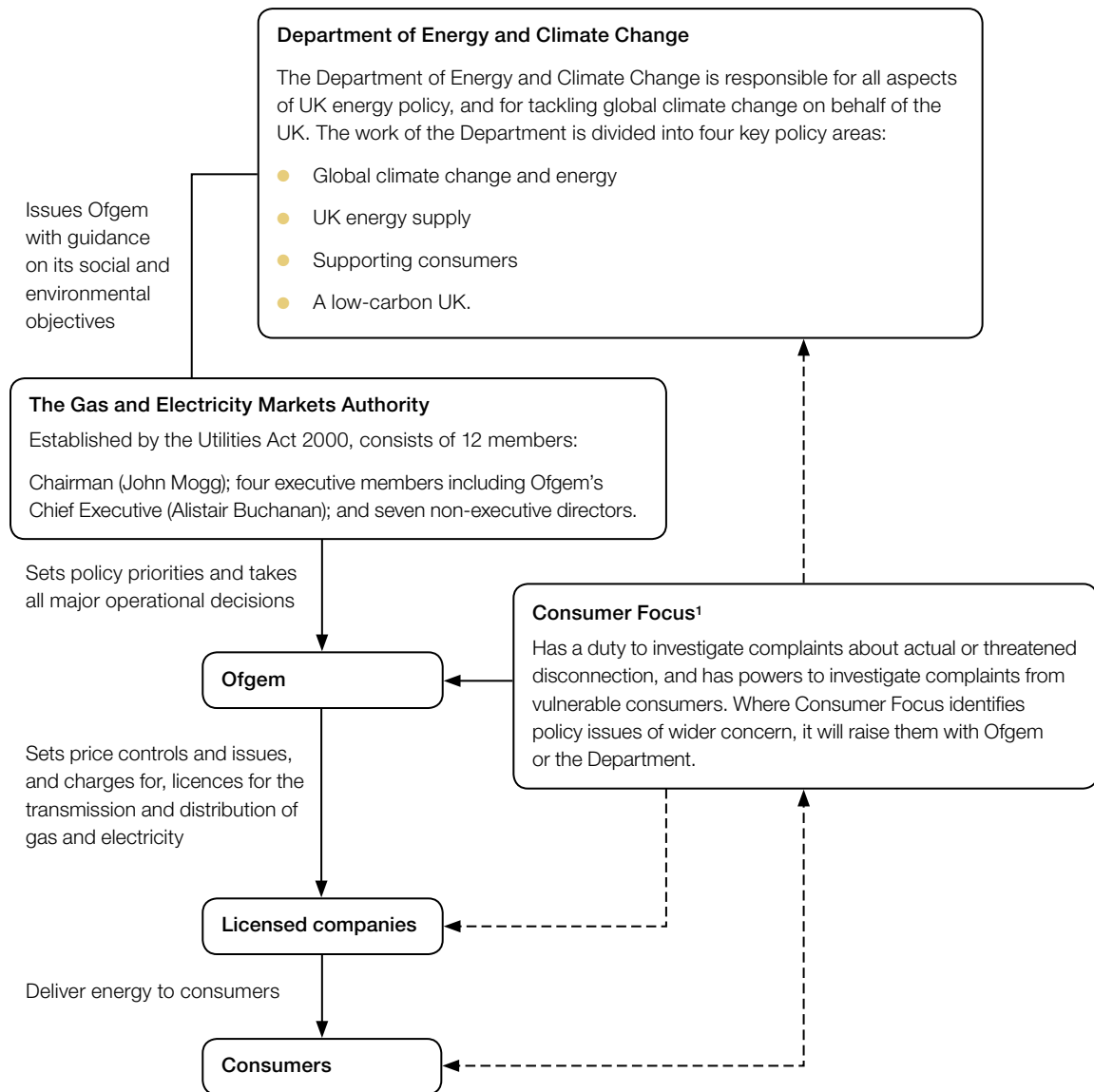
4 In addition, EU directives place obligations on member states to have independent energy regulators. In accordance with Article 35 of the Electricity Directive and Article 39 of the Gas Directive, the Authority has been designated as the National Regulatory Authority for Great Britain, which is required to be independent of government and of industry. Under these Directives one of its regulatory tasks is to ensure that gas and electricity legislation complies with the Directives and other relevant EU legislation. Ofgem has also been designated as the National Regulatory Authority under the Regulation on Wholesale Energy Market Integrity and Transparency (REMIT). This contains prohibitions against insider trading and market manipulation. The Department is required to ensure, by June 2013, that Ofgem has the necessary investigatory and enforcement powers to apply the prohibitions set out in REMIT.

¹ Department of Energy and Climate Change, *Social and Environmental Guidance to the Gas and Electricity Markets Authority*, January 2010. Available at: www.decc.gov.uk/assets/decc/what%20we%20do/uk%20energy%20supply/energy%20markets/regulation/1_20100121172046_e_@@_guidancegaselecmarkets.pdf

² Department of Energy and Climate Change, *Ofgem Review Final Report*, July 2011. Available at: www.decc.gov.uk/assets/decc/11/meeting-energy-demand/energy-markets/2151-ofgem-review-final-report.pdf

³ Her Majesty's Stationery Office, *Draft Energy Bill*, Cm 8362, May 2012. Available at: www.official-documents.gov.uk/document/cm83/8362/8362.pdf

Figure 1
Regulatory responsibilities for gas and electricity markets



NOTES

- 1 In April 2013, the Citizens Advice service will take responsibility for, and be funded to deliver, general consumer advocacy and education. At the same time, Consumer Focus will be restructured to become the Regulated Industries Unit (RIU), initially with responsibility for postal services and energy in England, Scotland and Wales, for post in Northern Ireland and for water in Scotland. In 2014, the RIU will transfer to the Citizens Advice service, and in Northern Ireland responsibility for consumer issues in relation to post will transfer to the General Consumer Council for Northern Ireland. Legislation will be required to make this happen, including a transfer of Consumer Focus's statutory powers and duties.
- 2 Solid lines represent statutory responsibilities.

Source: National Audit Office

5 As part of its statutory duties, Ofgem administers and regulates a number of environmental programmes devised by government. These include the Renewables Obligation, Climate Change Levy exemptions, the Renewable Heat Incentive and the Carbon Emissions Reduction Target.

