

**National Grid Electricity Transmission plc
Balancing Principles Statement Audit**

Supplement to the Balancing Principles Statement report for the year ended 30 September 2013.

Prepared by: PricewaterhouseCoopers LLP dated 27 November 2013



National Grid Electricity Transmission plc Balancing Principles Statement Audit

Supplement to the Balancing Principles Statement report for the year ended 30 September 2013

Supplement to our report on compliance with the Balancing Principles Statement for the year ended 30 September 2013

- 1 We have reviewed the extent to which National Grid Electricity Transmission plc (“National Grid”), in its procurement and use of Balancing Services, has complied with the Balancing Principles Statement (“BPS”) prepared by National Grid pursuant to Paragraph 5 of Condition 16 of its Transmission Licence, for the year ended 30 September 2013 (“the Year”). We have undertaken this review in accordance with the with the Form of Agreement 4538/03/SW agreed between ourselves and National Grid Company Plc on 8 March 2004, which was subject to Amendment Number 4 which was agreed with National Grid Gas Plc on 30 September 2011.
- 2 The results of our review for the Year have been communicated to both National Grid and to the Office of Gas and Electricity Markets (“Ofgem”) in our main report (“BPS Report”) which should be considered in conjunction with this Supplement.

Purpose of this Supplement

- 3 This Supplement has been prepared in conjunction with the BPS Report to provide additional details relating to the work performed in respect of the compliance by National Grid with the BPS.
- 4 From paragraph 8 onwards of this Supplement, we describe the review approach defined in the approach document dated 20 September 2013 and the approach adopted by us in our role as the Balancing Principles Statement Auditor.

Use of this Supplement

- 5 This Supplement is intended solely for the use of the Directors of National Grid and Ofgem. While we acknowledge that this Supplement will be published on the National Grid website, this is for information purposes only and we do not intend that it should be relied upon by anyone other than the parties mentioned above.
- 6 The maintenance and integrity of the National Grid website is the responsibility of the Directors of National Grid. The work that we carried out does not involve consideration of the maintenance and integrity of that website and, accordingly, we accept no responsibility for any changes that may have occurred to this report since it was initially presented on the website.
- 7 This Supplement has been prepared in the expectation that National Grid and Ofgem will have sufficient experience of Balancing Services to understand the issues raised without further background explanation and to evaluate the contents of this report in the context of the scope of our work.

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Objective and scope of the Balancing Principles Statement Review

- 8 The Balancing Principles Statement¹ (“BPS”) sets out, at a high level, National Grid Electricity Transmission plc’s (“NGET’s”) obligations and responsibilities in respect of the management of supply and demand over the national transmission network and has been written to be consistent with NGET’s licence obligation to “operate the licensee’s Transmission System in an efficient, co-ordinated and economical manner”.
- 9 The objective of our review is to form an independent opinion based on our review work as to the compliance of NGET, in all material respects, with the BPS in respect of the use of Balancing Services for the year ending 30 September 2013 (“the Year”).
- 10 This Review Approach has been prepared by PricewaterhouseCoopers LLP (“PwC”) and accepted by NGET as the basis for the current year’s audit, as required in the contractual arrangements in place between PwC and NGET in respect of this audit.
- 11 Condition C1 of NGET’s Transmission Licence defines Balancing Services as:
- (a) Ancillary Services;
 - (b) offers and bids made in the Balancing Mechanism; and
 - (c) other services available to the licensee which serve to assist the licensee in operating the licensee’s transmission system or co-ordinating and directing the flow of electricity onto and over the GB transmission system, as appropriate in accordance with the Act or the standard conditions and/or in doing so efficiently and economically, but shall not include anything provided by another transmission licensee pursuant to the System Operator Transmission Owner Code.
- 12 The scope of our review will cover:
- (a) the receipt and validation (including application of default data) of Physical Notification (“PN”) data;
 - (b) the consistency of demand and operational data provided to market participants during the Day Ahead and within day balancing processes to data used internally by NGET and confirmation that the required timetable for the issue of this data has been met;
 - (c) the call off of Balancing Services in cost order during the day-ahead balancing process. Balancing Services to include Ancillary Services active power contracts only;
 - (d) the call off of Balancing Services in cost order during the within day balancing process. Balancing Services to include Ancillary Services active power contracts and accepted Bids and Offers in the Balancing Mechanism including Pre Gate Closure BMU Transactions (“PGBTs”); and
 - (e) NGET’s adherence to internal operating procedures for activities that impact the call off of Balancing Services during the day-ahead and within day balancing processes. For the avoidance of doubt, this includes internal operating procedures that relate to the management of transmission constraints and response/reserve holdings during the day-ahead and within day balancing processes.
- 13 For the purpose of clarity we note that in assessing internal operating procedures relevant to the above activities, those aspects that involve engineering decisions that NGET make are expressly excluded from the scope of our review, as agreed with NGET.

