5 History, activities and financial performance of NIE

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Origin and structure

5.1. This chapter deals with the financial structure and performance of NIE, provides a commentary on NIE's results since the year ended 31 March 1992 for its various activities and makes a comparison of NIE's performance with expectations at the time of its flotation in June 1993. As discussed in Chapter 3, NIE was established in its present form in 1992[1] as part of the restructuring of the electricity supply industry in Northern Ireland. Until then the public electricity authority (see paragraph 3.13) was fully integrated vertically, embracing all activities from generation to the sale of electricity to end-users and the retailing of electrical appliances. On 1 April 1992 the power station assets and liabilities were separated off and the rest of the operations were vested in a new public limited company, NIE, which also assumed a new activity of power procurement (see paragraph 3.24).

5.2. NIE remained in state ownership until June 1993 when the company was floated on the London Stock Exchange. To this end, it issued a prospectus on 3 June 1993 offering for sale 164.6 million ordinary shares of 25p each (76 per cent of its authorized share capital), which at the offer price had a total value of £362 million. The offer price was 220p, of which 100p was to be payable at flotation (21 June 1993) and the balance of 120p on 28 June 1994. The vendor, the DED, acted on behalf of the Government.

5.3. The DED holds a special share of £1 in NIE which gives it the right to attend and speak at NIE's annual general meetings and certain class rights conferring a veto on certain changes to NIE's Articles of Association, notably the Article preventing a person-or persons acting together in concert-from having an interest of 15 per cent or more in NIE's voting capital.

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[1]NIE's accounts for the year ended 31 March 1992 included all its activities prior to reorganization; in particular they included generation as well as transmission, distribution, supply and retailing. Accordingly, in some of the tables shown in this chapter, information for 1992 is not comparable with later years.

5.4. The company has three principal businesses-the PPB, T&D and Supply-and a number of smaller activities, the most significant of which is appliance retailing. The contributions of these various activities to NIE's turnover and HCA operating profits in the year ended 31 March 1996, the most recent completed financial year, are shown in Table 5.1.

TABLE 5.1 **NIE: breakdown of turnover and operating profits in 1995/96**

	Turnover £m	*Percentage of turnover*	*Operating profit £m*
PPB	301	57	9
T&D	166	32	81
Supply	497	95	13
Intra-business sales	(463)	(89)	-
Total regulated turnover	501	95	103
Appliance retailing	26	5	-
Other	24	5	3
Inter-business sales	(26)	(5)	-
Total for the group	525	100	106

Source: NIE published accounts.

5.5. On 31 March 1996 NIE had some 238,000 shareholders, of which 224,000 owned up to 500 shares each (together accounting for 36 per cent of issued capital), 14,000 owned between 501 and 10,000 shares (14 per cent of issued capital), 207 owned between 10,001 and 49,999 shares (3 per cent of issued capital) and 189 owned holdings of 50,000 shares or more (47 per cent of issued capital). On that date the only shareholder holding more than 3 per cent of NIE's capital was the DED with a holding of 3.68 per cent. This holding was sold in December 1996, but the DED retained its £1 special share.

5.6. In July 1996 the DG published price control proposals for NIE's regulated businesses, viz the PPB, T&D and Supply covering the five years from 1997/98 to 2001/02 (the four years 1997/98 to 2000/01 in the case of Supply). NIE accepted the proposals for the PPB but rejected those for T&D and Supply. The reference to the MMC was made by the DG on 18 September 1996 under Article 15 of the Electricity Order and these matters have therefore come to the MMC for investigation. The restrictions on T&D charges are set out in Schedule 4 to NIE's licence, and those on Supply charges in Schedule 6. Under the Order the DG is able to change provisions of NIE's licence with the agreement of the company or, if the company disagrees, following a reference to the MMC.

5.7. The following sections describe the individual businesses in turn and summarize their financial results. We then look at the financial performance of the group as a whole.

The Power Procurement Business

5.8. The PPB derives its revenues from sales of electricity to relevant suppliers at the Bulk Supply Tariff. Out of these revenues it must pay to the generators the availability and energy payments and other amounts payable under the PPAs (see Chapter 3), and amounts due to the ESB for the usage of and energy derived from the Northern Ireland/Republic of Ireland interconnector. If the Scottish interconnector is built, the PPB will in future years also have to pay for electricity supplied through that interconnector and charges for its use (see paragraph 5.43). It also seeks to recover, via the Bulk Supply Tariff, its own costs of operating this business. NIE is also permitted to recover landbank costs (see paragraph 5.45).

5.9. NIE is obliged by the DED under Article 35 of the Electricity Order to have available certain amounts of generation capacity from plant using renewable sources of energy. NIE is permitted by the DG to pass on these costs to its customers through the Bulk Supply Tariff, obviating the need for a special tariff charge to cover these non-fossil fuel costs.

5.10. The performance of the PPB since 1992 is shown in Table 5.2.

TABLE 5.2 **PPB financial performance, 1992/93 to 1995/96***

				£ million
	Years ended 31 March			
	1992/93	*1993/94*	*1994/95*	*1995/96*
Turnover	249	271	282	301
HCA operating profit (before exceptional costs)	3	3	6	9
HCA net assets at year end	5	5	9	11
CCA operating profit (before exceptional costs)	2	4	6	9
CCA net assets at year end	5	5	9	11
				per cent
Performance indicators†				
HCA operating profit as percentage of turnover	1	1	2	3
HCA operating profit as percentage of HCA average net assets	94	69	90	90
CCA operating profit as percentage of turnover	0.4	1	2	3
CCA operating profit as percentage of CCA average net assets	‡	71	84	87

Source: NIE published and regulatory accounts.

*A summary of NIE's performance for all its activities is shown in Table 5.11.
†The percentages are calculated on actual results, rather than the rounded figures shown in the table.
‡Information is not available.

5.11. Annual turnover increased in the four years to 1995/96 from £249 million to £301 million (21 per cent), during which time HCA profits increased from £3 million in 1992/93 to £9 million in 1995/96. In 1995/96 the HCA and CCA operating profits were only 3 per cent of turnover, but some 90 per cent of HCA or CCA net assets.

5.12. Table 5.3 shows NIE's costs for the two years to March 1996 under the PPAs. Total power station costs for 1995/96 were £290 million, of which availability costs from the four power stations accounted for 54 per cent. Availability costs have turned out higher than expected because a lower availability was assumed for the power stations when the PPAs were drawn up in 1992.

TABLE 5.3 **PPB electricity costs for 1994/95 and 1995/96 (at 1996/97 prices)**

	Years ended 31 March		*Percentage breakdown for 1995/96*
	1994/95	*1995/96*	
	£m	*£m*	*%*
Availability payments to power stations			
Kilroot	54	54	35
Ballylumford	51	54	35
Belfast West	32	32	20
Coolkeeragh	16	16	10
	153	156	100
Energy payments			
Kilroot	40	44	33
Ballylumford	70	64	48
Belfast West	19	22	16
Coolkeeragh	5	4	3
	134	134	100
Total electricity costs	287	290	
	%	*%*	
Percentage due to availability	53	54	
Percentage due to energy costs	47	46	
	100	100	

Source: NIE.