6 In the Department's review of its delivery landscape in May 2011,⁴ the Department proposed a comprehensive Memorandum of Understanding and Service Level Agreements for each programme that Ofgem E-Serve delivers. In addition to existing exchanges of letters that agree funding and administrative arrangements on individual programmes, officials from the Department and Ofgem have recently discussed the option of using an exchange of letters to set out how Ofgem will work with the Department in the context of the overall programme Ofgem administers on behalf of government. Ofgem plans to put proposals to the Authority before the end of 2012. These proposals will then need to be agreed by the Department.

7 To support the achievement of its principal objective, which is to protect the interests of existing and future gas and electricity customers, Ofgem has set out its corporate themes in its *Corporate Strategy and Plan 2011-16*:

- building a low carbon economy;
- helping to maintain security of energy supplies;
- promoting quality and value for energy consumers; and
- ensuring timely and efficient delivery of government programmes for a sustainable energy sector.⁵

8 The Authority has published its forward work programme for 2012-13 under each of these four corporate themes.⁶

How Ofgem is organised

9 Ofgem is headed by a Chief Executive who is the Accounting Officer. He is supported by a senior management team, which is responsible for the management and resourcing of the business, under the direction of the Authority.

10 As at 31 March 2012, Ofgem consisted of two business units supported by corporate functions (**Figure 2** overleaf):

- **Ofgem:** responsible for statutory regulation, employing 270 staff.
- **Ofgem E-Serve:** responsible for administering environmental programmes devised by government and employing 155 staff. It has its own Management Committee, which decides on all operational matters relating to E-Serve's management and resourcing.
- **Corporate functions:** comprising Finance, Human Resources, Information Management and Technology, Procurement and Estates and Project Management Group and employing 134 staff. These functions previously sat within E-Serve.

11 A further 34 people work in the Executive, including Corporate Affairs staff, the Chairman and seven non-executive directors.

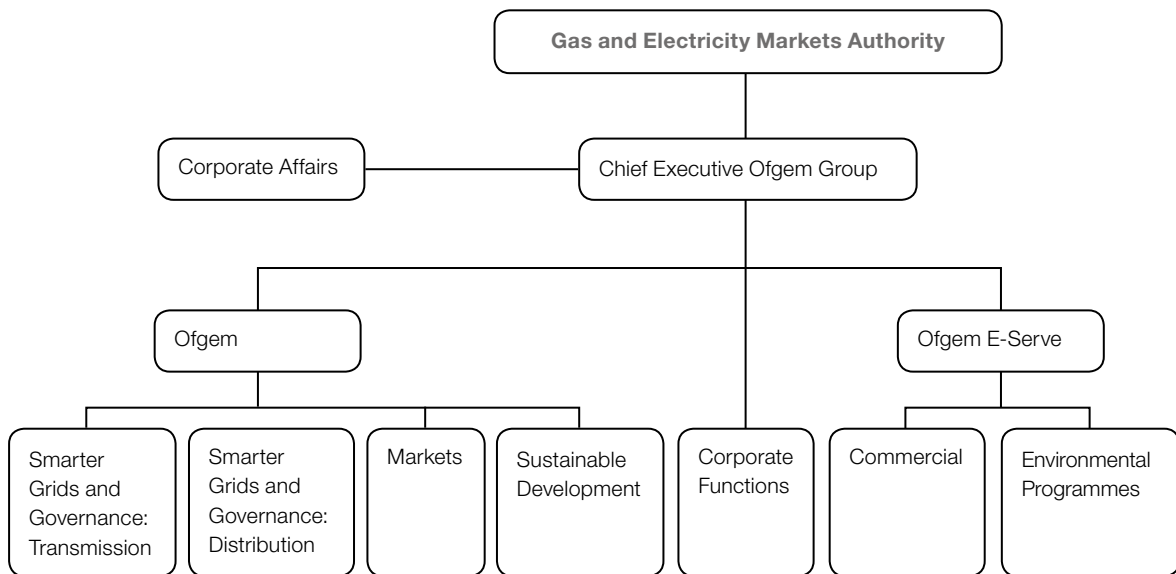
⁴ Department of Energy and Climate Change, *Review of DECC's delivery landscape*, May 2011. Available at: www.decc.gov.uk/assets/decc/About%20us/1656-delivery-review.pdf

⁵ Ofgem, *Corporate Strategy and Plan 2011-2016*, March 2011. Available at: www.ofgem.gov.uk/About%20us/CorpPlan/Documents1/Corporate%20Strategy%20and%20Plan%202011%20-%202016.pdf

⁶ Ofgem, *Forward Work Programme 2012-13*. Available at: www.ofgem.gov.uk/About%20us/CorpPlan/Documents1/Forward%20Work%20Programme%202012-13.pdf

Figure 2

Ofgem's organisational structure as at 31 March 2012



Source: Ofgem website, www.ofgem.gov.uk/About%20us/transparency/sd/Documents1/Ofgem%20Org%20Charts%20Sept%202011.pdf

Where Ofgem spends its money

12 Ofgem's gross expenditure in 2011-12 was £62.0 million, 5.6 per cent higher than the previous year. Spending by Ofgem E-Serve (including corporate functions) accounted for £35.4 million, 13 per cent less than 2010-11. Spending by the rest of Ofgem, including its regulatory activities, was £26.6 million, an increase of 46 per cent compared with 2010-11. Ofgem's key regulatory activities included the Retail Market Review, three price control reviews and enforcement. In 2011-12, there was a reduction in Ofgem E-Serve's workload as a result of one-off work on Smart Meters that Ofgem was asked to undertake in 2010-11. At the same time Ofgem E-Serve took responsibility for administering the Renewable Heat Incentive, which was launched in November 2011. It was also the first year for administering the Warm Home Discount scheme. In 2011-12 Ofgem also worked with the Department on preparations for the launch of the Energy Company Obligation (ECO) scheme in 2012, which, with the Green Deal, will replace the Carbon Emissions Reduction Target and Community Energy Saving Programme.

13 Ofgem's staff costs in 2011-12 amounted to £36.1 million, an 11 per cent increase on the previous year. Its staff numbers increased by 23 per cent to 593, in order to deliver the major projects set out in paragraph 12. Ofgem increased the staffing of its regulatory functions by 60. Its organisational structure change resulted in 134 corporate staff moving out of Ofgem E-Serve, but Ofgem E-Serve increased its residual staff numbers by 83 to cover additional administration of the government's environmental programmes (**Figure 3**).