¹ – *Balancing Principles statement versions 10.0 effective 1 April 2011 and version 11.0 effective from 1 April 2013*

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- 14 In agreement with NGET we have excluded from the scope of our review the procedures of NGET which address the following activities described in the BPS:
- (a) Emergency Instructions and Involuntary Reductions as described in the Grid Code for use in preserving system security in exceptional circumstances;
 - (b) operational planning activities undertaken prior to the Day Ahead stage;
 - (c) engineering decisions taken in the calculation of transmission constraints and response/ reserve holdings;
 - (d) engineering decisions made in the call off of Ancillary Services or acceptance of Bids and Offers in the balancing mechanism;
 - (e) the procurement of Balancing Services to provide services to external system operators via System-to-System Services;
 - (f) acceptance of arbitrage trades made within the Balancing Mechanism;
 - (g) the management and planning of transmission system outages; and
 - (h) the use of 'other services' as referred to in the definition of Balancing Services in paragraph 11 (c) above.
- 15 For the avoidance of doubt, it is not the responsibility of the BPS Auditor to:
- (a) confirm that the BPS is consistent with legislation/statutory obligations;
 - (b) confirm that system security has been maintained at all times; or
 - (c) review the accuracy of forecast demand as prepared by NGET compared to actual demand.
- 16 In interpreting the BPS, we have relied on our own interpretation of that statement. We are not legal advisors and have not taken independent legal advice and shall therefore have no responsibility to NGET or the Office of Gas and Electricity Markets ("Ofgem") were a court to interpret or construe the BPS in a different way from us.

Call-off of Balancing Services in cost order

- 17 As described above, we are required, as part of our review, to assess whether Balancing Services have been called-off in cost order. Part C paragraph 5 of the BPS, recognises that under certain circumstances it may not be possible to call-off Balancing Services in cost order and lists these circumstances. We have discussed the interpretation of cost order with NGET as it relates to our review and have agreed that we should apply the following assumptions to our review of the call-off of Balancing Services:
- Balancing Services called-off during the day ahead balancing process (Ancillary Services active power contracts) have been selected based on lowest cost over the next 24 hour period.
- 18 Balancing Services called-off during the within day balancing process (Ancillary Services active power contracts and accepted Bids and Offers in the Balancing Mechanism) have been selected based on lowest cost over the subsequent 'Gate Closure period' following the service being called-off. The term 'Gate Closure period' is defined as the length of time between Gate Closure for a given Settlement Period and the end of that Settlement Period. Where it is not possible to call-off Balancing Services in cost order, Part C paragraph 5 of the BPS states that NGET may take account of the '*observed and declared dynamic operating characteristics of available generation and demand Balancing Services*'. During the

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course of our work we have assumed that the observed operating characteristics, are those characteristics observed by NGET since NETA 'go-live' on 27 March 2001.

- 19 We have assumed that PN data forms part of the '*observed and declared dynamic operating characteristics of available generation*'. As such, we have assumed that actions taken by NGET to mitigate risks to the security of the Transmission network arising from abnormal PN data is within the scope of Part C paragraph 5 of the BPS.

