

# Audit of Ausgrid's 2011/12 Regulatory Information Notice - Demand Management Incentive Scheme

23 January 2013

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**Ausgrid**

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**PARSONS  
BRINCKERHOFF**

*Parsons Brinckerhoff Australia Pty Limited  
ABN 80 078 004 798*

*Level 27, Ernst & Young Centre  
680 George Street  
Sydney NSW 2000  
GPO Box 5394  
Sydney NSW 2001  
Australia*

*Telephone +61 2 9272 5100  
Facsimile +61 2 9272 5101  
Email [sydney@pb.com.au](mailto:sydney@pb.com.au)*

*Certified to ISO 9001, ISO 14001, AS/NZS 4801  
A GRI Rating: Sustainability Report 2011*

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Author: B. Smith-Kerr, J. Thompson

Reviewer: J. Thompson

Approved by: Peter Walshe

Signed: 

Date: 23 January 2013

Distribution: Ausgrid (via email)

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## AUDITOR'S STATEMENT

The auditor audited the regulatory information notice (RIN) information prepared by Ausgrid for the Australia Energy Regulator for the period 1 July 2011 to 30 June 2012 in respect of the Demand Management Incentive Scheme (DMIS).

This audit report has been prepared in accordance with the audit requirements outlined in Appendix C of Section 28M(e) of the National Electricity (Act) Law. The auditor's responsibility is to express an opinion on the data provided in the Demand Management Incentive Scheme template 14b. Audited items were assessed for whether the information is verifiable, reconciled with the audited statutory accounts and prepared in accordance with the relevant Australian Energy Regulator (AER) approved Cost Allocation Methodology.

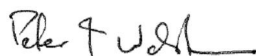
The audit grades are outlined in the table below.

Item	Compliance Grade	Assessment
DMIS – Part B: D-factor scheme		
Verifiable	Yes	All information was able to be traced to source data.
Reconciled with the audited statutory accounts	Yes	The values in the RIN tables were (in aggregate) reconciled to the audited statutory accounts.
Prepared in accordance with the approved 'Cost Allocation Methodology'	Yes	Complies.

The audit involved obtaining evidence about the information and disclosures in the RIN. The procedures used depended on the auditor's judgment, including the assessment of the risks of material misstatement at the disclosure level, whether due to fraud or error. In making the risk assessments, the auditor considered internal controls, system controls relating to the preparation and fair presentation of the estimates and disclosures made in the RIN in order to design audit procedures that are appropriate in the circumstances.

In our opinion, the information provided in the RIN is a fair representation of Ausgrid's actual performance.

Yours sincerely



**Peter Walshe**

Principal Consultant

Parsons Brinckerhoff Australia Pty Limited

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# 1. Introduction

This section of the report provides background on the need for the work, describes the audit and review approach undertaken by Parsons Brinckerhoff and sets out the report structure.

## 1.1 Background

The Australian Energy Regulator (AER) issued a Regulatory Information Notice (RIN) under Division 4 of Part 3 of the National Electricity (NSW) Law to Ausgrid on 28 October 2011. This notice requires Ausgrid to provide, prepare and maintain information in a manner and form specified in the RIN. The requirements that must be complied with and the information that must be provided by Ausgrid to the AER (in respect of its Sydney, Central Coast and Hunter Regions distribution network services) are for the purpose of:

- monitoring the compliance of Ausgrid with the 2009-14 distribution determination
- publishing reports
- making future distribution determinations.

## 1.2 Scope of work

Ausgrid engaged Parsons Brinckerhoff to undertake a compliance audit of information provided by Ausgrid to the AER for the period 1 July 2011 to 30 June 2012.

The information audited was:

- regulatory template 14b in respect of the Demand Management Incentive Scheme (DMIS). This template relates to the D-factor.

This report presents the audit findings for the DMIS relating to the D-factor. The scope of the audit excluded a review of template 14a, which relates to the Demand Management Incentive Allowance (DMIA).