14 Ofgem's spending on consultants in 2011-12 was £9.5 million, 19 per cent lower than 2010-11. This reduced Ofgem's consultancy costs as a proportion of its total staff and consultancy costs to 21 per cent, from 27 per cent the previous year (**Figure 4**). In 2011-12, consultancy spend on environmental schemes and projects fell from £5.4 million in 2010-11 to £2.0 million in 2011-12. In 2010-11 most consultancy spend was on environmental schemes and projects, most notably the offshore transmission regime. During 2011-12, as the regime became more embedded, Ofgem reduced its use of consultants, while other new environmental schemes such as the Renewable Heat Incentive and Warm Home Discount rely more on internal IT expertise.

Figure 3

Total staff numbers and breakdown (average full-time equivalent during the year)

Year	Total staff numbers	Ofgem	Ofgem E-Serve	Corporate functions	GEMA
2011-12	593	270	155	134	34
2010-11	451	210		206	35
Change 2010-11–2011-12	+142	+60		+83	-1

NOTE

1 In 2010-11 corporate functions were incorporated within Ofgem E-Serve and so separate staffing figures are not available.

Source: Ofgem

Figure 4

Staff and consultancy costs

Year	Staff costs	Consultancy costs	Consultancy as a percentage of total staff and consultancy costs
	(£m)	(£m)	(%)
2011-12	36.1	9.5	21
2010-11	32.5	11.8	27
2009-10	26.2	9.1	26
2008-09	20.6	6.4	24

Source: Ofgem, Annual Report and Accounts 2011-12

15 Most of Ofgem's remaining expenditure is on its accommodation. Costs for its buildings were £10.0 million in 2011-12, £3.7 million of which was recharged to the Department for Environment, Food and Rural Affairs (Defra). This was 10 per cent higher than in 2010-11. This increase includes an increase in the rates bill and in the cost of building contractors at Millbank, to work on the façade of the Grade 2 listed building. Ofgem estimates its building costs to be £10,500 per full-time equivalent employee. More efficient use of the building resulted in a reduction from the previous year's figure of £10,900.⁷

16 Ofgem estimates the total value of the environmental programmes it administers on behalf of government to be £5.2 billion in 2011-12. These programmes are funded through levies and other obligations placed on industry, which feed through

to energy bills for consumers. At the last spending review in 2010, HM Treasury introduced the Levy Control Framework, which establishes a cap on the Department's levy-funded spending. The levies include the Renewables Obligation (£2,020 million in 2011-12), the Feed-in Tariff (£130 million in 2011-12) and the Warm Homes Discount (£275 million in 2011-12). The total cap in 2011-12 was set at £2.9 billion. Ofgem E-Serve's role is to administer these schemes including providing information requested by the Department to enable it to manage spend within the Levy Control Framework. The Treasury has set the cap with headroom that allows spending to be up to 20 per cent in excess of the cap. The Department is required to agree changes to levy policies to bring them into line with the agreed cap and, if the cap is expected to be exceeded, to agree a plan with HM Treasury to reduce the spending.

⁷ The cost per head is calculated on the basis of the cost net of Defra's contribution.

Recent developments

17 The Energy Act 2011 came into force in October 2011. It provided for the introduction of the Green Deal and Energy Company Obligation (ECO) and provided the option for the Department to appoint Ofgem as the administrator subject to an order being made. ECO will replace the Carbon Emissions Reduction Target (CERT) and Community Energy Saving Programme (CESP), with effect from January 2013. Households will be able to access support for installation of energy efficiency measures through ECO from this point onwards.

18 The 2012 Draft Energy Bill, to provide for Electricity Market Reform, was published in May 2012. The Environment and Climate Change Committee, in its scrutiny of the Draft Energy Bill, raised concern over a potential conflict of interest for National Grid in taking on a delivery role, and a fear that this decision may lead to unnecessary additional costs to consumers.⁸ The Department and Ofgem are considering conflict of interest issues raised in the consultation on the topic, which closed in April 2012, and how any conflicts of interest could be addressed through business separation rules and Ofgem's oversight. A Memorandum of Understanding and a legally binding agreement dealing with the management of information were signed by the Department and National Grid in May 2012. These documents are designed to reduce the potential for conflicts of interest and to ensure appropriate governance frameworks are in place.⁹

19 Ofgem is required by the Energy Act (2011) to produce analysis for the Department of electricity capacity margins under a range of scenarios. In October 2012, Ofgem published the first annual Electricity Capacity Assessment,¹⁰ which forecast a reduction in electricity generation margins (the amount of spare generation capacity on the system) from 14 per cent to 4 per cent over the next four years to 2015-16.

Capability and leadership

20 The Civil Service People Survey aims to provide consistent and robust metrics to help government understand the key drivers of engagement, so that it can build upon strengths and tackle weaknesses across the Civil Service. The survey of civil servants includes a range of questions across nine themes which seek to measure their experiences at work. We present here the results of the first ever staff survey for Ofgem – undertaken in October 2011 – covering the themes of leadership and managing change, and understanding of organisational objectives and purpose (**Figure 5**). The Ofgem results compared with the 17 main spending departments are in Appendix Two.

21 As part of the annual survey, each participating organisation receives an engagement index assessing the level of staff engagement determined by: the extent to which staff speak positively of the organisation, are emotionally attached and committed to it, and are motivated to do the best for the organisation.

22 In 2011, Ofgem achieved an engagement index of 63, eight points higher than the Civil Service average. Seventy per cent of staff would recommend Ofgem as a great place to work. This is 27 points higher than the civil service average. Ofgem's staff have a strong understanding of the organisation's purpose (86 per cent positive) and have more confidence than colleagues in civil service organisations in the way its senior management make decisions and the overall management of Ofgem. Only 37 per cent of Ofgem staff believe that change in their organisation is well managed, but this is 10 points higher than the civil service average, and less than a third (31 per cent) feel that changes made by Ofgem are usually for the better, which is eight points higher than the civil service average.