5.13. NIE's income in 1995/96 from the Bulk Supply Tariff, the level of which largely reflects NIE's payments under the PPAs, amounted to £293 million, 56 per cent of NIE's total income.

5.14. Because the DG's proposals for the PPB were accepted by NIE, we have not investigated this business as part of our inquiry.

The Transmission & Distribution Business

5.15. The T&D Business comprises the planning, development, construction, operation and maintenance of the T&D network, which is used to transmit and distribute electricity from the power stations to the customers' premises. NIE's Supply Business, second-tier suppliers authorized by the DG and relevant exempt self-suppliers (that is, customers with average demand greater than 1 MW who purchase directly from the PPB) pay at the appropriate Use of System tariff for the use of the T&D network.

5.16. In managing the T&D Business, NIE seeks to optimize the return on its investment in the network whilst complying with its licence obligations. In particular, its obligations include:

- duties to develop and maintain an efficient, co-ordinated and economical system;
- the requirement to plan, develop, operate and maintain the T&D network in accordance with the standards drawn up by NIE and approved by the DG;
- the requirement to report to the DG on system performance and security in relation to availability and quality of service;
- compliance with the Grid Code relating to operation of the T&D system covering both day-to-day operations and technical aspects; and
- other health, safety and environmental issues.

Charges to customers

5.17. NIE is required to offer terms for connection to the network to any person who requests them, and to offer terms for Use of System to any authorized electricity operator. NIE has standard terms and conditions which cover Use of System charges, connection charges (which are excluded from the T&D price control) and other excluded services (see paragraph 5.19). Use of System charges arise in relation to the transmission and distribution of electricity and are subject to a price control formula determined by the DG, as described in Chapter 4. NIE is required to publish annually its Use of System charges following approval by the DG.

5.18. The bulk of the T&D Business's revenues are derived from Use of System charges. These charges are intended to reflect the costs of providing, operating and maintaining the T&D network. The charges are paid by any person taking a supply of electricity through the T&D network and are calculated by reference to the units distributed and the characteristics of the supply (such as the voltage of the connection to the network, the characteristics of the load and the metering requirements). The charges also reflect electrical flows on the network and the need to provide adequate capacity at all voltage levels to protect network security. For 1995/96 the T&D turnover represented 32 per cent of NIE's total turnover.

Excluded services

5.19. Some services provided by the T&D Business are excluded from the T&D price control formula. They include the following:

- connection charges;
- rechargeable work (for example, network alterations carried out for customers at their request and recoverable repairs arising from third party damage to NIE plant and equipment);
- the provision of special meters required by customers beyond the normal provision; and

- other special services provided at the request of customers.

5.20. NIE has an obligation to ensure that connection charges are set at a level which will ensure that an appropriate proportion of costs incurred is recovered and a reasonable rate of return on the capital assets employed in providing connections is earned. Historically NIE's policy, approved by the DG, has been to charge customers 60 per cent of the cost of connection and to recover the remainder through Use of System charges. For sites of 12 dwellings or more, a standard connection charge of £257 per dwelling applies which NIE estimates is only 30 per cent of the cost of connection. NIE has expressed concern to the DG that a lack of clarity over the allocation between T&D network assets and connection assets results in charges under the present policy that are not cost-reflective and can expose NIE to significant risks. NIE requested that the DG change the basis for connection charges but the DG decided not to deal with this matter in the price control proposals which he published in July 1996. NIE asked the MMC to take account of this matter in the present inquiry.

5.21. The financial performance of the T&D Business is shown in Table 5.4.

TABLE 5.4 **T&D Business financial performance, 1992/93 to 1995/96***

				£ million
		Years ended 31 March		
	1992/93	*1993/94*	*1994/95*	*1995/96*
Turnover	147	153	163	166
HCA operating profit (before exceptional costs)	58	66	78	81
HCA net assets at year end	214	214	256	293
CCA operating profit (before exceptional costs)	37	44	55	59
CCA net assets at year end	397	394	421	448
				per cent
Performance indicators				
HCA operating profit as percentage of turnover	40	43	48	49
HCA operating profit as percentage of HCA average net assets	29	31	33	30
CCA operating profit as percentage of turnover	25	29	34	36
CCA operating profit as percentage of CCA average net assets	9†	11	13	14

Source: NIE published and regulatory accounts.

*A summary of NIE's performance for all its activities is shown in Table 5.11.
†The 1993 figure is based on the closing CCA net assets value.

5.22. Over the four years to March 1996 annual turnover grew from £147 million to £166 million (a 13 per cent increase) and the HCA return on turnover increased from 40 per cent in 1992/93 to 49 per cent in 1995/96 (this compares with an increase in the CCA return from 25 to 36 per cent). The HCA return on net assets remained in the region of 30 per cent but the CCA return on net assets rose from 9 per cent in 1992/93 to 14 per cent in 1995/96. At March 1996 the CCA net assets, at £448 million, were 53 per cent higher than the HCA net asset value. This compares with an equivalent difference of 86 per cent at March 1993.

The Supply Business

5.23. The Supply Business acquires electricity from the PPB and uses the T&D network in order to supply customers. Supply Business costs of sales consist of Bulk Supply Tariff and Use of System charges. Revenues arise from sales of electricity to domestic, commercial, industrial and other customers.

5.24. Under its licence NIE is obliged to offer a tariff to customers whose maximum demand does not exceed 1 MW. Those customers with demand in excess of 1 MW are obliged to take electricity under contract, although with the agreement of NIE any customer can become a contract customer. NIE has a wide range of tariffs which reflect the variety of its customers' requirements. However, NIE is required to fix its tariffs so that the price payable by customers taking a comparable supply is the same, irrespective of their geographical location within Northern Ireland.

5.25. Most tariffs fall into two broad categories:

- quarterly tariffs, which apply to most domestic, small commercial and industrial customers and comprise a standing charge and one or more unit (kWh) rates; and

- monthly tariffs, which are available to NIE's larger commercial and industrial customers and are related to the type of demand profile they require, for example based on seasonal or daily demand factors.

5.26. In the year ended 31 March 1996 approximately 99.4 per cent of NIE's customers were sent quarterly accounts. Such customers accounted for 56 per cent of the units consumed and 65 per cent of NIE's turnover from sales of electricity. The remainder, 4,198 customers, were sent monthly accounts. Bills for unmetered supplies such as street lighting, traffic lights and other installations are based on an assessment of the electricity consumption of the equipment in use.

5.27. NIE has various mechanisms in place to ensure prompt settlement of bills, for example monthly and weekly payment schemes, saving stamps (now discontinued) and card-operated prepayment meters. At 31 March 1996 approximately 48 per cent of the 575,000 domestic customers were on payment schemes such as direct debit (65,000), prepayment Powercards (84,000), easy-saver schemes (98,000) or budget payment (20,000). The operation of the prepayment Powercard scheme has enabled NIE to reduce disconnections because customers to whom Powercards are issued (including delinquent debtors) can only maintain their supply of electricity by purchasing units for the Powercards. The cost of units purchased includes, where relevant, an element for the payment of past debts. NIE has operated a zero disconnection policy since October 1996. NIE told us that while these mechanisms would substantially reduce the incidence of bad debts, it was not practicable to eliminate this problem completely.