## 1.3 Persons conducting the audit

Appendix C of Section 28M(e) of the National Electricity (NSW) Law sets out requirements for the class of person to conduct the audit. Parsons Brinckerhoff's attests that it meets these requirements, specifically:

- Parsons Brinckerhoff is independent from Ausgrid and all of its related bodies corporate.
- A trained lead auditor managed the audit process and is responsible for the audit.
- Members of the audit team have audit experience gained through conducting performance audits of electricity businesses, including data sampling in the electricity industry.
- Members of the audit team have the relevant technical knowledge of the areas audited and the associated engineering, IT systems, asset management and customer service

aspects. They also understand the procedures and methodologies underlying the data and the AER's relevant definitions for all information.

- With respect to the audit of financial information, members of the audit team understand regulatory accounting methods and the AER's approved Cost Allocation Methodology.

## 1.4 Overview of audit methodology

Parsons Brinckerhoff's audit approach was conducted in compliance with the audit requirements outlined in Appendix C of Section 28M(e) of the National Electricity (NSW) Law. For the DMIS, this requires that the audited items be assessed for:

- whether the information is verifiable, and whether all financial information can be reconciled with the audited statutory accounts of the business
- whether the financial information has been prepared in accordance with the relevant AER approved Cost Allocation Methodology.

The audit methodology involved the following steps:

- Develop audit procedures
- Review material provided prior to interviews
- On-site interviews, review of data, data sources, data storage systems, reporting systems, data calculation records and procedures
- Draft report
- Final report.

## 1.5 Audit grades

An audit grade was assigned for each data item as follows.

Item	Audit grade
Verifiable	Yes/No
Reconciled with audited statutory accounts	Yes/No
Prepared in accordance with the relevant AER approved Cost Allocation Methodology	Yes/No

## 1.6 Report structure

This audit report is structured as follows:

- Section 2 – Demand Management Incentive Scheme



## 2. Demand management incentive scheme

This section outlines the Auditor's assessment of Ausgrid's DMIS RIN figures in relation to Part B – D-factor Scheme (section 14b of the RIN).

### 2.1 Summary of audit requirement

In accordance with the RIN, the auditor is required to assess the DMIS RIN data to determine:

- whether it is verifiable
- whether it can be reconciled with the audited statutory accounts of the business
- whether it has been prepared in accordance with the relevant AER approved 'Cost Allocation Methodology'.

Table 2-1, Table 2-2, Table 2-3, Table 2-4, Table 2-5, Table 2-6 and Table 2-7 show the information reported by Ausgrid in the RIN.

**Table 2-1 AVOIDED DISTRIBUTION COSTS – ONGOING PROJECTS (RIN table 14b.1)**

Name of project	Total avoided dist. cost cap (\$ t-3)	Costs previously claimed (\$ t-3)	Residual cost cap (\$ t-3)	Residual cost cap (\$ t-2)	DM implementation costs incurred (\$ t-2)	Total costs being claimed (\$ t-2)
Wollombi embedded generator ext 2	0	276,630	0	0	277,660	0
Greenacre DM Project	4,701,081	83,143	4,617,938	5,080,655	639,720	639,720
Terrey Hills PFC & Generation	102,261	0	102,261	112,508	0	0
Willoughby STS DM Project (Stage 2)	1,755,980	98,590	1,657,390	1,823,460	3,946	3,946
NW Pennant Hills Generation	1,438,262	477,390	960,872	1,057,151	127,789	127,789
Medowie DM Project	2,414,608	64,103	2,350,505	2,586,026	1,027,001	1,027,001
East Maitland DM Project	1,552,946	19,992	1,532,954	1,686,556	143,334	143,334
<b>Total DM Costs Claimed</b>	<b>11,965,138</b>	<b>1,019,848</b>	<b>11,221,920</b>	<b>12,346,356</b>	<b>2,219,450</b>	<b>1,941,790</b>

**Table 2-2 AVOIDED distribution costs – new projects (RIN table 14b.2)**

Name of project	PV capex without DM initiative (\$ t-2)	PV opex without DM initiative (\$ t-2)	PV capex with DM initiative (\$ t-2)	PV opex with DM initiative (\$ t-2)	PV total avoided dist. costs cap (\$ t-2)	DM costs incurred during the regulatory year (\$ t-2)	Total costs being claimed (\$ t-2)
<Did not apply>							
<b>Total DM Costs Claimed</b>							