8 Environment and Climate Change Committee, *Draft Energy Bill: pre legislative scrutiny*, July 2012. Available at: www.publications.parliament.uk/pa/cm201213/cmselect/cmenergy/275/275.pdf

9 More information is available at: www.decc.gov.uk/en/content/cms/news/nat_grid_mou/nat_grid_mou.aspx

10 Ofgem, *Electricity Capacity Assessment*, October 2012. Available at: www.ofgem.gov.uk/Markets/WhIMkts/monitoring-energy-security/elec-capacity-assessment/Documents1/Electricity%20Capacity%20Assessment%202012.pdf

Figure 5
Civil Service People Survey 2011: Ofgem

Theme	Theme score (% positive) ¹	Difference from civil service average ²
Leadership and managing change		
I feel that Ofgem as a whole is managed well	56	+16
Senior managers in Ofgem are sufficiently visible	62	+17
I believe the actions of senior managers are consistent with Ofgem's values	51	+12
I believe that the senior management team has a clear vision for the future of Ofgem	36	-3
Overall, I have confidence in the decisions made by Ofgem's senior managers	50	+14
I feel that change is managed well in Ofgem	37	+10
When changes are made in Ofgem they are usually for the better	31	+8
Ofgem keeps me informed about matters that affect me	62	+7
I have the opportunity to contribute my views before decisions are made that affect me	37	+2
I think it is safe to challenge the way things are done in Ofgem	44	+6
Organisational objectives and purpose		
I have a clear understanding of Ofgem's purpose	86	+3
I have a clear understanding of Ofgem's objectives	80	+1
I understand how my work contributes to Ofgem's objectives	84	+3
Ofgem as a place to work		
I am proud when I tell others I am part of Ofgem	63	+11
I would recommend Ofgem as a great place to work	70	+27

NOTES

- 1 The proportion who selected either "agree" or "strongly agree" for a question.
- 2 The 2011 benchmark is the median per cent positive across all participating organisations.
- 3 The complete set of results from the survey is available at: www.civilservice.gov.uk/about/improving/employee-engagement-in-the-civil-service/people-survey-2011

Source: Ofgem People Survey Results, Autumn 2011

Part Two

Financial management

23 The ability of public bodies to control costs and drive out waste requires professional financial management and reporting. In particular, public bodies need to be better at linking costs to services and benchmarking performance to determine whether costs are justified and value for money can be improved. Organisations also need to move their risk management arrangements from a process-led approach to one which supports the efficient and effective delivery of services. Improvements in these areas will help public bodies deliver cost-effective services as they make difficult decisions over the coming years.

24 Departments are required to publish Governance Statements with their Annual Report and Accounts, which describe their arrangements for corporate governance, risk management and oversight of locally delivered responsibilities. Governance Statements replace Statements on Internal Control, which were published in previous years. They are designed to include additional discussion of how governance in departments works in line with the Corporate Governance Code.¹¹

Financial out-turn for 2011-12 and comparison with budget

25 Ofgem's gross spending of £62.0 million in 2011-12 was 14 per cent less than the main estimate approved by Parliament of £72.0 million.¹² Spending by Ofgem E-Serve (including corporate functions) was £35.4 million, 22 per cent below budget. This was primarily a result of lower than anticipated expenditure on staff and consultancy. Spending by the rest of Ofgem, including its regulatory activities, was on budget at £26.6 million. Ofgem has spent less than its budget in each of the last three years (**Figure 6**).

26 Ofgem's operating income in 2011-12 was £61.4 million, comprising £40.0 million from licence fees and £21.3 million other income (**Figure 7**). It received a further £674,000 from public funds to meet the cost of its administration of Climate Change Levy exemptions.

27 In addition to the income to fund its activities, Ofgem collected net receipts for the Consolidated Fund totalling £114.7 million.¹³ Most of this, £104.1 million (including £0.7 million in interest), related to the Non-Fossil Fuel Obligation orders.¹⁴ This is higher than in 2010-11 when £89.7 million was collected. These receipts are accounted for in a Trust Statement, which forms part of the Ofgem Annual Report and Accounts.

Figure 6

Ofgem total spend in comparison to budget

Year	Total spend (£m)	Budget (£m)	Percentage underspend (%)
2011-12	62.0	72.0	14
2010-11	58.8	78.7	25
2009-10	51.1	53.9	5

Source: Ofgem, *Annual Report and Accounts*

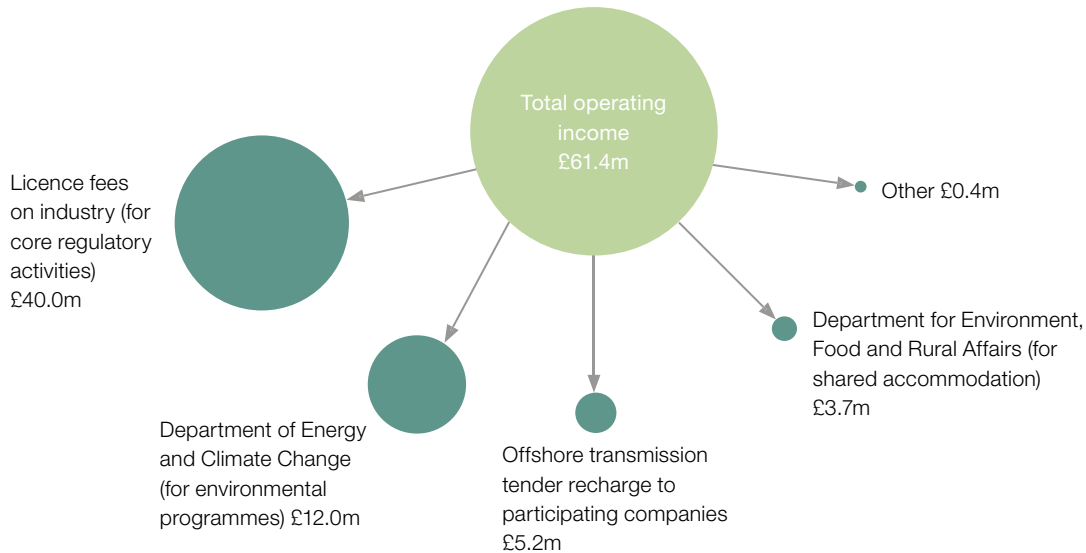
11 HM Treasury, *Corporate governance in central government departments: code of good practice 2011*, June 2011. Available at: www.hm-treasury.gov.uk/psr_governance_corporate.htm

12 HM Treasury, *Office of Gas and Electricity Markets Main Estimates, 2011-12*. Available at: www.hm-treasury.gov.uk/d/ofgem_main_supply_estimates_april11.pdf

13 Ofgem, *Annual Report and Accounts 2011-12*, July 2012.

14 The Non-Fossil Fuel Obligation (NFFO) supported renewable electricity, and operated from 1994 to 2002. It awarded contracts on the basis of a set price for electricity over the period of the contract. Contract payments were originally subsidised by a fossil fuel levy on consumer bills. However, since 2002 revenues from the sale of NFFO-generated electricity have exceeded contract payments. The excess is paid into a Fossil Fuel Levy account managed by Ofgem, and transferred to the Consolidated Fund.