5.28. The financial performance of the Supply Business since 1992 is shown in Table 5.5.

TABLE 5.5 **Supply Business financial performance, 1992/93 to 1995/96***

£ million

	Years ended 31 March			
	1992/93	*1993/94*	*1994/95*	*1995/96*
Turnover	421	452	473	497
Bulk Supply Tariff, Use of System and other costs of sales	(389)	(418)	(438)	(461)
Net Supply turnover	32	34	35	36
HCA operating profit (before exceptional costs)	9	10	11	13
HCA net assets at year end	26	26	28	29
CCA operating profit (before exceptional costs)	5	12	5‡	16
CCA net assets at year end	26	26	28	29
				per cent
Performance indicators				
HCA operating profit as percentage of turnover	2.1	2.2	2.3	2.6
HCA operating profit as percentage of net Supply turnover	28	29	31	36
HCA operating profit as percentage of HCA average net assets	34‡	38	40	45
CCA operating profit as percentage of turnover	1.2	2.7	1.1	3.2
CCA operating profit as percentage of net Supply turnover	15	35	14†	44
CCA operating profit as percentage of CCA average net assets	20‡	47	19	56

Source: NIE published and regulatory accounts.

*A summary of NIE's performance for all its activities is shown in Table 5.11.

†The reduction in CCA profits for 1995 is due to a £5.7 million MWCA charge, which is the main difference between the HCA and CCA profits.

‡The 1993 figure is based on the closing HCA or CCA net assets value, as appropriate.

5.29. The turnover of the Supply Business increased from £421 million in 1992/93 to £497 million in 1995/96 (an 18 per cent increase). The bulk of the Supply Business turnover reflects the pass-through of Bulk Supply Tariff and Use of System costs. After deduction of these costs of sale, net Supply turnover increased from £32 million to £36 million (13 per cent) over the same period. This net turnover has to cover the Supply Business costs and produce a return. The HCA profit in the Supply Business rose from 28 per cent of net supply turnover in 1992/93 to 36 per cent in 1995/96.

5.30. The HCA operating profit as a percentage of HCA net assets rose from 34 per cent in 1992/93 to 45 per cent in 1995/96, compared with a CCA equivalent rise from 20 to 56 per cent. The large variation between the HCA and CCA operating profits is due mainly to MWCA, which in some years were a credit to profits.

5.31. The HCA and CCA net assets of the Supply Business were relatively stable over the four years to March 1996, rising from £26 million to £29 million. The Supply Business has minimal fixed assets (£200,000). Its main asset comprises customer debtors, which at March 1996 totalled £100 million.

5.32. The DG's published proposals for the Supply Business price controls involved giving the Supply Business a profit allowance equal to 0.5 per cent of turnover. However, for this purpose the DG reduced the base turnover by 20 per cent of the Bulk Supply Tariff because in his view the generation cost base in Northern Ireland was too high. The DG said that his decision on the 0.5 per cent profit allowance accorded with the decision of the MMC in the SHE inquiry and would give NIE profits of some £2 million a year in 1996/97 prices.

Appliance retailing

5.33. NIE's Retail Business operates a chain of 34 stores under the ShopElectric name. The stores sell a broad range of electrical goods and also act as an important point of contact for NIE's domestic and smaller commercial customers.

5.34. The stores are connected to NIE's customer database and provide a range of services for the Supply Business. For instance, bills may be paid at the stores and applications for new supplies can be made and processed in them. NIE told us that the shops were initially established and located for the convenience of customers for paying bills, making enquiries, agreeing payment methods and obtaining advice. Appliance retailing was added later to this service base. NIE said that the shops continued to provide face-to-face service which was very much in demand by customers in Northern Ireland, and that this was demonstrated by the fact that 40 per cent of customers continued to pay their electricity bills through the shops despite the availability of other payment mechanisms. NIE commented that a number of RECs which moved out of the retail business were obliged to continue to provide these services and had opened supply service shops.

5.35. NIE supports its appliance retailing with a servicing and repair facility for electrical appliances and with appliance delivery and connection services. It does this by its in-house ShopElectric Services department and a number of outside contractors. ShopElectric also provides extended warranty schemes.

5.36. NIE is one of the main retailers of electrical goods in Northern Ireland. It has traditionally concentrated on white goods-such as cookers, washing machines and refrigerators-and consumer electronic products. Its main competitors include Currys, Dixons and a number of local independent retailers.

5.37. In the five years to March 1996 the Retail Business's annual turnover was fairly stable at approximately £25 million. In 1992/93 the business made an operating loss of £1 million (before exceptional costs of a further £4 million). Since then the business has been close to break-even (see Table 5.11). The Retail Business is not subject to price regulation.

Other activities

5.38. NIE has various profit centres which it has established over the last six years from pre-existing departments in order that they would improve standards of service, show greater commercial awareness and accountability, and avoid having their costs apportioned over the core businesses on an arbitrary basis. These activities are not regulated but the majority of their sales are internal to NIE so that their charges are largely part of the cost base of the T&D and Supply Businesses which must be recovered via regulated charges. NIE told us that the profit centres had been, and continued to be, market tested to ensure competitive pricing.

5.39. The activities of the profit centres are as follows:

- *Telecommunications*. This centre provides a wide range of communications services for the various businesses within NIE. The services make use of both public and private telecommunications networks and the tariff structure for the services depends upon the type of service, for example stand-alone or global shared resource. [*Details omitted. See note on page iv.*]

- *Information systems*. This centre provides information technology services to NIE, for example project management, software procurement and development, systems integration, operation of hardware, and software support. [*Details omitted. See note on page iv.*]

- *Training and conferences*. This centre is responsible for implementation of NIE's training policy and also offers conference and accommodation services. NIE told us that the centre provided services to a number of outside organizations as well as to its own businesses. [*Details omitted. See note on page iv.*]

- *Transport*. This centre provides cars, commercial vehicles and mobile plant for use throughout NIE, together with fleet management, repairs and servicing, and transport advice. [*Details omitted. See note on page iv.*]

- *Civil projects*. This centre provides civil engineering, architecture and quantity surveying services to extend and maintain the property portfolio and the T&D network infrastructure and to manage NIE's environmental responsibilities. *Details omitted. See note on page iv.*]

- *Culcavy*. This centre provides a warehousing, storage and delivery system for engineering materials to meet the needs of NIE's capital and maintenance programmes, together with the warehousing of electrical appliances for the Retail Business. [*Details omitted. See note on page iv.*]

5.40. NIE also has small activities, within separate Landbank and Interconnector Businesses, that produced £1.5 million turnover, principally internally, in the year to March 1996.

5.41. NIE had a small international operation to provide technical assistance to electricity utilities overseas. It supplied personnel and expertise in a range of specialist areas. For the year to March 1996 its turnover was £0.6 million, it made a loss of £0.1 million and its net assets were £0.4 million. This activity has now been discontinued.

5.42. The turnover from the activities described in paragraphs 5.38 to 5.41 plus miscellaneous corporate income rose from £7 million in 1992/93 to £24 million in 1995/96. Aggregate profits were around £3 million in each year except in 1994/95 when the result was break-even (see Table 5.11).