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Review approach

- 20 Our review approach consists of the following, in respect of NGET's use of Balancing Services:
- (a) reviewing the computer systems and/or internal operating procedures that NGET have in place that relate to the use of Balancing Services;
 - (b) testing on a sample basis to the extent we considered necessary, the ongoing operation of the relevant computer systems and/or internal operating procedures during the Year; and
 - (c) testing on a sample basis to the extent that we considered necessary, the data processed by the relevant computer systems and/or internal operating procedures during the Year.
- 21 We will design our testing to provide reasonable assurance that the call-off of Balancing Services during the Year has been carried out in accordance with the sections of the BPS within the scope of our review.
- 22 In undertaking our review, we will assess the risk of a material non-compliance of the areas of the BPS within the scope of our review. In areas where we have identified specific risks, or where weaknesses have been identified in the operation of specific internal controls, these compliance tests will be supplemented by substantive tests of detail of the relevant underlying data. Our initial assessment of risks is presented in Appendix A below.
- 23 We will select eight Settlement Days for testing in the Year. The selection of the particular days reviewed will be based solely on our assessment of risk. It will represent a mixture of "normal" days and other days where we identify unusual factors (e.g. outages, weekends, clock change days or days around a specific event) which, in our view, represent a risk as to compliance with internal operating procedures.
- 24 In respect of our review of accepted Bids and Offers in the Balancing Mechanism we will select and review 48 half-hour periods within the eight sample days selected per paragraph 23 above. Our selection of half-hour periods reviewed will be weighted towards periods of high activity in the Balancing Mechanism and also where accepted Bids and Offers have resulted in higher System Buy Prices or lower System Sell Prices.
- 25 Where it is more efficient for us to do so, we will use Computer Assisted Audit Techniques ("CAATs") and run tests for the entire selected sample day. CAATs involve the use of data manipulation tools to perform automated tasks such as matching two or more types of records, identifying patterns and looking for anomalies.
- 26 Where we do not find sufficient samples of particular events/activities on the selected sample days we will select data from additional days to ensure that the sample sizes selected are in line with PwC policy.
- 27 Throughout our work, we will continue to monitor developments that impact upon the call-off of Balancing Services and where we identify a resulting risk in respect of our review we will assess the risk and determine an appropriate response.

Materiality

- 28 We will plan and perform our review so as to be able to provide reasonable assurance that NGET has used the Balancing Services in all material respects in accordance with the BPS. A draft of our report is included in Appendix B below.

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29 The assessment of what is material, and therefore what issues, if any, warrant inclusion in the BPS Report, is a matter of professional judgement. However, in applying this professional judgement, we will judge a failure on NGET's part to comply with the BPS as being material if, in our opinion, a reasonable professional person, considering NGET's adherence to the BPS in the round, would form a different view as to whether NGET had complied with the BPS dependent as to whether or not the matter was disclosed to them. In applying this judgement we will take into account the following factors:

- (a) the extent to which the actual outcome would have been different had the principles set out in the BPS been applied;
- (b) the surrounding circumstances at the time(s) of any failure to comply with the BPS;
- (c) the aggregate impact in the Year of any failure to comply with the BPS; and
- (d) the relative significance of the particular provision of the BPS that NGET have failed to comply with.

More detailed description of review work undertaken

30 The review work that we have carried out can be divided into the main areas shown below.

Receipt and validation of Physical Notification data

31 Validation/accepted data:

- Sample test accepted data items, confirming data complies with required validation rules;
- Review validation controls built into file transfers (e.g. record counts, control totals etc.); and
- Identify and sample test key management controls over quality of data and, where relevant, sample test any instances where validation rules have been overridden for a valid reason.

32 Default data:

- Sample test data items that have been defaulted to check that the correct default data has been applied; and
- Sample test defaulted data items to check that a valid PN data submission has not been made by the relevant market participant.

33 Incidents/exceptions:

- Review a sample of incidents where electronic transfer has been interrupted and of the actions taken designed to prevent data files being lost/duplicated;
- Review a sample of correspondence/help desk queries from market participants questioning rejection of a data files; and
- Sample test rejected items to check that data was rejected for a 'valid' reason.

The consistency of data provided to market participants during the "day-ahead" and "within-day" balancing processes to data used internally by NGET

34 Accepted items and controls:

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- Sample test data items to check that the data had been submitted to the Balancing Mechanism Reporting Agent ('BMRA') directory in the required timescales;
- Sample test data items, reviewing evidence that procedures have been complied with (e.g. sign off of checklist, evidence of review and approval of value);
- Sample test controls over input of data to SORT/SPICE (e.g. sign off of input, one-for-one checking); and
- Sample test data items to check values reported to BMRA to data input sheets.

35 Incidents/exceptions:

- Review a sample of any complaints/disputes raised by market participants to identify any that related to the late provision of data; and
- Review a sample of operational log/fault log for IT systems to check for any system failures that have resulted in late delivery of data.

The call-off of Ancillary Services contracts in cost order during the “day-ahead” balancing process

36 Accuracy of data available:

- Check for a sample of days that the list from which contracts has been selected agrees to a list of contracts in place at that time;
- Sample test days to confirm that the assessment of the need for BM Startup contracts has been carried out as required and documented in procedures;
- Confirm evidence of management's review and approval of decision; and
- Sample test BM Startup contracts called, to check that the decisions have been made in accordance with documented procedures.