Figure 7
Ofgem's operating income in 2011-12



NOTE

1 Individual figures do not sum to total due to rounding.

Source: *Ofgem Annual Report and Accounts 2011-12*

28 The remaining receipts, also shown in the Trust Statement, are from fines and penalties arising from enforcement activities, which amounted to £10.7 million in 2011-12, compared with £24.8 million in the previous year. £4.3 million of receipts from fines and penalties (40 per cent of the total) was a penalty placed on National Grid Gas in February 2012 for failing to meet standards of service required for controlled gas escaped in four networks. In October 2012, there were 11 ongoing investigations relating to eight companies. These investigations covered a variety of matters including mis-selling, non-compliance with regulations and consumer protection laws and misreporting of data.

Progress on cost reduction

29 Departments remain under pressure to reduce costs. The scale of cost reduction required means that departments need to look beyond immediate short-term savings, and think more radically about how to take cost out of the business and how to sustain this longer term.

30 In February 2012, we examined the cost reductions achieved by 12 departments in our report *Cost reduction in central government: summary of progress*.¹⁵ We found that departments successfully cut spending by £7.9 billion (2.3 per cent) in 2010-11 compared with 2009-10, but further cuts are needed in most departments over the next four years to meet spending targets. We concluded that fundamental changes are needed in government to achieve sustainable reductions on the scale required. Departments will achieve long-term value for money only if they identify and implement new ways of delivering their objectives, with a permanently lower cost base.

¹⁵ Comptroller and Auditor General, *Cabinet Office and HM Treasury, Cost reduction in central government: summary of progress*, Session 2010-2012, HC 1788, National Audit Office, February 2012.

31 Since 2005, Ofgem has sought to control its costs by limiting annual increases to its projected annual 'baseline' costs to the Retail Prices Index less a specific percentage. This approach to efficiency is known as 'RPI-X'. Ofgem set a baseline of £34.1 million for the core licence fee-funded activities it carried out in 2005 and future year budget ceilings were calculated according to the baseline plus RPI-3. Between 2005 and 2010, Ofgem's licence fee-funded budget decreased from £36.1 million to £33.1 million, and for the period Ofgem reported savings of £11.9 million.¹⁶ Ofgem's responsibilities for administering a number of additional environmental programmes resulted in total expenditure of £51.1 million in 2009-10.

32 The Authority, which determines Ofgem's strategy, agreed a further five-year cost control period running from 2010-11 to 2014-15 using the RPI-3 approach (**Figure 8**). The baseline for 2010-11 was £81.5 million, which was substantially higher than the previous 2005 baseline because of the additional responsibilities Ofgem had taken on. Ofgem estimates that RPI-3 will result in savings over the period of £12.5 million and reports savings to 2011-12 of £4.9 million as a result of the first two years of the regime. For 2012-13, Ofgem notes that budgeted expenditure exceeds by £2.3 million the budget ceiling for meeting its savings commitment. It considers this will be offset by agreed carry-over savings.

Figure 8

Ofgem's RPI-3 calculation for 2010–2015 and actual/planned expenditure over the period

	2010-11 £m	2011-12 £m	2012-13 £m	2013-14 £m	2014-15 £m
Baseline	81.5	81.0	73.5	79.9	79.4
Adjustment ¹	–	-8.6	5.1	–	–
RPI	2.0	3.4	3.8	2.0	2.0
Baseline + RPI ²	83.5	75.8	82.4	81.9	81.4
Less 3 per cent	-2.5	-2.3	-2.5	-2.5	-2.4
Budget ceiling	81.0	73.5	79.9	79.4	79.0
Actual/planned expenditure³	58.8	62.0	82.2	76.2	76.6

NOTES

- 1 The adjustment for 2011-12 comprises a £9.6 million reduction for Smart Meters and a £1.0 million increase for offshore wind. The adjustment for 2012-13 comprises a £4.5 million increase for administering programmes on behalf of government, and £0.6 million increase relating to the implementation of the government's reform of the electricity market.
- 2 The RPI figures used for each of the five years are 2.4 per cent, 4.8 per cent, 4.8 per cent, 2.5 per cent and 2.5 per cent respectively.
- 3 Actual expenditure is shown for 2010-11 and 2011-12 and planned expenditure for subsequent years.

Source: Ofgem, *Forward Work Programme 2012-13, March 2012*

33 Ofgem reports savings in its regulatory activities of £4.64 million in 2011-12, which it primarily attributes to freezing salaries, cutting pension costs and tight control over its consultancy spending. Ofgem carried forward this saving to be offset against future licence fee charges. This follows a saving of £5.3 million carried forward from 2010-11.

NAO financial audit findings

34 Our financial audit work indicates that Ofgem has sound systems of financial controls and reporting. The Comptroller and Auditor General gave an unqualified opinion on Ofgem's 2011-12 accounts and Trust Statement. All previous years have also received an unqualified audit opinion.

Issues raised in the Governance Statement

35 We work with departments and their sponsored bodies to improve the quality and transparency of published Governance Statements. We aim to ensure that the processes by which Statements are produced are robust and that the Statements comply with Treasury guidance.¹⁷

36 Ofgem's Governance Statement identified no significant internal control issues. It reported that, during the year, a number of key activities had been undertaken to monitor and enhance the internal control environment:

- strategic risks were reviewed by the Senior Management Team, Management Committee and the Audit Committee;
- the Risk Committee agreed Ofgem's strategic risks; and
- the risk management strategy was updated in November 2011, making risk management an integral part of policy-making, planning and delivery.