The Scottish interconnector

5.43. NIE and ScottishPower plan to build a 250 MW interconnector between Northern Ireland and Scotland which would be connected to their respective transmission systems. This project was formally adopted as a major infrastructure project for Northern Ireland in 1991. The total capital costs, which would be borne by NIE, are currently estimated at a net figure of £140 million after an EC grant of some £71 million at out-turn prices.[1] There are two agreements with ScottishPower, covering transmission and supply. Under the supply agreement ScottishPower would supply electricity to NIE for a period of at least 15 years from the commissioning of the interconnector at prices based on England and Wales Pool prices. Paragraph 3.31 refers to NIE's expected usage of the interconnector and NIE's commitments thereon.

5.44. The transmission agreement contains a number of limits on the parties' liabilities to each other in the event of breach. NIE's liability to ScottishPower for any breach arising prior to commissioning is subject to a maximum liability of £37 million, at December 1992 prices indexed against the RPI, plus the reimbursement of ScottishPower's costs in respect of legitimate planning and preparation costs. The agreement contemplates that NIE and ScottishPower will enter into further agreements concerning the detailed arrangements for operation of the interconnector. NIE can, however, withdraw from the project without breach, first, where NIE or ScottishPower fail to obtain any of the necessary planning consents, and secondly, if, up to the date of commencement, there is a forecast cost overrun of over 10 per cent of the original project cost estimate. None of the circumstances which would enable NIE to withdraw from the project has occurred to date.

Landbank

5.45. NIE is required by the DG to maintain a landbank of property to safeguard the supply of electricity in Northern Ireland. This landbank covers the existing power stations and certain other sites held by NIE. The four existing power stations are leased at a nominal rent under long leases to their private owners. Landbank properties may be made available to generators proposing to build new generation capacity on such terms as

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[1]The grant has been set by the European Commission under the Northern Ireland Single Programme 1994-99 at 35 per cent of the project expenditure up to a maximum of £175 million at December 1992 prices.

the DG directs. On termination of a lease to a generator the Landbank Business may incur liabilities due to contamination of the sites. NIE is permitted to pass on all landbank costs to the PPB and its transmission licence requires that NIE should neither suffer a loss nor achieve a profit through carrying out this activity.

Management and employees

5.46. On 31 March 1996 NIE's Board consisted of nine persons, as noted at Appendix 5.1. The four executive directors were:

Dr Patrick Haren	-	Chief Executive
Mr Gordon Woodworth	-	Group Finance Director, who stepped down from the Board in December 1996 and was succeeded by Mr Nigel Wilson
Mr Walter McClay	-	Supply Director
Mr Harry McCracken	-	Operations Director

From 6 December 1996 Mr McClay also stepped down as Supply Director. The Supply Director's duties have been absorbed jointly by the Operations and Finance Directors. The Executive Board is now made up of Dr Patrick Haren-Chief Executive, Mr Nigel Wilson-Finance Director and Mr Harry McCracken-Operations Director.

5.47. The Chairman of NIE is Mr David Jefferies who is also Chairman of NGG. At 31 March 1996 NIE had five non-executive directors, but there are now four, following the stepping down of one member at NIE's 1996 annual general meeting. There are five Board Committees, as shown in Appendix 5.1.

5.48. The Board meets not less than ten times a year. Specific matters dealt with include group strategy, major investment decisions and the award of significant contracts. The Board also has a special responsibility for identifying risks, and powers are delegated to committees which monitor and report regularly to the Executive Committee and Board on various risks. These operational risks committees include Fuel and Foreign Exchange Risk Management, Information Technology and Safety. The foreign exchange risk issue is discussed in paragraph 5.67.

5.49. NIE has a comprehensive system of planning and budgeting with the annual budget approved by the Board. Performance against budget is monitored through monthly finance reports. NIE has a policies and procedures manual, operational and financial review mechanisms, control certificates and an independent internal audit department.

5.50. Capital expenditure is controlled by annual capital budgets, detailed investment appraisal and review procedures, and Board-approved financial limits of authority.

5.51. The analysis of NIE's employees is shown in Table 5.6, together with a summary of NIE's staff costs since 1992. NIE's total staff costs have fallen from £83 million in the year to March 1992 to £68 million in the year ended March 1996, reflecting a substantial reduction in personnel over the four-year period. Turnover (net of PPB sales) per average employee increased from £43,600 in 1992/93 to £59,400 in 1995/96, both at out-turn prices, an increase of 36 per cent over the four years.

TABLE 5.6 **NIE: staff analysis, 1991/92 to 1995/96**

					£ million
			Years ended 31 March		
	1991/92	*1992/93*	*1993/94*	*1994/95*	*1995/96*
Total costs (including National Insurance)	83	85	80	72	68
Less costs capitalized	(20)	(19)	(19)	(18)	(17)
Net costs to profit and loss account	63	66	61	54	51
Analysis of annual average staff numbers by function:					
Managerial	46	49	46	39	36
Technical and engineering	644	604	571	527	501
Administration and sales	1,439	1,408	1,320	1,164	1,086
Industrial and apprentices	1,863	1,790	1,599	1,305	1,203
	3,992	3,851	3,536	3,035	2,826
Average total costs per staff member in year (£'000)	20.8	22.2	22.7	23.6	23.8
Full-time equivalents (FTE) at year end	*	3,751	3,061	2,740	2,570
Reduction in staff in year (FTE)	*	*	(690)	(321)	(170)
Percentage reduction in year	*	*	(18)	(10)	(6)
Turnover (less PPB sales) per average employee (£'000)	*	43.6	44.7	51.1	59.4

Source: NIE published accounts and prospectus for 1992 figures.

*Information is not available.

Financial performance of NIE

5.52. At 31 March 1993 NIE had cash balances of some £85 million. As part of the flotation process it paid a dividend of £16.5 million and repaid a debenture of £70 million, both to the DED.

5.53. The £70 million debenture was the level of debt that the Government believed it should recover for its financial support to NIE in the past. A report by the NIAO on the privatization of NIE,[1] published in October 1994, indicated that this debt was negotiated between NIE and the DED based on forecast operating costs, capital expenditure and gearing of NIE (see paragraph 5.85). The debt, bearing interest of 0.25 per cent over LIBOR, was created on 14 May 1993 by transfer from NIE's accumulated reserves and was repaid on 24 June 1993. The dividend of £16.5 million was paid on 1 June 1993, shortly before flotation.

5.54. The principal subsidiary undertakings of NIE at 31 March 1996 are shown in Appendix 5.2. Table 5.7 shows NIE's profit and loss account for the five years to 31 March 1996, based on HCA accounts and a reconciliation to the CCA accounts. Key performance indicators are also shown.

[1]Report by the Comptroller and Auditor General for Northern Ireland entitled *The Privatisation of Northern Ireland Electricity*.

