

# **Jemena Electricity Networks (Vic) Ltd**

## **2016-20 Electricity Distribution Price Review Regulatory Proposal**

### **Revocation and substitution submission**

Attachment 8-10 KPMG - Definition of RIN actuals

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Dear Matthew

## **Definition of “Actual Information”**

### **Introduction**

Jemena Electricity Networks (Vic) Limited (Jemena) is required to provide information to the Australian Energy Regulator (AER) that is specified by the following Regulatory Information Notices (RINs) issued by the AER:

- Annual Reporting RIN (RIN A);
- Economic Benchmarking RIN (RIN B);
- Category Analysis RIN (RIN C); and
- F-Factor RIN (RIN F).

The RINs also set out requirements for:

- how Jemena is to prepare and maintain the information required by the RINs; and
- audit and assurance of the information provided under the RINs.

The requirements of the RINs provide the reporting framework which an audit or assurance practitioner is required to attest to in order to be able to provide an audit or assurance report.

The RINs provide a number of defined terms to assist in the interpretation of the RINs' requirements. These terms include:

- “Estimated Information”; and
- “Actual Information”.

Appendix A to this report reproduces those definitions, along with other RIN definitions that are relevant to the matters addressed by this report.

In its preliminary decision on Jemena's distribution determination 2016 to 2020, the AER provided further guidance on the interpretation of Actual Information. Relevant extracts of the preliminary decision are set out at Appendix B to this report.

We understand that when the AER consulted with stakeholders in 2013 on the terms "Estimated information" and "Actual information" in relation to the RINs, it was for the purposes of helping to describe or characterise information provided by Network Service Providers (NSPs) in response to the RINs.

The RINs issued to Jemena provide that:

- with effect from the 2015 Regulatory Year, with the exception of inherently estimated information as specified by the AER in the RIN templates, Jemena is to report only Actual Information in response to the RIN B; and
- with effect from the 2016 Regulatory Year, with the exception of inherently estimated information as defined by the AER in the RIN, Jemena is to report only Actual Information in response to RIN C.

These requirements change the application of the term "Actual Information" from one of a description of a subset of information, to one of defining an exclusive condition for all information reported under the RINs (except for information that the RIN B and RIN C templates identify as inherent estimates). The point at question is whether the defined term "Actual Information" is fit for this revised purpose.

## **Purpose**

The sole purpose of this report is to assist Jemena to manage its obligations to respond to the RINs. This report may be provided by Jemena to the AER for this purpose.

## **Scope**

The scope of this report is confined to RIN B and RIN C. This report considers the following matters on which Jemena has sought advice from KPMG.

1. How do you interpret the AER's definition of Actual Information in the RINs? Please use examples to illustrate your answer. Please advise whether the AER's further explanation of "Actual Information" in the Jemena preliminary determination dated 29 October 2015 would change your answer.
2. Does your interpretation of Actual Information in the RINs reconcile with generally accepted accounting principles and concepts? Please use examples to illustrate your answer.
3. If your answer to 2 is in the negative, are there any potential consequences for the level / nature of the assurance an auditor could provide over the completed RIN responses?

4. What information, which Jemena reported in the 2014 RIN responses was reported as Actual Information?

The following sections of this report set out KPMG's responses to each of these questions and the basis of each response.

### Question 1

- a) How do you interpret the AER's definition of Actual Information in the RINs? Please use examples to illustrate your answer.**

This definition is set out at Appendix A. It has two conditions which both need to be satisfied to fulfil the definition. They require that the information presented:

- 1) is materially dependent on historical records that are used in the normal course of business (Condition 1); and
- 2) is not contingent on judgements and assumptions for which there are valid alternatives that could lead to a materially different presentation (Condition 2).

Condition 1 concerns the source of information.

Condition 2 concerns the nature of the information.

These two conditions are independent. That is to say, any requirement for judgement or an assumption is independent of whether the resulting data is recorded in historical records used in the normal course of business.

Turning to each of these conditions:

#### **Condition 1**

We interpret this condition as meaning that the resulting information is required to be sourced from historical records that a Network Service Provider (NSP) would maintain for its own purposes. This condition can apply to both financial and non-financial information.

However, it does not follow that Jemena's current financial and non-financial information will as a matter of course, fulfil Condition 1. This is because if the information required by a RIN is not recorded by Jemena for its own use *in the normal course of business* (KPMG emphasis), it will not fulfil Condition 1 and hence will not meet the definition of Actual Information.

The population of all information fields that a business could possibly account for is very broad and for practical intents and purposes, can be assumed to be limitless. It is not realistic to assume that a complex (or possibly any) enterprise such as a NSP will capture and record all possible information in the normal course of business. Rather, good business practice is to constrain information capture and records to information which may be:



- required to satisfy regulatory requirements, including corporate reporting, compliance issues such as environmental and technical regulations, and taxation obligations; or
- cost effective for it to capture and record for its own management purposes.