¹⁷ HM Treasury, *Public spending and reporting: Managing Public Money*, May 2012. Available at: www.hm-treasury.gov.uk/psr_mpm_index.htm

Part Three

Reported performance

37 Government needs robust, timely information on its activities, costs, progress against its objectives, and the cost-effectiveness of its activities. It also needs to be able to interpret that information, by reference to trends, benchmarks and other comparisons, to identify problems and opportunities. Departments need reliable information on which to design and deliver services and monitor quality, be confident about their productivity, and drive continuous improvement.

38 The government aims to make more information available to the public to help improve accountability and deliver economic benefits. Ofgem is not a main spending department, and so is not subject to the reporting framework that requires the main spending departments to publish Quarterly Data Summaries showing progress against specific milestones, input indicators and impact indicators. Ofgem nonetheless supports the principle of providing transparent data to support public accountability.

Reporting performance: annual report and corporate plans

39 Ofgem has designed its performance measurement system around its four corporate themes, which together cover both its regulatory activity and its management of environmental programmes. Individual priorities have an associated set of activity-based deliverables that describe specific outputs, such as the publication of key documents or achievement of certain milestones. Ofgem's five-year Corporate Strategy and Plan includes a schedule of deliverables due in each quarter of the forthcoming financial year, and it reports on performance against them in its Annual Report. These are equivalent to the milestones published in departmental business plans. In 2012-13, Ofgem enhanced the non-financial section of the corporate planning process by linking objectives, activities and projects to outcomes that will be reported by corporate theme.

40 Ofgem reports on its operational performance using corporate performance indicators, which cover areas such as response times to complaints. It also reports on performance against its internal sustainable development targets, which provide a measure of Ofgem's progress towards operating its business more sustainably.

Performance reported by Ofgem

41 Ofgem's deliverables for 2011-12 were set out in its Corporate Strategy and Plan for 2011-16.¹⁸ Ofgem stated in its annual report that it had achieved 47 of the 51 deliverables it had set for 2011-12 (**Figure 9**).

42 Ofgem has stated that its key 2011-12 deliveries included:

- publishing jointly with the Department the Offshore Transmission Coordination Project;
- publishing proposals for the Retail Market Review; and
- developing the Smart Meters Code of Practice.

43 The joint Department and Ofgem Offshore Transmission Coordination Project, published in March 2012, identified measures to address six areas of potential barriers to the development of coordinated networks. These are: planning an efficient and economic network; anticipatory investment; consenting; risk reward profile; regulatory boundaries; and technology. Offshore generators (for example, offshore wind farms) have a choice of constructing the transmission assets themselves or to opt for an Offshore Transmission Owner (OFTO) to do so. If they construct the assets themselves, then the generator must transfer the assets to an OFTO after construction and before coming into operation. OFTOs are selected on a competitive basis through a tender process run by Ofgem.

44 Under its Retail Market Review Ofgem published proposed reforms for domestic and non-domestic consumers in November and December 2011 and consultation on these closed in February 2012. Ofgem's proposals aimed to improve the quality of service and reduce tariff complexity in energy retail markets. One key element proposed is to strengthen the Mandatory Auction, so that the 'Big Six' energy suppliers would need to sell up to 25 per cent of their generation through an open and transparent auction.

¹⁸ Ofgem, *Corporate Strategy and Plan, 2011-16*, March 2011. Available at: www.ofgem.gov.uk/About%20us/CorpPlan/Documents/1/Corporate%20Strategy%20and%20Plan%202011%20-%202016.pdf

Figure 9

Ofgem's performance against deliverables by strategic theme

Theme	Number in Corporate Plan	Total achieved in year	Deferred to 2012-13	No longer applies
1 Building a low carbon economy	17	14	2	1
2 Helping to maintain security of supply	2	2	0	0
3 Promoting quality and value for customers	16	15	1	0
4 Timely and efficient delivery of government programmes	16	16	0	0
Total	51	47	3	1

Source: Ofgem Annual Report and Accounts 2011-12

45 In October 2012, Ofgem announced plans for reducing tariff complexity, and providing clearer information and fairer treatment to consumers. Proposed reforms include each supplier being limited to four tariffs for each fuel, each of which will be expressed as a standing charge and a single unit price. Suppliers will be required to give customers personalised information about the cheapest tariff they offer, with vulnerable customers who have not switched supplier being offered a personalised estimate from across the market. Fairer treatment will be achieved through standards of conduct that will be enforced by fines. Consumers will default to the cheapest tariff at the end of fixed-term contracts, and Ofgem will also be considering ways of promoting more collective switching.

46 The Department, industry, consumer groups and Ofgem have developed the Smart Meter Installation Code of Practice. This sets the rules for energy suppliers' installation programmes and so is a key element of the preparations for the roll-out of smart meters from April 2014. The Code is designed to help inform consumers about how their smart metering system works so that they can get the most benefit from smart metering. The Code is also designed to protect consumers during the installation process.

47 Two of the three deliverables that were deferred from 2011-12 related to RIIO (Revenue = Incentives + Innovation + Outputs) price controls, the new framework for controlling the prices that gas and electricity network operators charge for their services. There is no competition between network companies or statutory limits on spending, so through RIIO Ofgem must ensure that investment in networks is both necessary and efficient. Both of these deferred deliverables were completed by July 2012. These were:

- the publication of a decision letter on the gas distribution price control (RIIO-GD1) fast-track process after reviewing business plans submitted by gas distribution networks. The decision was not to retain any gas distribution network within the fast-track process because of material issues with the plans that would be difficult to resolve in the restricted timescale; and
- the announcement of the final proposals for the selection for fast-track price control decisions on SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd, which own the transmission networks in Scotland. This resulted in Ofgem agreeing price controls providing for investment of £7.6 billion, and Ofgem estimates that this will add £2.80 per year to the average domestic electricity bill by 2021.

48 The third deferred deliverable was the implementation of changes to network companies' ring-fence licence conditions. The ring-fence conditions in gas and electricity network operator licences provide assurance that network operators always have the financial and operational resources necessary to fulfil their obligations under legislation and their licences. The Authority decided in October 2011 that Ofgem needed more time to work up its proposals in this area, and so deferred implementation until April 2013.

49 The one 2011-12 deliverable that Ofgem reported no longer applied was to make a decision on potential RII-GD fast-track companies as it was decided not to fast-track any in 2011-12.

50 In 2011-12, Ofgem reported that it had fully achieved all of its 18 corporate performance indicators, which cover its performance, for example on responding to complaints and granting licence applications. This is an improvement on 2010-11, when Ofgem failed to meet three of its corporate targets.