TABLE 5.7 **NIE: consolidated profit and loss account, 1991/92 to 1995/96**

£ million

	Years ended 31 March				
	*1991/92**	*1992/93*	*1993/94*	*1994/95*	*1995/96*
HCA accounts					
Turnover	434	453	482	498	525
Net operating costs	†	(381)	(400)	(403)	(419)
Operating profit on ordinary activities	54	72	82	95	106
Exceptional items	(39)	(15)	(8)	(12)	0
Profit before interest	15	57	74	83	106
Net interest receivable	0	8	1	4	1
Profit on ordinary activities before taxation	15	65	75	87	107
Taxation charge	†	(15)	(14)	(20)	(20)
Profit after taxation	†	50	61	67	87
Dividends	0	(17)	(19)	(22)	(24)
Retained profit for the year	†	33	42	45	63
Performance indicators summary					
Turnover growth (%)	†	5	6	3	5
Operating profit as percentage of turnover	12	16	17	19	20
Profit before interest as percentage of turnover	3	13	15	17	20
Profit after tax growth (%)	†	†	22	10	30
HCA effective taxation rate (%)	†	23	19	23	19
Dividend cover (times)	‡	3.0	3.2	3.1	3.6
Earnings per ordinary share (p)	‡	30.3	36.7	41.0	58.8
Dividend per share (p)	‡	10.0	11.4	13.4	19.0
Dividend growth (%)	‡	‡	14	18	42
Inflation as measured by RPI annual change to year end	4.0	1.9	2.3	3.5	2.7
Employees at year end (FTE)	*	3,751	3,061	2,740	2,570
Net cash inflow from operating activities (£m)	*	98	114	96	110
CCA information					
HCA profit before interest as above	15	57	74	83	106
CCA adjustments:					
Depreciation	*	(22)	(22)	(23)	(23)
CoSA and MWCA	*	(4)	2	(5)	2
CCA profit before interest	*	31	54	55	85
CCA effective taxation rate (%)	*	38	26	33	23
CCA operating profit as percentage of turnover§	*	10	13	13	16
CCA profit before interest as percentage of turnover§	*	7	11	11	16

Source: NIE published accounts, prospectus for 1992 figures, and submission to MMC.

*The 1991/92 figures are NIE's estimates of the results of the continuing activities because the original company was reorganized prior to flotation.

†Information not available.

‡Not applicable.

§The difference between these two indicators is due to exceptional items.

5.55. Over the five years to March 1996 annual turnover increased from £434 million to £525 million, equating to an increase of 21 per cent in nominal terms. Operating profits almost doubled from £54 million to £106 million and profits after tax increased from £50 million in 1992/93 to £87 million in 1995/96. These results were achieved after the writing-off of exceptional costs, relating to reorganization and the flotation process, totalling £74 million in the four years to March 1995. In addition in 1995/96 NIE was able to buy back approximately 15 per cent of its issued shares at a cost of £98 million (see paragraph 5.65).

5.56. In the four years to March 1996 annual net cash inflows from activities ranged between £98 million and £114 million. CCA profits before interest (but after exceptional costs) increased from £31 million to £85 million, equating to an increase of 165 per cent over the four years.

5.57. HCA operating profits as a percentage of turnover increased from 16 per cent in 1992/93 to 20 per cent in 1995/96, while CCA profits increased from 10 per cent of turnover to 16 per cent over the same period.

5.58. In the four years to March 1996 HCA earnings per share almost doubled from 30p to 59p and dividends per share increased from 10p to 19p, with annual dividend growth varying between 14 and 42 per cent and averaging 25 per cent.

5.59. Table 5.8 shows NIE's balance sheet summary for the five years to 31 March 1996 based on HCA accounts and a reconciliation to the CCA accounts. Key performance indicators are also shown. Our comments on this information are noted in the subsequent paragraphs.

TABLE 5.8 **NIE: consolidated balance sheet, 1992 to 1996**

£ million

	As at 31 March				
	*1992**	*1993*	*1994*	*1995*	*1996*
HCA accounts					
Tangible fixed assets†	310	344	365	401	443
Stock and debtors less creditors (excluding borrowings)	88	57	22	10	29
Net operating assets	398	401	387	411	472
Cash less borrowings	30	86	61	82	(18)
Dividends payable	0	(17)	(13)	(16)	(20)
Deferred income and grants	(79)	(85)	(90)	(96)	(99)
Provisions	(48)	(59)	(47)	(38)	(27)
Net assets	301	326	298‡	343	308§
Financed by					
Share capital and reserves (equity)	301	326	298	343	308
Performance indicators summary					
HCA operating profit as percentage of HCA average net assets	18¶	23	26	30	33
HCA debt to equity multiple	¤	¤	¤	¤	0.06
HCA post-tax profit as percentage of equity	¤	15	20	20	28
HCA net assets per share (p)	¤	¤	181	209	220
Share price (p at year end)**	¤	¤	385	328	418
Market capitalization at year end (£m)	¤	¤	634	540	583
CCA information (£m)					
HCA net assets as above	301	326	298	343	308
Increase in valuation of fixed assets†	251	238	217	239	219
Change in values of other net assets	(54)	(54)	(54)	(56)	(57)
CCA net assets	498	510	461	526	470
CCA net operating assets††	649	639	604	650	691
Performance indicators summary					
HCA operating profit as percentage of HCA average net operating assets	14¶	18	21	24	24
CCA operating profit as percentage of CCA average net operating assets††	¤	7	10	11	13

Source: NIE published accounts and *Financial Times*.

*The 1992 figures are NIE's estimates of the results of the continuing activities because the original company was reorganized prior to flotation in June 1993.

†Table 5.14 shows movements of HCA and CCA tangible fixed assets.

‡In June 1993 NIE repaid a debenture of £70 million to the DED. Hence its net asset value fell between 31 March 1993 and 31 March 1994.

§In 1995/96 NIE purchased approximately 15 per cent of its share capital, with a book value of £6 million, for £98 million. Hence its net asset value fell between 31 March 1995 and 1996.

¶For 1992, the closing net operating assets and net assets are used instead of averages.

¤Information is not applicable or not available.

**For 1994, the share price shown is adjusted to take account of share capital changes arising from partly-paid shares becoming fully paid. The actual share price based on partly-paid shares issued at the time was 265p. Based on this value the market capitalization of the partly-paid shares in issue was £436 million.

††The CCA net operating assets equals HCA net operating assets plus the CCA increase in the valuation of fixed assets. The CCA adjustments to other net assets are disregarded in calculating this figure.

5.60. HCA net operating assets increased from £398 million to £472 million over the four years to March 1996, whilst the equivalent CCA net operating assets rose from £649 million to £691 million. The reason for the difference between the CCA and HCA figures is the revaluation adjustment to fixed assets to arrive at their CCA valuations, which ranged between £217 million and £251 million over the five years.

5.61. HCA net assets increased from £301 million at March 1992 to £308 million at March 1996. However, over the five-year period NIE absorbed the creation of the debenture of £70 million and its subsequent repayment to the DED in 1993 (see paragraph 5.53) and the share buy-back, which cost £98 million in 1995 (see paragraph 5.65). These factors reduced the increase in net assets that otherwise would have arisen.

5.62. The return based on comparing HCA operating profits with HCA average net operating assets increased over the five years from 14 to 24 per cent. CCA operating profits as a percentage of CCA average net operating assets increased in the four years to 1996 from 7 to 13 per cent.