**Table 2-3 Foregone revenues (RIN table 14b.3)**

Name of project	Reasonable estimate of foregone revenue (\$ t-2)
Wollombi embedded generator ext 2	0
Greenacre DM Project	140,708
Terrey Hills PFC & Generation	7,518
Willoughby STS DM Project (Stage 2)	92,397
NW Pennant Hills Generation	0
Medowie DM Project	1,456
East Maitland DM Project	10,926
<b>Total estimate of foregone revenue (\$ t-2)</b>	<b>253,005</b>

**Table 2-4 Partial demand management costs (RIN table 14b.4)**

Name of partial DM project	Avoided distribution cost cap (AC value max - \$ t-2)	Load at risk without DM (MVAh)	Load at risk with DM (MVAh)	Avoided dist. cost value (AC value - \$ t-2)	DM costs incurred during the regulatory year (\$ t-2)	Total costs being claimed (\$ t-2)
<Did not apply>						
<b>Total</b>						

**Table 2-5 Economic value of loss management investments (RIN table 14b.5)**

Name of project	Assessment of the quantity of energy loss avoided	Estimated unit value (based on AEMO average price data, or referenced to an independent source or third party)
<Did not apply>		
<b>Total value energy loss avoided (\$ t-2)</b>		

**Table 2-6 Total DM costs being claimed plus foregone revenues (RIN table 14b.6)**

Item	Present value
Avoided distribution costs - ongoing projects	1,941,790
Avoided distribution costs - new projects	0
Foregone revenues	253,005
Partial demand management costs	0
Economic value of loss management investments	0
Audit costs	12,425
<b>Total costs claimed (\$t-2)</b>	<b>2,207,220</b>
Nominal WACC	10.02%
<b>Total costs claimed (\$ t)</b>	<b>2,671,707</b>

**Table 2-7 D-factor calculation (RIN table 14b.7)**

DM cost pass through amount (t) (\$t)	2,671,707
SRR (t-1)	1,758,700,000
AF revenue (t-2)	253,005
DM cost pass through amount (t-1) (\$t-1)	1,008,396
SRR (t-2)	1,562,700,000
AF revenue (t-3)	60,813
<b>D-factor</b>	<b>0.00087404</b>
<b>D-factor (3dp)</b>	<b>0.001 Defer</b>

## 2.2 Overview of Ausgrid's DMIS reporting systems

Ausgrid had seven non-tariff demand management projects applicable under the D-factor scheme for which costs were incurred or revenue foregone in 2011/12.

The process to extract expenditure data for the D-factor projects from Ausgrid's reporting and accounting systems is well understood by relevant staff. While no specific procedures apply, each project is assigned a unique identifying number in SAP – DMIA projects are 12920 and D-factor projects are 12919 – and standard SAP reporting routines are used to extract expenditure data for reporting purposes. The auditor sighted a report from the SAP system containing the expenditure associated with the DMIS in 2011/12.

Ausgrid extracts the line item expenditure details for each DM project directly from SAP into a Microsoft Excel spreadsheet 'D factor calcs 201112\_draft for audit V2.xlsx' (this data is referred to in this report as 'SAP report'). This extraction uses the SAP identifying numbers noted above. A summary report is also created using a Cognos reporting tool called TM1 (referred to in this report as the 'TM1 report'). Spreadsheets are used to store the SAP data and to calculate the foregone revenue as well as the avoided distribution cost cap based on the extracted SAP data and other historical records stored in previous year's spreadsheets and reports. The RIN data is compiled by manual entry of data from the SAP report and other spreadsheets into the RIN template.

**Observations on process controls**

In reviewing the calculation of foregone revenue, the auditor noted that the calculations in the 'Mtr data' sheet are dependent on the order of the records in this sheet. The auditor tested the significance of ordering within the sheet on the foregone revenue calculation by randomising the records and found the dependence to be material. It is also noted that Ausgrid does not have a written procedure or works instruction for the maintenance and use of the foregone revenue spread sheet. In the view of the auditor, while this represents a weak control in the calculation of foregone revenue, our audit of the foregone revenue for the 2011-12 period confirmed the correct sorting had been performed on each of the foregone revenue spread sheets.