51 As a public body, Ofgem must comply with central government sustainability requirements. Ofgem's performance against the Greening Government Commitments,¹⁹ effective from April 2011, is shown in **Figure 10**. Ofgem also reported its progress against other environmental initiatives including its building

Display Energy Certificate and its disclosures under the CRC Energy Efficiency Scheme. For 2011-12, Ofgem reported that:

- it had improved its Display Energy Certificate from an initial G (165) in 2008 to D (82) in 2011;
- it was ranked equal first for carbon trading readiness in the first league table under the CRC Energy Efficiency Scheme, in 2011;
- it was awarded ISO14001 Environmental Management System certification for its London office in 2012;
- it reduced its greenhouse gas emissions by 21 per cent to 753 tonnes, and is on track to meet its 2015 target;
- its water consumption stayed constant since 2009 despite an increase in staff numbers. In 2012, it implemented a water saving programme to target high use areas with water-efficient technologies that will help Ofgem reach the good practice benchmark of 4 to 6m³ per full-time equivalent employee; and
- its total waste increased by 22 tonnes over the last two years, in part explained by an increase in the number of staff. Waste per full-time equivalent employee decreased over the financial year, and Ofgem has sent no waste to landfill in the last two years.

Figure 10

Ofgem's performance against Greening Government Commitments targets

Greening Government commitments	2009-10 baseline	Target by 2015	2011-12 performance	Increase/ (decrease) from 2009-10 baseline
1 Cut greenhouse gas emissions by 25 per cent (tonnes)	956	717	753	(21%)
2 Reduce waste by 25 per cent (tonnes)	85	64	107	26%
3 Reduce water consumption (m ³ per full-time equivalent employee) ¹	9.5	6	9.5	0%

NOTE

- 1 Water consumption of more or equal to 6m³ per full-time equivalent employee (FTE) is regarded as poor practice, 4m³ to 6m³ per FTE as good practice and less than 4m³ per FTE as best practice.

Source: Ofgem Annual Report and Accounts 2011-12

19 Department for Environment, Food and Rural Affairs, Sustainability Development website, available at: sd.defra.gov.uk/gov/green-government/commitments/

Developments in administering energy and environmental programmes

52 Ofgem E-Serve administers a number of environmental programmes devised by government, with a total estimated value in 2011-12 of £5.2 billion (**Figure 11**). In 2012-13, Ofgem set up an E-Serve Programmes Committee to advise the Authority on the effectiveness and efficiency of Ofgem E-Serve in delivering a range of energy programmes for the Department.

53 For some of the programmes that Ofgem administers on behalf of government, there have been significant developments during the course of 2011-12.

54 For **Feed-in Tariffs**, there has been a huge uptake of solar photovoltaic installations registered with Ofgem. More than 99 per cent of all registered installations were photovoltaic installations. During 2010-11, there were on average 2,400 photovoltaic installations per month. This grew to 18,000 during 2011-12. The installed capacity has increased tenfold from less than 100,000kW in March 2011 to more than 1,000,000kW in March 2012. As a result of this escalation the Department initiated legislative changes to the scheme, including a reduction in the tariff rate.²⁰ This has resulted in the number of installations increasing more slowly: since April 2012, the monthly average has dropped back to 13,300.

Figure 11

Programmes administered by Ofgem and their associated costs/values in 2011-12

Programme	Description	Type of cost	£ million
Renewables Obligation /Renewable Energy Guarantees of Origin	Places an obligation on suppliers to source an annually increasing amount of electricity supplies from renewable sources.	Cost to suppliers	2,020
Carbon Emissions Reduction Target (CERT)	Requires all domestic gas and electricity suppliers with more than 50,000 customers to make savings in carbon emissions by promoting the uptake of low carbon energy solutions such as loft insulation.	Cost to suppliers	1,200
Community Energy Savings Programme (CESP)	Requires gas and electricity suppliers and electricity generators to deliver energy saving measures to domestic consumers in specific low-income areas of Great Britain.	Cost to suppliers	110
Offshore Transmission Licensing	Awards licences to operate offshore transmission networks through a competitive tender process.	Transfer value of transmission assets in the first tender round	1,100
Climate Change Levy exemption	Provides exemptions to the payment of the Climate Change Levy on supplies generated from new renewable sources.	The saving that suppliers make as a result of claiming exemptions	310
Feed-in Tariffs	Requires licensed electricity suppliers to pay a tariff to small-scale low-carbon generators for the electricity they produce.	Cost to suppliers	130
Warm Home Discount Scheme	Provides support via suppliers to customers in or at risk of fuel poverty.	Cost to suppliers	275
Renewable Heat Incentive	Provides a tariff payment to low carbon generators for the renewable heat they produce.	Payment from the Department	42

Source: Ofgem

20 More information is available at: www.ofgem.gov.uk/Sustainability/Environment/fits/Pages/fits.aspx

55 The **Renewable Heat Incentive** scheme for non-domestic schemes was introduced in November 2011. In March 2012, the Department announced that Phase 2 of the Renewable Heat Incentive, which will compensate domestic users for producing heat, has been further delayed until summer 2013. Ofgem administers the scheme for non-domestic consumers and will administer the scheme for domestic consumers when it has been launched.

56 The Department published its decision on future renewable energy subsidy levels in July 2012. These changes to the bands of the **Renewables Obligation** will be available from 2013 to 2017, when they will be replaced by Feed-in Tariffs with Contracts for Difference. Ofgem will administer the new rates and the scheme until its closure in 2037. Changes include:

- support for onshore wind is to fall by 10 per cent;
- rates for offshore wind will reduce as the technology becomes cheaper;
- support for large-scale marine energy will more than double;
- there will be a new band for existing coal power stations converting to biomass; and
- there will be no immediate reduction in support for large-scale solar power.

Issues identified by the NAO

57 The NAO's report on **offshore electricity licensing**²¹ highlighted the benefits flowing from the innovative use of competition to award companies licences to transmit electricity from offshore wind farms. We reported that the Department and the Authority had been innovative in creating a new competitive market for the ownership and maintenance of offshore transmission assets and have secured good levels of investment in challenging financial conditions. We judged that giving licensees a 20-year income, rising each year with inflation, even though their financing costs do not rise with inflation, appeared generous and leaves consumers bearing the risk of inflation.