5.63. NIE shows in its balance sheet deferred income and grants, which at March 1996 totalled £99 million (HCA). NIE's accounting policy is to credit such contributions received to a deferred income account and transfer sums to the profit and loss account based on usage of the assets to which they relate. Such credits to the profit and loss account partly offset the depreciation charges. Table 5.9 shows a summary of deferred income movements for the four years to March 1996. NIE received on average £9 million a year in these forms of income.

TABLE 5.9 **Deferred income movements for NIE, 1992/93 to 1995/96**

£ million

	Years ended 31 March			
	1992/93	*1993/94*	*1994/95*	*1995/96*
Brought forward	79	85	90	96
Receivable in year	9	9	9	7
Credited to profit and loss account	(3)	(4)	(3)	(4)
Carried forward	85	90	96	99

Source: NIE.

5.64. Over the four years to March 1995 NIE was able to fund its activities from cash flows; consequently it had minimal borrowings and was almost totally ungeared. In Table 5.14 we compare the annual depreciation charge (excluding deferred income) with asset additions on an HCA and CCA basis. In 1995/96 depreciation represented 35 per cent of asset additions on an HCA basis and 76 per cent on a CCA basis.

5.65. At 31 March 1995 NIE had in place a £180 million revolving credit facility with a syndicate of banks which had been put in place in April 1993 as part of the flotation process. In June 1995 the future needs of NIE were assessed and a new five-year facility for £100 million was negotiated. Some of this facility was called upon in 1995/96 when NIE purchased approximately 15 per cent of its share capital for £98 million. At 31 March 1996 net debt was £18 million. The shares were purchased for £3.97 a share, which equated to an 80 per cent increase over the nominal flotation price of 220p. Shareholder approval was granted at the preceding annual general meeting to buy up to 14.9 per cent of NIE's share capital. [
Details omitted. See note on page iv.
]

5.66. At March 1996 NIE's net debt of £18 million gave rise to a debt-to-equity multiple of 0.06, a level of debt that is very low for the sector. Table 5.10 shows debt and other key data for other companies in the energy sector.

TABLE 5.10 **Comparative financial ratios for companies in the energy sector**

Company	*Year end**	*Debt £m*	*Equity £m*	*Debt-to-equity multiple*	*Market capitalization† £m*	*P/E ratio†*	*Dividend cover†‡*	*Gross yield†*
British Gas	Dec '95	2,924	7,462	0.4	9,624	27.8	0.5	8.3
East Midlands Electricity	Mar '96	231	391	0.6	1,209	10.1	0.2	6.5
Eastern	Mar '95	298	832	0.4	§	§	§	§
ESB	Dec '95	797	676	1.2	§	§	§	§
London Electricity	Mar '96	264	500	0.5	1,148	9.3	0.2	7.3
Manweb	Mar '95	46	548	0.1	§	§	§	§
Midlands Electricity	Mar '96	226	501	0.5	6§	§	§	§
NGG	Mar '96	1,255	1,102	1.1	3,245	7.6	0.2	7.3
National Power	Mar '96	381	2,666	0.1	5,437	8.5	0.4	6.6
NORWEB	Mar '95	173	592	0.3	§	§	§	§
Northern	Mar '96	205	276	0.7	602	5.4	0.4	8.8
PowerGen	Mar '96	334	2,252	0.1	3,869	6.7	3.9	4.8
SHE	Mar '96	198	866	0.2	1,219	8.1	2.5	6.3
ScottishPower	Mar '96	632	1,208	0.5	3,959	10.3	2.0	5.7
SWALEC	Mar '95	39	377	0.1*	§	§	§	§
SWEB	Mar '95	62	494	0.1*	§	§	§	§
Southern	Mar '96	52	839	0.1	1,865	8.4	0.4	7.6
Seeboard	Mar '95	N/A	561	N/A	§	*	§	§
Yorkshire	Mar '96	226	521	0.4	1,215	9.3	0.3	6.4
NIE	**Mar '96**	**18**	**308**	**0.06**	**508**	**6.2**	**3.1**	**6.6**

Source: MMC based on FT Extel database and *Financial Times* at 3 December 1996.

*Where the company data are shown for 1995, it means that the company was taken over (or reorganized in the case of British Gas) and this is the last year of data available.

†This information is at 3 December 1996.

‡The dividend cover is very low for some companies because they paid large special dividends.

§Information not available (due to, for example, take-over).

5.67. A major financial commitment for NIE relates to its payments to the independent generators for fuel and availability under the PPAs. The fuel payments depend on international fuel price indices and sterling/US dollar exchange rates. NIE aims to minimize short-term volatility arising from this exposure by the use of hedging strategies pursued under the control of the Fuel and Foreign Exchange Risk Management Committee. Although NIE can pass on such costs through the Bulk Supply Tariff, it told us that it believed the hedging strategy was sound management practice and contributed to the fulfilment of its economic purchasing obligation.

5.68. NIE has a potential deferred tax liability which it has not provided in its accounts. At March 1993 the potential liability was £45 million and by March 1996 it had increased to £69 million.

5.69. NIE's performance analysed for its main activities is shown in Table 5.11.

TABLE 5.11 **NIE: analysis of turnover and operating profits, 1991/92 to 1995/96**

£ million

	Years ended 31 March				
	1991/92	*1992/93*	*1993/94*	*1994/95*	*1995/96*
Analysis of turnover					
PPB	*	249	271	282	301
T&D	*	147	153	163	166
Supply	*	421	452	473	497
Inter-business sales	*	(397)	(440)	(467)	(489)
Total regulated turnover†	407	420	436	451	475
Appliance retailing	25	26	26	24	26
Other	2	7	20	23	24
Total turnover per Table 5.7	434	453	482	498	525
Analysis of HCA operating profit					
PPB	*	3	3	6	9
T&D	*	58	66	78	81
Supply	*	9	10	11	13
Total regulated profit†	53	70	79	95	103
Appliance retailing	1	(1)	1	(1)	-
Other	-	3	2	1	3
Total profit per Table 5.7	54	72	82	95	106
					per cent
Operating profit as percentage of turnover					
PPB	*	1	1	2	3
T&D	*	40	43	48	49
Supply‡	*	2.1	2.2	2.3	2.6
Supply (net of PPB and T&D sales)‡	*	35	36	41	43
Total electricity activities	13	17	18	21	22
Appliance retailing	4	(4)	2	(3)	1
Other	-	43	13	2	12
Total for all activities	12	16	17	19	20

Source: NIE published accounts.

*Information is not available.

†Regulation took effect from 1 April 1992.

‡The Supply profit is shown as a percentage of Supply turnover both gross and net of T&D and PPB sales. Most of the inter-business sales relate to the pass-through of charges from the PPB and the T&D Business.

5.70. The annual regulated turnover increased over the five years to March 1996 from £407 million to £475 million, an increase of 17 per cent. Over this period the electricity operating profits increased from £53 million to £103 million (a 94 per cent increase). Profits from the other activities had a minimal effect on overall operating profits but accounted for up to £50 million of NIE's total turnover.