Also, it does not follow that all information:

- needs to be captured and recorded in the same way and to the same degree of detail;
- will be subject to the same risks of misstatement; and
- will require uniform accounting procedures and controls.

For example, the efficient management of information may require different accounting controls and procedures according to factors such as:

- the importance and materiality of the information to users including the potential of the information to influence their economic decisions; or
- whether the information is required for multiple purposes or to be accessed frequently, in the normal course of business.

The principal reasons why information presented in a RIN template may not meet Condition 1 include that the information:

- may not exist or may not be capable of capture by the NSP;
- may exist and be capable of capture but may not currently be required to be captured and recorded by a NSP in the normal course of business; and
- may be captured and recorded but not according to the classifications and categorisations required by a RIN. For example, labour costs could be reported according to:
  - source of costs, such as salaries, superannuation payments, leave provisions, benefits in kind; or
  - objects of costs, such as total labour cost per function, activity, cost centre or staff classification.

The last point presents a particular compliance risk because of the specific cost categorisations required by the RINs and by RIN C in particular. If an information category required by a RIN cannot be reported by a NSP's existing records:

- that information will not fulfil Condition 1 and hence will not meet the definition of "Actual Information"; and
- it will be necessary to manipulate or process information extracted from a NSP's records to satisfy the RIN requirements. Such a process may typically include undertaking allocations and calculations (such as pro rata estimates) to reclassify information from the NSP's existing chart of accounts or data record categorisations to the categorisations required by

a RIN. Requirements for estimation typically arise from such a process where the basis of allocation used for reclassification also may not be captured by a NSP's records.

For example, page 105 of Jemena's Basis of Preparation document for its 2014 RIN C describes how Jemena has needed to make a number of estimations to calculate the average productive work hours per Average Staffing Level in accordance with a RIN disclosure requirement that does not align with categorisations maintained in the normal course of business by Jemena's historical records.

While the above analysis assumes that it is reasonable to expect a business to collect and record information necessary to meet regulatory requirements, it is improbable that any NSP's approach to information capture and storage would:

- capture without modification, the range of information necessary to satisfy a RIN's requirements; and
- present information according to categories that enable the information to be extracted from the NSP's records without modifications that may require the use of estimates.

We note that the RIN's Definition of Actual Financial Information includes that:

*"Actual information may include ..... any adjustments made to the accounting records to populate DNSPs' regulatory accounts and responses to the Notice."*

This statement suggests that:

- Actual Information includes both:
  - information recorded in the accounting records; and
  - information sourced from the accounting records that has been re-presented, re-categorised or whose amount has been adjusted in order to populate the RINs; and
- Jemena's accounting records may not need to specifically match the RIN disclosure requirements in order for Condition 1 to be satisfied.

It appears to follow from Condition 1 that as a minimum, the AER intends that where adjustments are made, they are calculated using information that is sourced from historical records that are used in the normal course of business.

For example, assume that in order to meet a RIN categorisation a labour cost recorded in the historical financial records needs to be reallocated to RIN disclosure categories on the basis of labour time spent on different activities. If the attribution of labour time between those activities:

- can be sourced from historical records used in the normal course of business, then the adjustment would meet Condition 1 and the resulting disclosure in the RIN templates would be "Actual Information"; but

- cannot be sourced from historical records used in the normal course of business, then the adjustment would not meet Condition 1 and the resulting disclosure in the RIN templates would not be "Actual Information".

However, the AER could intend the meaning of this phrase to extend to literally any adjustment (i.e. all adjustments). If so, it would open the definition of Actual Information to include in some circumstances, information sourced from outside of historical records used in the normal course of business. The AER's meaning is unclear but it is open to this interpretation.

We also note that the reference to adjustments in the RINs' definition applies only to accounting records. It does not apply to adjustments to information that may be maintained outside of accounting records. (e.g. Reclassifications of non-financial information sourced from non-financial records not used in the normal course of business).

The challenge that Condition 1 poses for Jemena is that the AER's definition of Actual Information requires Jemena to modify its data capture processes and associated data accounting controls such that the capture, recording and quality assurance of all non-financial information and at least all unadjusted financial information (if not all financial information), required for RIN reporting, becomes part of the normal course of business. However, because of the reasons set out above, until this can be achieved, Jemena could be at risk of being unable to report in its responses to the RINs, information that is exclusively Actual Information.

The response to Question 4 in this report indicates both that the 'gap' to be closed for Jemena to be able to exclusively report Actual Information could be significant and an imperative for change to approaches and procedures. While it is outside the scope of this report to assess the scope and extent of the work required, we understand that Jemena is examining this question as part of its response to the AER's preliminary decision on Jemena's distribution determination 2016 to 2020. We do however comment that reasonable certainty about the future RIN requirements, particularly where these requirements are at a detailed, prescriptive level, would be likely to improve the efficiency of accounting procedure and process development to meet the RINs' requirements for Actual Information.

The requirement of Condition 1 for information required by a RIN to be maintained in records maintained by Jemena for its own use in the normal course of business also suggests that this information is to be subject to the accounting controls and processes that are applied for day-to-day business purposes.