While in the 2011-12 period no foregone revenue is being claimed for customer embedded generation projects, the auditor noted that in calculating foregone revenue for these projects Ausgrid relies on export metering data to confirm the amount of energy generated by customer's plant. In addition, reliance is also placed on internal email records to confirm that Ausgrid requested the generator operation for the purposes of demand reduction during times of network constraint. To avoid claiming foregone revenue in the case of the customer running the generation plant for other reasons, Ausgrid relies on reconciling the export metering and internal dispatch request emails. The auditor notes that this is an undocumented manual reconciliation that relies on correctly identifying dispatch emails that may have been sent many months earlier. While no foregone revenue is being claimed for such projects during the 2011-12 period, nonetheless in the view of the auditor this represents a weak control in the calculation of foregone revenue that could lead to a material error in this calculation where such foregone revenue is claimed.

**2.3 Audit findings**

For the 2011/12 audit period, Ausgrid's reported DMIS data have been assigned the audit grades outlined in Table 2-8.

**Table 2-8 Ausgrid's compliance grade for the DMIS**

Item	Compliance Grade	Assessment
DMIS – Part B: D-factor scheme		
Verifiable	Yes	All information was able to be traced to the source data.
Reconciled with the audited statutory accounts	Yes	The values in the RIN tables were (in aggregate) reconciled to the audited statutory accounts.
Prepared in accordance with the approved 'Cost Allocation Methodology'	Yes	Complies.

These audit findings are supported by the objective evidence in section 2.4.

**2.4 Objective evidence**

The following evidence supports the auditor findings and Table 2-9 lists the documents reviewed by the Auditor.

**Table 2-9 Documents reviewed for DMIS**

Document title
Ausgrid D-Factor Submission for Costs and Revenue Foregone 2011-2012 Report to the AER Jan-13 (D-Factor Annual Report 2011-12_draft for audit V2.docx)
D-Factor Submission for Costs & Revenue Foregone 2010-2011 Report to the AER, March 2012 (D-Factor Annual Report 2010-11 FINAL_public version.pdf )
Audit of Ausgrid's 2010/11 Regulatory Information Notice – DMIS
Extract from the 2009 Ausgrid Final Determination (Table 16.23, page 320)
SAP report: Demand Management Total Monthly Expenditure by Internal Order Jun-12 (This is a reference used to identify the report which is run to extract monthly expenditure data from SAP on Internal Order number 919 – D-factor projects.)
SAP report: Display Actual Cost Line Items for Orders
Ausgrid Final RIN 201112 Worksheet 14b_for audit V2.xlsx
D factor calcs 201112_draft for audit V2.xlsx
2010-2011 RIN template (Demand Attachment A - RIN Regulatory Templates_160312.xlsx)
Greenacre PFC Revenue Foregone 1112.xlsx; Willoughby PFC Revenue Foregone 1112.xlsx; TerryHills PFC Revenue Foregone 1112 V2.xlsx; Medowie PFC Revenue Foregone 1112.xlsx; East Maitland PFC Revenue Foregone 1112.xlsx
<i>Superseded documents (below)</i>
Ausgrid D-Factor Submission for Costs and Revenue Foregone 2011-2012 Report to the AER Dec-12
Template 14b D-factor (for audit).xlsx
D factor calcs 201112_draft for audit.xlsx
Ausgrid D-factor Submission for 2010/11 Costs and Foregone Revenues (Ausgrid DFactor 2010-11 Submission.pdf (Feb-12) and D Factor Submission for 201011_v2 (for audit).docx (Dec-11))
D factor calcs 201011 v4 (for audit).xls
TerryHills PFC Revenue Foregone 1112.xlsx

**DMIS - Part B: D-factor scheme**

The extraction of Ausgrid's 2011/12 DMIS expenditure was verified from the reporting and accounting systems (SAP) as follows:

- The auditor positively verified the 'DM implementation costs incurred (\$t-2)' (RIN Table 14b.1) against the SAP report for the ongoing projects reported in the RIN data for:
  - (i) Wollombi embedded generator ext 2 (129190050)
  - (ii) Greenacre DM Project<sup>1</sup> (129190051 and 129190071)
  - (iii) Willoughby STS DM Project (129190054 and 129190061)
  - (iv) NW Pennant Hills Generation (129190070)
  - (v) Medowie DM Project (129190074)

<sup>1</sup> This project includes 'Greenacre-Sefton Risk Mgmt DM Project' (129190051), together with 'GAP - Sefton PFC Implementation (129190071).