5.71. NIE's HCA net assets analysed by activities are shown in Table 5.12 for the five years to 31 March 1996.

TABLE 5.12 **NIE: analysis of net assets and profitability, 1992 to 1996**

£ million

	As at 31 March				
	1992	*1993*	*1994*	*1995*	*1996*
Analysis of HCA net assets					
PPB	2	5	5	9	11
T&D	193	214	214	256	293
Supply	61*	26	26	28	29
Total regulated†	256	245	245	293	333
Inter-business adjustments	0	(1)	(20)	(20)	(21)
Appliance retailing	20	14	20	20	20
Other‡	25	68	53	51	(24)
Net assets per Table 5.8	301	326	298	343	308
HCA operating profit as percentage of HCA average net assets§					*per cent*
PPB	¶	94	69	90	90
T&D	¶	29	31	33	30
Supply	¶	34¤	38	40	45
Total regulated† (excluding inter-business adjustments)	21	30	32	35	33
Appliance retailing	3	-5	3	-4	2
Other	3	6	4	2	**
Total (excluding inter-business adjustments)	18	23	26	30	33

Source: NIE published accounts.

*This figure shows predominantly the debtor position at 1992, but the corresponding internal creditor position was not apportioned to this business, as has been done in later years.

†Regulation took effect from 1 April 1992.

‡The change in 'other' net assets between 1995 and 1996 arises from the share buy-back totalling £98 million in 1995/96.

§The 1992 figure is based on closing net assets.

¶Information is not available.

¤This is based on the closing net assets for 1993 rather than average net assets because the corresponding figure for 1992 cannot be determined with accuracy.

**Due to the share buy-back in 1995/96 the net assets for 'other' became a negative figure. Accordingly calculation of this percentage would be meaningless.

5.72. The regulatory regime under which NIE operates can result in the under- or over-recovery of revenues in a particular year when actual recoveries are compared against the maximum permitted revenues. Where there is an over-recovery of PPB, T&D or Supply Business revenues against the regulated maximum allowable amounts, revenues are deferred equivalent to the over-recovered amounts. The deferred amount is deducted from turnover and included in provisions. Where there is an under-recovery in a business and it is matched by an over-recovery in another business, this amount is added to turnover and the provision for over-recovery reduced. Table 5.13 shows a summary of the under- and over-recoveries in NIE's PPB, T&D and Supply Businesses for the four years to 31 March 1996.

TABLE 5.13 **Summary of (over-) and under-recoveries for NIE, 1993 to 1996***

£ million

	As at 31 March			
	1993	*1994*	*1995*	*1996*
PPB	1	3	2	9
T&D	0	(1)	0	7
Supply	(6)	(12)	(2)	(9)
Total regulated	(5)	(10)	0	7

Source: NIE published accounts.

5.73. To date, NIE has been able to recover under-recoveries to which it is entitled. If competition develops in, for example, the Supply Business, this ability could be constrained in the future because increases in NIE's tariffs could lead to customers switching to alternative suppliers.

Comparison with expected performance

Performance expectations

5.74. The prospectus at the time of flotation commented on the directors' expectations for the various businesses and provided an overview for NIE as a group. Appendix 5.3 sets out relevant extracts. The main points, and a brief account of actual performance since the flotation, are set out below:

- *The PPB*. The directors did not expect the PPB to make significant profits. Although unexpected changes in fuel costs could be recovered from electricity suppliers under the Bulk Supply Tariff, the directors intended to minimize the adjustments by currency and fuel price hedging arrangements. The performance of the PPB is shown in Table 5.2, which shows that over the four years to March 1996 HCA operating profits increased from £3 million to £9 million (an increase from 1 to 3 per cent of turnover).

- *The T&D Business*. The directors stated that the large majority of NIE's profits would be earned from the T&D Business, which until the next review period in April 1997 should provide NIE with a stable and secure revenue stream. The directors commented that with only 25 per cent of revenues being permitted to increase in line with unit sales, NIE's profits from volume growth were constrained. The directors intended to reduce real unit costs through productivity and efficiency measures. In the longer term, they expected NIE's T&D Business to earn a satisfactory return on its asset base. The out-turn for the T&D Business is shown in Table 5.4. Over the four years to March 1996, annual turnover grew from £147 million to £166 million and HCA operating profits increased from £58 million to £81 million. Thus HCA profits as a percentage of turnover increased from 40 to 49 per cent, compared with the CCA equivalent which increased from 25 to 36 per cent. HCA profits as a percentage of HCA average net assets remained in the region of 30 per cent, compared with the CCA equivalent which increased from 9 to 14 per cent.

- *The Supply Business*. The directors said that they expected the profits of the Supply Business to be volatile from one year to the next, reflecting inherent uncertainty when forecasting costs and volumes. The directors commented that the Supply Business held no franchise over customers, and holders of second-tier licences were free to compete with NIE for electricity sales in all markets. Competition could result in downward pressure on margins, especially if competition was in sales of electricity to commercial and industrial customers with a maximum demand under 1 MW. The directors estimated, however, that only 6 per cent of the Supply Business's charges represented direct costs that were subject to competitive threat. To date, the Supply Business has not become subject to significant competition by the second-tier licence-holders. The results of the Supply Business for the four years to March 1996 are shown in Table 5.5. Over this period its annual HCA operating profits increased from £9 million to £13 million, representing an increase in profit as a percentage of turnover from 2.1 to 2.6 per cent. CCA operating profit over this period fluctuated between £5 million and £16 million, the main reason for the volatility being the MWCA.

- *Appliance retailing*. The directors said that they intended to improve the productivity and efficiency of the Retail Business in order to maximize its profitability. The prospectus also noted that in the six years before flotation NIE had undertaken a major shop refurbishment programme involving the implementation of a uniform design and layout. The performance of the retail shops is shown in Table 5.11 and indicates that over the four years to March 1996 the business broadly broke even on turnover of some £25 million a year.

5.75. On page 47 of the prospectus the directors set out their dividend policy. At the flotation offer price, the gross yield was expected to be 5.8 per cent. The directors said that in the absence of unforeseen circumstances they expected to increase dividends in real terms. The actual dividend performance is shown in Table 5.7.

5.76. On page 69 of the prospectus the views of the DG were disclosed, and it was reported that the DG would have regard among other things at the next price review (which we are now examining) to the actual and prospective cash flows of NIE, including any further savings achievable through greater efficiency and where appropriate any additional costs arising from changes in the environmental or wider regulatory regime. He further said that he would have regard to the rate of return which the markets would then require.

Capital expenditure forecasts

5.77. NIE commented in the prospectus that annual capital expenditure was expected to increase substantially over the five years from flotation, taking account of the costs of the Scottish interconnector which at the time had a cost estimate of £175 million before receipt of an EC grant of £61 million. The directors indicated that they expected to finance future capital expenditure from a combination of internally generated funds and increased borrowings over the decade from flotation. They said that borrowings were expected to peak towards the end of the decade and the expectation was that the Scottish interconnector would be commissioned by the end of 1997. The directors also indicated NIE's contingent liabilities relating to its obligations in respect of the landbank, principally in respect of compensation if a power station lease was terminated. Under such circumstances, NIE could have a potential obligation to finance modifications to generating equipment if the successor generator was not able to finance the work. Hence NIE could be faced with costs which it would only be able to recover, if at all, over several years.