37 Analytical review:

- Sample test BM Startup contracts called, to check the cost of contract compared to others available that met geographical or constraint limitations.

The call-off of Balancing Services in cost order during the “within-day” balancing process

38 Accuracy of data available:

- Confirm for a sample of days that the list from which Ancillary Services contracts has been selected agreed to a list of contracts in place at that time;
- Sample test days to confirm that the assessment of the need for Ancillary Services contracts has been carried out as required and documented in procedures;
- Check evidence of management's review and approval of decision;
- Sample test Ancillary Services contracts called, to check that the decision has been made in accordance with documented procedures;
- Confirm evidence of management's review and approval of decision; and
- Sample test PGBTs issued to check that the decision to issue the PGBT has been taken in accordance with the documented procedures.

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39 Analytical review:

- Sample test Ancillary Services contracts that have been called to review cost of contract compared to others available that met geographical or constraint limitations;
- Sample test Bids/Offer to check that the “operational plan” indicates that balancing measures have been required and that the Bid/Offer accepted met requirement stated in the plan;
- Sample test Bids/Offer accepted to check the preparation of the “operational plan” that identifies the need for balancing measures and check that this has been prepared in accordance with documented procedures;
- Sample test Bids/Offer to confirm whether accepted Bid/Offer have been the least cost of the Bids/Offer available. Where this was not the case, review any explanation provided by NGET control engineers and check this explanation against the available information. We will review explanations provided by NGET for instances where the least cost Bid/Offer was not accepted for reasonableness. We are not, by profession, engineers and our challenge on engineering decisions is therefore limited as to whether the explanation seemed to us reasonable;
- Review evidence of authorisation/post-event review of decision by management;
- Review, analytically, Bids/Offer accepted over the course of review Year to seek to identify whether any Balancing Mechanism Units appeared to be selected more frequently than others;
- Sample test the PGBTs issued to check that such an action was appropriate in view of the operational plan produced;
- Sample test the PGBTs issued to check that a suitable number of PGBT Offers has been received by NGET prior to the decision to select a specific generating unit, and that the PGBT issued formed part of the least cost solution, subject to constraints, and displayed no bias.

General IT Controls Testing

40 The majority of transactions regarding input and output of data are sent and processed electronically. Consequently, significant assurance over these procedures will be obtained by reviewing the strength of the IT controls existing over these areas.

41 Our review will focus on the following in respect of controls over SPICE and SORT:

- security administration;
- software change control;
- logical access control;
- computer operations;
- contingency planning; and
- physical security

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Appendix A: - Risk and response table

| Risk | Our response |
|--|--|
| <p>Engineering decisions not most economical:</p> <p>Decisions to accept bids and offers are made to comply with variety of parameters, for example the frequency and constraints between zones. While such decisions will achieve the requirements per other parameters they may not always be the most economical contract.</p> | <p>As auditors we recognise our limitation in determining whether such decisions were most appropriate in the given circumstances. We will obtain a representation from NGET that such decisions made did not have any more economical alternatives.</p> |
| <p>Retrospective amendments to data</p> <p>Errors may be noted in balancing data which is available in the balancing systems or data which is published on the BMRS. Such errors may have to be retrospectively amended. Incorrect data presents a risk of errors in the balancing process.</p> | <p>Through discussions with NGET we will identify any such errors which identified by management. Based on the nature of errors and the subsequent analysis, performed by NGET, of the impact of these errors we will formulate additional tests to confirm compliance with the requirements of BPS.</p> |
| <p>System failures(failure of balancing systems and other events affecting balancing process)</p> <p>System failures may require the operations staff to:</p> <ul style="list-style-type: none"> - Perform certain actions and subsequently recover systems and potentially data; or - Take special decisions to ensure continuity of the balancing process. <p>Such events increase the risk of error or actions that are not consistent with the BSC.</p> | <p>Through discussion with Market Operations staff and review of Elexon circulars, we will identify any system failures experienced. We will determine the impact of any such failures on operational activities and review recovery actions taken.</p> |