However, for much of the information required by the RINs, particularly information that is specific to the RINs or presented according to RIN specific classifications, this may not be necessary or efficient, in order to reliably report that information. For example, we understand that Jemena considers the Regulatory Asset Base Data in Schedule 3.3 of RIN B to include examples of information that while required for RIN reporting purposes, is not required by Jemena to be recorded and maintained for day to day business purposes.

## **Condition 2**

We interpret Condition 2 as meaning that:

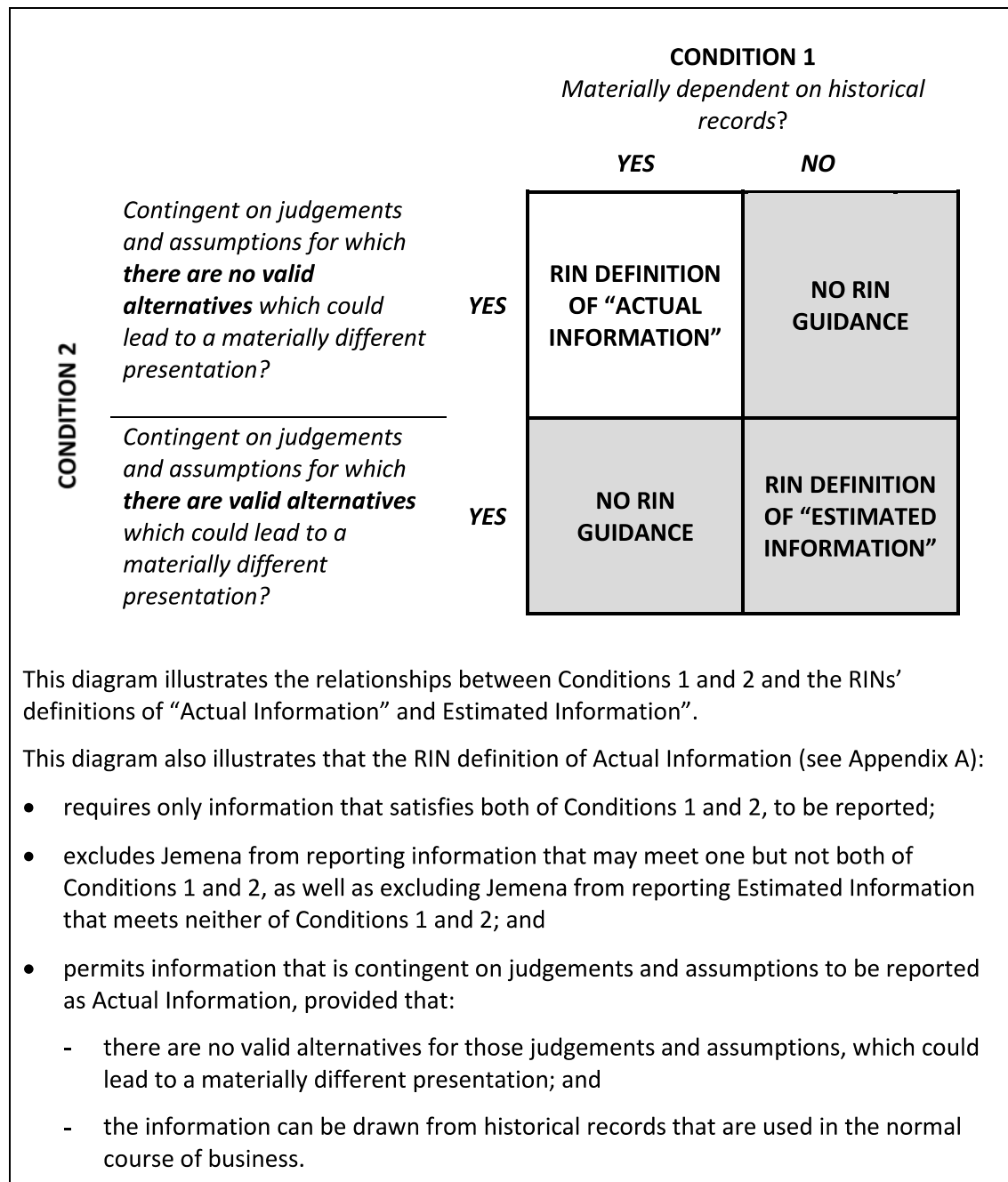
- actual Information can include information which is prepared or presented on an estimated basis through the use of judgements or estimates. Box 1 below, illustrates this interpretation. Appendix C also illustrates how:
  - the preparation of information on the basis of judgements and estimates is consistent with generally accepted accounting principles; and
  - information recorded in accounting and other information records may include information that has been determined on a basis of estimation; and
- where information is prepared on the basis of judgements or assumptions, it can only be Actual Information where there is a single set of valid assumptions and judgements, that is to say there are no valid alternative judgments and assumptions that could lead to a materially different presentation.