58 A briefing was prepared by the NAO on the **modelling used to set Feed-in Tariffs**²² which showed actual take up of Feed-in Tariffs (mainly through photovoltaic installation) to be much higher than predicted take up (as described in paragraph 54). The Department put this down to unexpected decreasing capital costs of photovoltaic panels.

59 The NAO also published a briefing for the Public Accounts Committee on the **Electricity Generating Landscape** in Great Britain.²³ It provided an overview of the key features of the policy and regulatory framework for electricity generation, and the nature of the transition required over the next 10 years to meet emissions reduction and renewable energy targets. It identified risks to delivering secure, low carbon and affordable electricity and issues for consideration by Parliament. The briefing noted that Ofgem had estimated that investment totalling £35 billion was required in electricity networks to 2020 and that Ofgem was reviewing National Grid's proposal to invest £21.3 billion, which would equate to an £11 increase in the average consumer bill by 2021. In July, Ofgem announced a preliminary conclusion on National Grid's proposal, which reduced its proposed investment to £20.2 billion. Ofgem's final decision on this is due for publication in December 2012.

21 Comptroller and Auditor General, *Gas and Electricity Markets Authority, Department of Energy and Climate Change, Offshore electricity transmission: a new model for delivering infrastructure*, Session 2012-13, HC 22, National Audit Office, June 2012. Available at: www.nao.org.uk/publications/1213/offshore_electricity.aspx

22 National Audit Office briefing: *The modelling used to set Feed-in Tariffs for solar photovoltaics*, National Audit Office, November 2011. Available at: www.nao.org.uk/publications/1012/fts_briefing.aspx

23 Comptroller and Auditor General, *Department of Energy and Climate Change, The government's long-term plans to deliver secure, low carbon and affordable electricity*, Session 2012-13, HC 189, National Audit Office, June 2012. Available at: www.nao.org.uk/publications/1213/electricity_landscape.aspx

Appendix One

Reports by the NAO of relevance to Ofgem since 2009

Publication date	Report title	HC number	Parliamentary session
27 June 2012	Department of Energy and Climate Change, The government's long-term plans to deliver secure, low carbon and affordable electricity	HC 189	2012-13
22 June 2012	Gas and Electricity Markets Authority and Department of Energy and Climate Change, Offshore electricity transmission: a new model for delivering infrastructure	HC 22	2012-13
November 2011	The modelling used to set Feed-in Tariffs for solar photovoltaics: A briefing for the House of Commons Energy and Climate Change Select Committee and Environmental Audit Committee	www.nao.org.uk/publications/1012/fits_briefing.aspx	
November 2011	Performance of Ofgem 2010-11: A briefing for the House of Commons Energy and Climate Change Select Committee	www.nao.org.uk/publications/1012/performance_of_ofgem_2010-11.aspx	
30 June 2011	Department of Energy and Climate Change, Preparations for the roll-out of smart meters	HC 1091	2010-2012
October 2010	Performance of Ofgem: A briefing for the House of Commons Energy and Climate Change Select Committee	www.nao.org.uk/publications/1011/performance_of_ofgem.aspx	
July 2010	The Electricity Generating Landscape in Great Britain: A briefing for the House of Commons Energy and Climate Change Select Committee	www.nao.org.uk/publications/1011/electricity_generating.aspx	
22 March 2010	Review of the UK's Competition Landscape: A review by the Comptroller and Auditor General	www.nao.org.uk/publications/0910/competition_landscape.aspx	

Appendix Two

Results of the Civil Service People Survey 2011

Question scores (% strongly agree or agree, or % yes)	Civil service overall	Ofgem
Leadership and managing change		
I feel that the Department as a whole is managed well	40	56
Senior civil servants in the Department are sufficiently visible	46	62
I believe the actions of senior civil servants are consistent with the Department's values	39	51
I believe that the departmental board has a clear vision for the future of the Department	39	36
Overall, I have confidence in the decisions made by the Department's senior civil servants	36	50
I feel that change is managed well in the Department	27	37
When changes are made in the Department they are usually for the better	23	31
The Department keeps me informed about matters that affect me	55	62
I have the opportunity to contribute my views before decisions are made that affect me	36	37
I think it is safe to challenge the way things are done in the Department	38	44
Organisational objectives and purpose		
I have a clear understanding of the Department's purpose	84	86
I have a clear understanding of the Department's objectives	79	80
I understand how my work contributes to the Department's objectives	81	84

Department for Business, Innovation and Skills (excluding agencies)																	
Cabinet Office (excluding agencies)																	
Department for Communities and Local Government (excluding agencies)																	
Department for Culture, Media and Sport (excluding agencies)																	
Ministry of Defence (excluding agencies)																	
Department for Education																	
Department of Energy and Climate Change																	
Department for Environment, Food and Rural Affairs (excluding agencies)																	
Foreign and Commonwealth Office (excluding agencies)																	
Department of Health (excluding agencies)																	
HM Revenue & Customs																	
HM Treasury (excluding agencies)																	
Home Office (excluding agencies)																	
Department for International Development																	
Ministry of Justice (excluding agencies)																	
Department for Transport (excluding agencies)																	
Department for Work and Pensions																	
	31	38	23	37	20	49	41	31	54	33	18	55	44	60	43	45	23
	46	49	35	47	27	53	62	44	56	53	31	67	50	68	47	59	21
	34	40	24	39	27	46	48	34	52	41	25	52	44	57	42	46	21
	29	33	22	31	20	43	30	21	51	28	22	39	33	60	39	36	20
	28	38	21	32	17	43	43	27	47	33	17	53	41	53	38	42	16
	24	27	20	33	12	32	31	21	40	19	15	42	24	40	31	31	19
	17	22	10	20	9	21	26	16	34	12	13	33	22	29	26	21	14
	59	55	50	60	41	58	64	56	60	53	39	65	62	68	56	64	39
	32	37	28	47	19	37	36	38	39	37	18	47	38	47	36	39	18
	33	41	25	42	31	39	41	40	43	33	27	55	39	43	36	45	27
	77	73	57	73	80	85	90	75	82	69	73	88	85	94	78	79	73
	70	66	53	67	72	81	85	70	79	63	70	78	80	93	72	74	71
	75	71	61	73	76	82	88	76	83	72	73	81	82	90	76	76	73

Where to find out more

The National Audit Office website is
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