5.78. The actual investment profile for NIE over the five years to March 1996 is shown in Table 5.14. The information shows HCA and CCA movements in assets and changes in the company's cash balances and deferred income (representing grants and contributions received on asset additions). Over the period NIE did not borrow money to finance fixed asset investments and instead accumulated cash resources of £82 million by March 1995 (prior to the share buy-back noted in paragraph 5.65). Additions in any year varied between £42 million and £67 million (averaging £55 million). Overall the HCA net book value of fixed assets increased by £133 million from £310 million at March 1992 to £443 million at March 1996 (compared with the CCA book value which increased from £561 million to £662 million over the same period).

TABLE 5.14 **NIE: investment profile, 1991/92 to 1995/96**

£ million

	Years ended 31 March				
	*1991/92**	*1992/93*	*1993/94*	*1994/95*	*1995/96*
Per HCA accounts					
Additions to tangible fixed assets	51	59	42	59	67
Adjustments		(7)			
Disposal of tangible fixed assets-book value	(0)	(0)	(0)	(0)	(2)
Depreciation on tangible fixed assets	(21)	(18)	(21)	(22)	(23)
Change in net book value of tangible fixed assets for year	30	34	21	37	42
Depreciation as a percentage of net additions	41	31	50	37	35
HCA net book value at year end	310	344	365	401	443
Cash balances less borrowings at year end	30	86	61	82	(18)
Deferred income and grants at year end	79	85	90	96	99
Per CCA accounts					
Additions to tangible fixed assets	†	53	38	51	57
Adjustments	†	4	5	44‡	5
Disposal of tangible fixed assets-book value	†	(0)	(0)	(0)	(0)
Depreciation on tangible fixed assets	†	(39)	(41)	(42)	(43)
Change in net book value of regulated fixed assets	†	18	2	53	19
Change in net book value of other fixed assets	†	2	(1)	5	3
Total change in net book value for year	†	20	1	58	22
Depreciation as a percentage of net additions§	†	74	107	82	76
CCA net book value at year end	561	581	582	640	662

Source: NIE published accounts and prospectus.

*For 1991/92, the information is obtained from NIE's prospectus or its regulatory accounts.
†Information is not available.
‡This represents a CCA adjustment for revaluation of assets.
§Net additions exclude adjustments, which arise from CCA revaluations.

5.79. The deferred income balances increased from £79 million in March 1992 to £99 million at March 1996, as is discussed in paragraph 5.63. At March 1996, deferred income represent 22 per cent of NIE's HCA net assets.

Northern Ireland Audit Office comments

5.80. The NIAO report (see paragraph 5.53) discussed the flotation of NIE in some detail and mentioned a number of concerns regarding NIE's flotation.

5.81. Regarding NIE's capital structure, NIAO said in paragraph 4.21:

> The negotiations on NIE plc's capital structure were aimed at establishing the correct balance between consumer prices, the long-term viability of NIE plc and flotation proceeds. Were the projected levels of operating costs and depreciation to be overstated, higher than anticipated profits would result. This would mean that either consumer pricing was set higher than necessary, or, the worth of the company was not fully realised in proceeds (or indeed a combination of the two consequences). NIAO has estimated that a £1 million increase in NIE plc's costs would equate to a reduction in flotation proceeds of some £5 million (assuming all other factors remained constant).

5.82. Regarding operating costs, NIAO said in paragraph 4.19:

> NIAO is concerned at the extent to which NIE's operating costs rose in the period leading up to privatisation. Even after taking into account the additional costs which would be incurred by NIE as a result of privatisation, the cost profile agreed for the five-year period 1992/93 to 1996/97 appears to NIAO to be high. The results published by NIE plc for the year ended 31 March 1994 serve to heighten NIAO's concern that the profile finally agreed may have overstated NIE plc's likely costs.

5.83. NIAO said that NIE argued for costs of some £130 million a year (in 1990/91 prices), totalling £647 million. The finally agreed forecast was £600 million, representing operating costs falling from £123 million in 1992/93 to £117 million in 1996/97. Table 5.15 compares the forecast with the actual out-turn for NIE.

TABLE 5.15 **NIE's operating cost forecast, 1992/93 to 1996/97**

£ million, at out-turn prices

	Years ended 31 March					
	1992/93	*1993/94*	*1994/95*	*1995/96*	*1996/97*	*Total for period*
Costs negotiated with the DED	134	135	135	137	141	682
Actual costs of NIE*	139	127	125	114	123†	628
Difference from forecast	-5	8	10	23	18	54

Source: NIAO report and NIE.

*These figures are the sum of cost of sales, distribution costs, administration costs and exceptional costs, net of depreciation and power purchase costs. They also exclude interest receivable.

†Estimate.

5.84. NIAO also considered the capital expenditure forecast of NIE and the extent to which it fell short of projections, resulting in lower depreciation costs and consequent higher profits for NIE. Table 5.16 shows the negotiated capital expenditure forecasts for NIE as a whole from 1992/93 to 1996/97, at out-turn prices, including and excluding the interconnector. Actual expenditure of £297 million fell £98 million short of estimated expenditure (excluding the interconnector) of £395 million.

TABLE 5.16 **NIE's capital expenditure forecast, 1992/93 to 1996/97**

£ million, at out-turn prices

	Years ended 31 March					
	1992/93	*1993/94*	*1994/95*	*1995/96*	*1996/97*	*Total for period*
Capital expenditure forecast (including the interconnector)	59	98	148	156	139	600
Less cost of the interconnector	-	(2)	(65)	(75)	(63)	(205)*
Capital expenditure forecast (excluding the interconnector)	59	96	83	81	76	395
Actual expenditure per Table 5.14	59	42	59	67	70†	297

Source: NIAO report and NIE.

*The interconnector is discussed in paragraph 5.43, which shows that a net cost of £140 million is expected after receipt of an EC grant.

†The amount shown in NIE's corporate plan is £84 million for 1996/97, but NIE subsequently told us that only £70 million expenditure was expected in the year.

5.85. The NIAO report discussed the £70 million debenture created at the time of NIE's flotation and how this amount was determined. The creation of the debenture was to compensate the UK Government for its past investment in NIE. In determining the level of this debenture, the capital costs of the Scottish interconnector were taken into account and it was expected that NIE's borrowings by 1996/97, taking account of this project, would exceed 100 per cent. At the time both the DED and NIE were told by their respective advisers that NIE's gearing should peak at no more than 60 per cent and that any movement over this level would have to be reflected in a lower flotation price, and hence a reduction in sale proceeds, to meet investor concerns. It was eventually agreed that NIE would accept a debenture of £70 million, designed to ensure that the projected gearing level would peak at 63 per cent in 1996/97 following completion of the Scottish interconnector. In fact, as noted in paragraph 5.64, NIE has largely avoided borrowings to date and the interconnector has not yet been built.

5.86. The NIAO concluded that the agreed capital structure understated NIE's financial position and therefore its ability to absorb debt. As a result, in the NIAO's view, it was arguable that the maximum possible level of debt had not been obtained by the Government from NIE. The NIAO's specific comments noted above were included in its conclusions.