Our response to Question 2 below explains that this aspect of the definition in combination with a requirement to report only Actual Information, could preclude Jemena from reporting valid information in certain circumstances.

Jemena will need to pay particular attention to the practical application of Condition 2 when reporting Actual Information that is based on a judgement or assumption. Condition 2 requires Jemena to identify all possible valid alternative judgements and assumptions that could give rise to a materially different presentation, in order for it to be able to determine that no valid alternative judgements or assumptions exist and hence for it to be able to classify that information as Actual Information

However, this risk is asymmetrical. In order to exclude an item of information from Actual Information, it is only necessary to identify a single instance of a valid alternative judgement or assumption which could lead to a materially different presentation.

Box 1: The requirement to report only Actual Information



**b) Please advise whether the AER's further explanation of "Actual Information" in the Jemena distribution determination preliminary determination dated 29 October 2015 would change your answer.**

Appendix B sets out the commentary on the definition of Actual Information, provided by the AER's preliminary decision. We examine each of the key points made by that commentary, below.

### **Point 1**

*"The definition of actual information requires information whose presentation is materially dependent on actual records.<sup>1</sup> This means actual physical information, for example, allows for the possibility that Jemena has undertaken some sampling to derive that information as against having recorded every instance."*

This statement interprets information whose presentation is materially dependent on actual records (Condition 1) as "actual physical information". However it is unclear what distinguishes "physical information" from any other form of information. This term is additional to those used in the RINs' definition but because its meaning is unclear it does not help to narrow the room for interpretation of "Actual Information". Further explanation is required of the meaning of "physical information" in order to be able to interpret the AER's meaning.

### **Point 2**

*"This means actual physical information, for example, allows for the possibility that Jemena has undertaken some sampling to derive that information as against having recorded every instance."*

The key matters that arise from this statement are that:

- the AER is explicitly acknowledging that Actual Information includes information that is provided on a basis of estimation. This is because sampling (and the example the AER goes on to provide), is by necessity, an estimation technique; and
- the requirement for sampling that the AER commented on would arise because of an assumption that Jemena's records of some data may be incomplete in some way and it is necessary to extrapolate an estimate for a population by sampling individual data points. This suggests that the AER may expect Actual Information to include information extracted from existing records to meet its needs, or from records that Jemena would not use in the

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<sup>1</sup> AER, *Economic benchmarking RIN for distribution network service providers*, Instructions and definitions, November 2013.

normal course of business (on the basis of a presumption that Jemena would not in the ordinary course of business, maintain incomplete records for its own use.)

However, while indicating that Actual Information can include information derived on the basis of estimates, the AER has been silent on the issue of solutions where valid alternative judgements and assumptions may arise in making an estimation.

### **Point 3**

*"... to some extent, it (Jemena) has already been providing information where the presentation is materially dependent on actual records. For example, where the RIN requests the number of trees per span, it is not our intention that every tree in an easement must be counted. Rather, a total number of trees can be derived from a reasonable sample. Jemena contracts out tree maintenance to a third party. In tendering for the contract those third parties must have an idea of the volume of work or number of trees they will be required to maintain"*

However, paragraph 1.6 of Appendix E (Principles and Requirements) of the RIN C issued by the AER to Jemena in March 2014, provides two exemptions from the requirement to provide only Actual Information for Subsequent Regulatory Years, one of which is the average number of trees per maintenance span. Paragraph 1.6 states:

*"1.6 JEN is exempted from its obligation to provide only actual information for Subsequent Regulatory Years for the following items (that is, may provide estimated information on an ongoing basis):*

*(a) Average number of trees per maintenance span as requested in regulatory template 2.7; ..."*

The AER's commentary in the preliminary decision and paragraph 1.6 of Appendix E of RIN C, appear to suggest that the AER considers one of the two items that it allows to be provided as Estimated Information, is an example of Actual Information. This aspect of the AER's explanation in the preliminary decision does not help to clarify the definition of Actual Information.

### **Point 4**

*"The definition of 'actual' data leaves a lot of room for interpretation."*

We agree with this statement which may recognise that there is scope for valid alternative interpretations. Jemena faces a risk of non-compliance if it is unable to determine *ex-ante* whether the AER considers Jemena's interpretation of the definition to be valid. The potential alternatives outlined below could help to address this risk.

### **Point 5**

*"We are looking for Jemena to use registers used in the ordinary course of business to derive actual information. We defined actual information as information materially dependent on*

*information recorded in the distributor's historical account records or other records used in the normal course of business, for example asset registers, outage analysis systems and tenders."*

This statement in effect reiterates the RIN definition. However, in combination with the other above statements made by the AER, it may be reasonable to interpret this as meaning Actual Information includes but is not necessarily constrained to, information recorded in the ordinary or normal course of business. The AER has also reiterated the requirement for Actual Information to be *materially dependent* (KPMG emphasis) on information recorded in historical records. This in turn suggests that the extent of Actual Information that is not sourced from historical records, should not be material.