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| Risk | Our response |
|--|---|
| <p>Operations during balancing system outages</p> <p>Balancing systems outages can be planned or unplanned and occur due to various reasons. The severity of these outages can vary and consequently NGET's response will depend on the conditions existing during the outage.</p> <p>During some outages data is required to be input manually into the system and there is a greater risk of error than where this is performed electronically using a stable and proven system. Also, where system failure, including failure of communication links, requires fall back to manual processes there is again a greater risk of error as operations staff implement processes they are less familiar with.</p> | <p>As part of our more detailed planning for the assignment we will identify key manual inputs and interactions with the systems and will tailor our review work programme to address the inherent risk of these activities.</p> <p>As above we will identify, through discussion with Market Operations staff and review of appropriate event logs, periods where manual processes were implemented and develop appropriate tests to review the validity of actions taken.</p> |

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Appendix B – Draft of our review opinion

The Directors
National Grid Electricity Transmission plc
National Grid House Warwick HQ
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

Our ref: DJG

Dear Sirs

Report on compliance with the Balancing Principles Statement for the year ended 30 September 2013 (“the Year”)

- 1 We have reviewed the extent to which National Grid Electricity Transmission plc (“NGET”), in its procurement and use of Balancing Services, has complied with the Balancing Principles Statement (“BPS”) for the year ended 30 September 2013. We have undertaken this review in accordance with the with the Form of Agreement 4538/03/SW agreed between ourselves and National Grid Company Plc on 8 March 2004, and subject to Amendment Number 3 which was agreed on 7 August 2008 and Amendment Number 4 which was agreed with National Grid Gas Plc on 30 September 2011.
- 2 Unless the context otherwise requires, words and expressions defined in the BPS, which is a document prepared by NGET pursuant to Paragraph 5 of Condition 16 of its Transmission Licence, have the same meanings in this report as in that statement. During the Year the BPS has been updated with the versions applicable being as follows:
 - Version 10.0 dated 1 April 2011; and
 - Version 11.0 dated 1 April 2013.

Respective responsibilities of NGET and Balancing Principles Statement Auditor

- 3 NGET is responsible for taking all reasonable steps to ensure its compliance with the BPS, in respect of its use of Balancing Services. It is our responsibility, within the Terms of Reference, to review on a sample basis, the compliance of NGET with the BPS in respect of the use of Balancing Services. This work is performed with a view to expressing an independent opinion as to whether any non-compliances with the BPS, which in aggregate we consider material, have come to our attention which would make us believe that NGET has not complied with the BPS, in respect of Balancing Services.

Basis of review and scope of work

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- 4 We have performed the engagement in line with the requirements of the International Standard on Assurance Engagement 3000, which provides guidance on ‘Assurance engagements other than audits or reviews of historical financial information’.
- 5 We have planned and performed our review in accordance with our review approach dated 20 September 2013, which we have agreed with NGET and which is set out in our document “Supplement to the Balancing Principles Statement report for the year ended 30 September 2013” (“the Supplement”) which we have sent to both NGET and the Office of Gas and Electricity Markets (“Ofgem”).
- 6 The Supplement provides a detailed description of the approach we have adopted to the review. In particular, it describes those aspects of Balancing Services that we have examined during our review and those which are outside the scope of this review. Our review included an examination, on a test basis, of both the Balancing Services procured and used by NGET, and of the estimates and judgements made by NGET in using Balancing Services. This report should be read in conjunction with the Supplement.
- 7 In reaching our conclusion we assessed the risk of a material breach of the way NGET has used Balancing Services compared with the requirements of the BPS, whether caused by fraud or other irregularity or error, and determined the adequacy of procedures and controls established by NGET to eliminate or reduce such risks.

Conclusion

- 8 Based on our review, nothing has come to our attention that causes us to believe that, for the Year, NGET did not in all material respects procure and use the various aspects of Balancing Services covered by this review as described in the Supplement in accordance with the BPS.

Use of this report

- 9 This report is intended solely for the use of the Directors of NGET and Ofgem. While we acknowledge that this report will be published on the NGET website, this is for information purposes only and we do not intend that it should be relied upon by anyone other than the parties mentioned above.
- 10 The maintenance and integrity of that website is the responsibility of the Directors of NGET. The work that we carried out does not involve consideration of the maintenance and integrity of that website and, accordingly, we accept no responsibility for any changes that may have occurred to this report since it was initially presented on the website.
- 11 This report has been prepared in the expectation that NGET and Ofgem will have sufficient experience of Balancing Services to understand the scope of our review without further background explanation.

Yours faithfully

David Gandee
PricewaterhouseCoopers LLP, Reading
Chartered Accountants and Registered Auditors