### **Summary**

The additional guidance provided by the preliminary decision provides little, if any, additional certainty. It:

- appears to recognise that Actual Information may include estimates;
- does not address a key criterion of Condition 2 that the Actual Information must not be based on estimates for which valid alternatives exist;
- continues to suggest that the extent of information extracted from records not used in the normal course of business, should not be material; and
- acknowledges but leaves open the breadth of potential interpretations of "Actual Information".

These findings do not lead us to change our interpretations provided in response to Question 1a, and we suggest that in the absence of further information or guidance from the AER, it would be prudent to closely follow the definition of Actual Information provided in the RINs, albeit recognising the point made by the AER that there is room for interpretation in the definition.

### **Question 2**

**Does your interpretation of Actual Information in the RINs reconcile with generally accepted accounting principles and concepts? Please use examples to illustrate your answer.**

To address this question, we have considered both the form and substance of the AER's definition.

#### ***The form of the definition***

Whilst accounting concepts distinguish between historical, forecast and pro-forma information, to the best of our knowledge, we are not aware of "Actual" information or data



being a generally accepted accounting concept. For example, an examination of the Australian Government Accounting Standards Board's (AASB's) Glossary of Defined Terms which summarises various terms used in Australian Accounting Standards, makes no reference to Actual Information or an equivalent concept. Nor are we aware of such a concept being included in Australian Accounting Standards or Interpretations.

### ***The substance of the definition***

Our response to Question 1 indicates that the AER's definition comprises two conditions:

- Condition 1 refers to the source of storage of the information; and
- Condition 2 considers whether the presentation of the information is materially contingent on judgements or assumptions.

We are not aware of any accounting concept or definition that considers either the source of storage of information or whether the information is recorded in the normal course of business. This factor alone indicates that Condition 1 results in the substance of the RINs' definition of Actual Information being inconsistent with generally accepted accounting principles and concepts.

Condition 2 requires that no *valid* (KPMG emphasis) alternative judgement or assumptions exist that could lead to materially different presentations.

As Box 1 illustrates, this leg of the definition does not preclude the use of judgements, estimates and assumptions which as Appendix C exemplifies, are generally accepted concepts recognised and embodied in Australian Accounting Standards.

Appendix C also exemplifies that Australian Accounting Standards allow assumptions about the future, and other major sources of estimation uncertainty, that have a significant risk of resulting in a material adjustment to reported historical information. Condition 2's prohibition on valid alternative assumptions that could lead to materially different presentations, is inconsistent with this treatment.

### ***Implications***

The future exclusion of judgements and assumptions where valid alternatives, judgements and assumptions may exist, is problematic.

It offers no guidance to Jemena on how it might satisfy Condition 2 where circumstances of alternative valid judgements and assumptions arise. If Jemena were to literally follow the AER's definition, it would be unable to report to the AER in the RIN templates items of information for which there are alternative valid judgements and assumptions.

What follows from this is that Jemena could be at risk of facing two contradictory RIN obligations as a consequence of the forthcoming obligation to report only Actual Information:

- one obligation is to report information in a RIN template that might otherwise be true and accurate but for compliance with this aspect of the definition of Actual Information; and
- the other is to comply with a requirement to report only Actual Information under a definition that bars Jemena from reporting certain items of valid information in response to a RIN.

To date, this quandary has not arisen because:

- Jemena has been allowed to report both Estimated Information including best estimates; and Actual Information, in the RIN templates; and
- information for which valid alternative judgements and assumptions may exist has to date been able to be presented as Estimated Information.

The requirement to report Actual Information to the exclusion of other information, is inconsistent with generally accepted accounting principles and concepts and Accounting Standards, as Appendix C describes. Accounting Standards are intended to guide the presentation of general purpose financial statements. However, the RINs provide a special purpose framework determined by the AER to obtain information to meet its needs. Therefore, the inconsistency of the definition of Actual Information with generally accepted accounting principles and concepts would not necessarily be problematic for the AER, if by being inconsistent, it better meets the AER's information needs.

However, this special purpose accounting framework both exposes Jemena to risk of non-compliance as we have explained above, and provides a very limited basis for defining the quality of information that may meet the AER's needs. The definition of Actual Information is concerned with the nature of the basis of capture and maintenance of the information (i.e. historical records) rather than the quality of information thus captured and recorded. There is not necessarily a relationship between Condition 1 of the AER's definition and information quality.

### ***Potential alternatives***

We suggest that the following alternatives to the current definition of Actual Information could mitigate compliance risk for Jemena, provide improved bases for defining information quality and help to mitigate the cost of establishing accounting processes and controls specifically for purposes of compliance with RIN reporting requirements.

#### *An amended definition of Actual Information.*

Condition 2 of the definition does not add to the integrity of the information to which it is applied. An amendment of the definition of Actual Information to remove Condition 2 from the definition would:

- remove the potential for an impasse provided by the prohibition of information for which valid alternative judgements and assumptions may exist; and

- provide greater consistency with generally accepted accounting principles and concepts including Australian Accounting Standards that might reasonably be expected to reduce the risk to Jemena of non-compliance.

Under this approach:

- a definition of the set of information that is complementary to "Actual Information" would be required. However the title "Estimated Information" would seem inappropriate because both the existing and amended definitions of Actual Information permit information to be prepared and presented on the basis of estimates. Rather, the names given to the set of amended Actual Information and its complement, might refer to the sources of the information instead of the terms "Actual" and "Estimated"; and
- a requirement for information to be sourced from records used in the normal course of business and the corresponding requirement for Jemena to implement associated accounting procedure and process change, would remain.

#### *A principles-based reporting framework*

This would replace the requirement for only Actual Information to be reported with a requirement for all information to be reported under a principles-based framework.

It is reasonable to suppose that for its purposes for the information provided in response to the RINs, the AER will require information that complies with general principles of:

- presenting information in accordance with a transparent basis of preparation. We note that the Basis of Preparation documents enable this, regardless of whether information is Actual Information or Estimated Information;
- presenting information that is complete, relevant, reliable, comparable and understandable;
- allowing an auditor or assurance practitioner to assess whether the information is prepared in all material respects accordance with that basis of preparation and on a basis that reports the substance of the underlying financial and non-financial information attributable to the services which the responses to the RINs report on; and
- presenting information whose freedom from material misstatement can be independently assessed by an auditor or assurance practitioner.

A principles-based framework could be applied consistently to both financial and non-financial information and would:

- provide an outcome based and more comprehensive, framework for setting standards of quality for the information reported under the RINs, than the definition of Actual Information;
- address the risks that arise from a requirement to meet Condition 1, of implementing accounting procedures and controls that are in excess of efficient requirements for

managing RIN information, particularly for information or categorisations that may be RIN specific;

- avoid risks of non-compliance where there may be uncertainty about the interpretation of Condition 1;
- remove the potential for impasse and non-compliance arising from Condition 2 of the definition of Actual Information; and
- provide consistency with generally accepted accounting principles and concepts and Australian Accounting Standards that might reasonably be expected to further reduce risk to Jemena of non-compliance and Jemena's regulatory compliance costs.

#### *Specification of materiality*

To further clarify the level of estimation that is acceptable, the AER, as the intended user of the RIN information, could provide further guidance on what it considers to be material to the presentation of RIN information. The RIN templates are comprised of a large number of spreadsheets with a highly diverse range of information covering various financial and non-financial variables. In this case, the AER's guidance will need to be suitably detailed to cover all of the RIN information and might be expected to vary according to the AER's intended uses for different types of information within the RINs. To some extent, the AER has already provided such guidance over the requirement to back cast the historical opex presentation if a change in an entity's Cost Allocation Method is 'material'. Materiality, in this scenario has been specifically defined by the AER as half a percent of total opex in the year in which the change occurred<sup>2</sup>.

This guidance from the AER could complement but not stand in the place of, any of the existing or amended definitions of Actual Information or a principles-based framework.

Such clarification could potentially reduce the compliance burden for Jemena and the associated costs of maintaining compliance by allowing further estimation, as long as the possibility of a change in presentation does not breach the AER's materiality thresholds.

### **Question 3**

**If your answer to 2 is in the negative, are there any potential consequences for the level/nature of the assurance an auditor could provide over the completed RINs?**

By way of background, we have set out the level of assurance required by the AER (the 'intended user' of the RIN information) that is set out in its RINs.

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<sup>2</sup> AER, Economic Benchmarking RIN Explanatory Statement – Section 4.1

<b>Economic Benchmarking RIN</b>	<ul style="list-style-type: none"> <li>• Audit of the actual historical financial information</li> <li>• Review of the estimated historical financial information</li> <li>• Review of actual and estimated historical non-financial information</li> </ul>
<b>Category Analysis RIN</b>	<ul style="list-style-type: none"> <li>• Audit of the actual historical financial information</li> <li>• Review of the estimated historical financial information</li> <li>• Review of actual and estimated historical non-financial information</li> </ul>

For the 2014 Regulatory Year, the AER accepted Jemena’s provision of estimated information where actual information was not available. For the 2015 Regulatory Year for RIN B and for the 2016 year for RIN C, Jemena is required to populate the RIN templates with only actual data, with the exception of inherently estimated information as specified by the AER.

An assurance practitioner provides assurance that the subject matter (the RIN information) is prepared to be consistent with suitable criteria (the RIN instructions as well as the associated Explanatory Statements and Instructions and Definitions documents<sup>3</sup>.)

An assurance provider’s ability to provide either reasonable or limited assurance over the RINs (depending on the AERs requirements) is not impacted by whether or not the definition of ‘Actual Information’ changes. In other words, reasonable or limited assurance can be provided over the current framework as it remains a suitable framework even if not one that is aligned with generally accepted accounting principles. However, if Jemena cannot comply in all material respects with the requirement to present Actual Information this may impact on the type of auditor’s report we issue (i.e. whether it is modified or unmodified).

KPMG’s audit/review reports issued over Jemena’s 2014 RIN’s are summarised in the table below:<sup>4</sup>

RIN B – financial information	Unmodified audit/review reports
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<sup>3</sup> An ‘assurance engagement’ is defined in the International Framework for Assurance Engagements issued by the International Auditing and Assurance Standards Board as "an engagement in which a practitioner aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of intended user(s) about a subject matter."

<sup>4</sup> Another assurance provider was engaged by Jemena to review the non-financial information in RIN B. We note that they issued an unmodified report.

RIN C – financial information	Unmodified audit/review reports
RIN C – non-financial information	Unmodified review report

For the 2015 and subsequent Regulatory Years, we have not commenced our audit/review procedures. However, if Jemena is unable to provide Actual Information where it is required to do so, it may not be in compliance with the RIN requirements. We will consider the impact of this on our audit/review reports by having regard to the magnitude of non-compliance and its impact on the intended user(s) and potentially issue a modified audit or review report, if the non-compliance is assessed as material to the overall RIN response. Furthermore, as more variables will be reported as Actual Information, more information will be subject to the requirement for reasonable assurance over actual historical information. This will lead to an increased audit effort and cost.

#### Question 4

**What information, which Jemena reported in the 2014 RINs, was reported as Actual Information?**

We have utilised the final reported templates for the 2014 RIN B and RIN C to perform our analysis. Jemena received unmodified audit/review reports for its 2014 RIN templates.

Based on:

- our analysis of the data points contained in these RIN templates, which were subject to unmodified reports; and
- the interpretation of Actual Information applied by Jemena in the 2014 RIN templates

we found that the percentage of information data points reported as Actual Information, was as follows:

*Table 1: Actual and Estimated Information data points reported in 2014 RINs*

	% Actual	% Estimated
RIN B - Financial	32%	68%
RIN B – Non-Financial	85%	15%
RIN C – Financial	10%	90%
RIN C – Non-Financial	77%	23%

The balances of estimated information in the above table includes information that is classified by the AER as inherent estimates.

## **Important Notice**

### ***Inherent Limitations***

This report has been prepared as outlined in the Scope Section. The services provided in connection with this engagement comprise an advisory engagement which is not subject to Australian Auditing Standards or Australian Standards on Review or Assurance Engagements, and consequently no opinions or conclusions intended to convey assurance have been expressed.

No warranty of completeness, accuracy or reliability is given in relation to the statements and representations made by, and the information and documentation provided by, Jemena Electricity Networks (Vic) Ltd management and personnel consulted as part of the process.

KPMG have indicated within this report the sources of the information provided. We have not sought to independently verify those sources unless otherwise noted within this report.

KPMG is under no obligation in any circumstance to update this report, in either oral or written form, for events occurring after the report has been issued in final form.

The findings in this report have been formed on the above basis.

### ***Third Party Reliance***

This report is solely for the purpose set out in the Purpose Section and for Jemena Electricity Networks (Vic) Ltd's information, and is not to be used for any other purpose or distributed to any other party without KPMG's prior written consent.

This report has been prepared at the request of Jemena Electricity Networks (Vic) Ltd in accordance with the terms of a purchase order dated 10<sup>th</sup> December, 2015, issued under our Agreement with Jemena Limited of January 2013. Other than our responsibility to Jemena Electricity Networks (Vic) Ltd, neither KPMG nor any member or employee of KPMG undertakes responsibility arising in any way for the use of this report for any purpose other than that for which it has been prepared.

Yours sincerely



Keith Lockey  
Director

## Appendix A – Selected RIN definitions

<i>Actual Information</i>	<p>Information presented in response to the <i>Notice</i> whose presentation is <i>Materially</i> dependent on information recorded in DNSP's historical accounting records or other records used in the normal course of business, and whose presentation for the purposes of the <i>Notice</i> is not contingent on judgments and assumptions for which there are valid alternatives, which could lead to a <i>Materially</i> different presentation in the response to the <i>Notice</i>.</p> <p>'Accounting records' include trial balances, the general ledger, subsidiary accounting ledgers, journal entries and documentation to support journal entries. Actual financial information may include accounting estimates, such as accruals and provisions, and any adjustments made to the accounting records to populate DNSP's regulatory accounts and responses to the <i>Notice</i>. 'Records used in the normal course of business', for the purposes of non-financial information, includes asset registers, geographical information systems, outage analysis systems, and so on.</p>
<i>Estimated Information</i>	<p>Information presented in response to the <i>Notice</i> whose presentation is not <i>Materially</i> dependent on information recorded in DNSP's historical accounting records or other records used in the normal course of business, and whose presentation for the purposes of the <i>Notice</i> is contingent on judgments and assumptions for which there are valid alternatives, which could lead to a <i>Materially</i> different presentation in the response to the <i>Notice</i>.</p>
<i>Financial Information</i>	<p>Information that is measured in monetary terms.</p>
<i>Materially</i>	<p>Information is material if its omission, misstatement or non-disclosure has the potential, individually or collectively to influence the economic decisions of users (including the AER) taken on the basis of the information provided in accordance with the <i>Notice</i>.</p> <p>This definition is based on the definition of materiality in the accounting standard AASB 1031.<sup>5</sup> This accounting standard provides context for the interpretation of this definition of materiality.</p>

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<sup>5</sup> We note that in January 2015, the accounting standard AASB 1031 *Materiality* was withdrawn and all materiality guidance will be based on guidance in existing Accounting Standards and in the revised IASB Conceptual Framework. Further detail on the withdrawal and applicable transition guidance is contained in AASB 2015-3 *Amendments to Australian Accounting Standards*



## **Appendix B – Further AER guidance on interpretation of actual information**

“The definition of actual information requires information whose presentation is materially dependent on actual records.<sup>6</sup> This means actual physical information, for example, allows for the possibility that Jemena has undertaken some sampling to derive that information as against having recorded every instance. We consider Jemena would have already been using a sampling method to comply with previous RIN responses. Therefore to some extent, it has already been providing information where the presentation is materially dependent on actual records. For example, where the RIN requests the number of trees per span, it is not our intention that every tree in an easement must be counted. Rather, a total number of trees can be derived from a reasonable sample. Jemena contracts out tree maintenance to a third party. In tendering for the contract those third parties must have an idea of the volume of work or number of trees they will be required to maintain.

The definition of 'actual' data leaves a lot of room for interpretation. Jemena stated its experts considered some of the data Jemena previously considered estimates would meet the actual information definition.<sup>7</sup> We consider there may be even more data that Jemena previously considered estimates that would meet the actual information definition.

We are looking for Jemena to use registers used in the ordinary course of business to derive actual information. We defined actual information as information materially dependent on information recorded in the distributor's historical account records or other records used in the normal course of business, for example asset registers, outage analysis systems and tenders.”

Source: *AER, Jemena Preliminary decision 2016-20, Attachment 7 – Operating expenditure, pp. 7-79, 7-80*

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<sup>6</sup> AER, *Economic benchmarking RIN for distribution network service providers*, Instructions and definitions, November 2013.

<sup>7</sup> Jemena, *Submission to its Regulatory proposal*, 13 July 2015, p. 5.

## Appendix C – Extracts from Australian Accounting Standards

Judgements and estimates are inherent to the preparation of financial statements in accordance with Australian Accounting Standards. In particular, we refer to the following Accounting Standard references.

Standard/Reference	Accounting Requirement
AASB 101 <i>Presentation of Financial Statements</i> , para 17(c)	A fair presentation requires an entity to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
AASB 101 <i>Presentation of Financial Statements</i> , para 125	An entity shall disclose information about the assumptions it makes about the future, and other major sources of <b>estimation uncertainty</b> at the end of the reporting period, that <b>have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year</b> . In respect of those assets and liabilities, the notes shall include details of: <ul style="list-style-type: none"> <li>- Their nature; and</li> <li>- Their carrying amount at the end of the reporting period.</li> </ul>
AASB 101 <i>Presentation of Financial Statements</i> , para 126	Determining the carrying amounts of some assets and liabilities <b>requires estimation of the effects of uncertain future events</b> on those assets and liabilities at the end of the reporting period. For example, in the absence of recently observed market prices, future-oriented estimates are necessary to measure the recoverable amount of classes of property, plant and equipment, the effect of technological obsolescence on inventories, provisions subject to the future outcome of litigation in progress, and long-term employee benefit liabilities such as pension obligations. <b>These estimates involve assumptions about such items as the risk adjustment to cash flows or discount rates, future changes in salaries and future changes in prices affecting other costs.</b>

Standard/Reference	Accounting Requirement
AASB 137 <i>Provisions, Contingent Liabilities and Contingent Assets</i> , para 25	<p><b>The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability.</b> This is especially true in the case of provisions, which by their nature are more uncertain than most other items in the statement of financial position. Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation <b>that is sufficiently reliable to use in recognising a provision.</b></p>

The following are examples of areas where significant estimation is applied by entities when preparing financial statements in accordance with Accounting Standards:

- Provisions including leave, redundancy, restructuring, warranty and legal provisions. Many businesses apply different methodologies of estimation and often the outcomes are materially different when such provisions are settled;
- Estimation of Recoverable Amount for asset impairment testing – For assessing asset impairments, an entity must estimate the recoverable amount of its Cash Generating Units (CGUs) using different possible methodologies. This process contains significant levels of estimation and is highly complex;
- Estimation of fair values – For assets such as biological assets which are recorded at ‘fair values’, an entity must estimate these fair values using one of a range of different valid valuation methodologies; and
- Recognition of capitalised tax losses – To enable recognition of tax losses, entities must apply significant levels of judgement to assess whether sufficient taxable income will be available in the foreseeable future to recover tax losses.