(vi) East Maitland DM Project (129190075)

The auditor notes that the DM implementation costs incurred for Terrey Hills PFC & Generation are zero.

- The auditor verified the financial information in the SAP report and the TM1 report against the live SAP system for the following projects:
  - (i) Wollombi embedded generator ext 2 (129190050)
  - (ii) Greenacre DM Project (129190051 and 129190071)
  - (iii) Willoughby STS DM Project (129190054 and 129190061)
  - (iv) NW Pennant Hills Generation (129190070)
  - (v) Medowie DM Project (129190074)
  - (vi) East Maitland DM Project (129190075)
  
- The auditor verified that the 'Total avoided distribution cost cap (\$ t-3)' in RIN Table 14b.1 matched the figures for the corresponding year in 'March 2012 (D-Factor Annual Report 2010-11 FINAL\_public version.pdf' and in the file 'Attachment A - RIN Regulatory Templates\_160312.xlsx' as well as in the 'D-Factor Submission for Costs & Revenue Forgone 2011-2012 Report to the AER' dated December 2012 (D-Factor Annual Report 2010-11 FINAL\_public version.pdf ) for each of the seven demand management projects:
  - (i) Wollombi embedded generator ext 2
  - (ii) Greenacre DM Project
  - (iii) Terrey Hills PFC & Generation
  - (iv) Willoughby STS DM Project
  - (v) NW Pennant Hills DM Project
  - (vi) Medowie DM Project
  - (vii) East Maitland DM Project
  
- In the initial review of information provided, the auditor was unable to positively verify the 'Total avoided distribution cost cap (\$ t-3)' figures in RIN Table 14b.1 against the corresponding figures set out in 'Ausgrid D-factor Submission for 2010/11 Costs and Foregone Revenues' (D factor Submission for 201011\_v2 (for audit).doc) or D factor calcs 201011 v4 (for audit).xls. The auditor requested further information in order to verify these figures. Ausgrid provided final versions of the 2010-11 annual report and RIN ('March 2012 (D-Factor Annual Report 2010-11 FINAL\_public version.pdf' and 'Attachment A - RIN Regulatory Templates\_160312.xlsx'). Using this information, the auditor was able to verify the 'Total avoided distribution cost cap (\$ t - 3) for each of the seven demand management projects, as set out under the previous point.
  
- The auditor verified that the 'Costs previously claimed (\$t-3)' in RIN Table 14b.1 matched the figures for the corresponding year for the following projects in the 'Ausgrid D-factor Submission for 2010/11 Costs and Foregone Revenues' (D factor Submission

for 201011\_v2 (for audit).doc) and D factor calcs 201011 v4 (for audit).xls for the following projects:

- (i) Wollombi embedded generator ext 2
  - (ii) Greenacre DM Project
  - (iii) Terrey Hills PFC & Generation
  - (iv) Willoughby STS DM Project
  - (v) NW Pennant Hills DM Project
  - (vi) Medowie DM Project
  - (vii) East Maitland DM Project
- The auditor notes that Ausgrid has stated that the 'avoided distribution costs – new projects' (RIN Table 14b.2) did not apply during the audit period.
  - The auditor reviewed Ausgrid's calculations of foregone revenue for the seven demand management projects in RIN Table 14b.3. The following spread sheets were reviewed:
    - (i) Greenacre PFC Revenue Forgone 1112.xlsx
    - (ii) Willoughby PFC Revenue Forgone 1112.xlsx
    - (iii) Terry Hills PFC Revenue Forgone 1112.xlsx
    - (iv) Medowie PFC Revenue Forgone 1112.xlsx
    - (v) East Maitland PFC Revenue Forgone 1112.xlsx.

The auditor reviewed the methodology used to calculate foregone revenue, as described in Appendix A of 'Ausgrid D-Factor Submission for Costs and Revenue Foregone 2011-2012 Report to the AER Dec-12 (D-Factor Annual Report 2011-12 (draft for audit).pdf). The methodology applied appears to be sound.

- Using the information initially provided by Ausgrid, the auditor was unable to positively verify revenue foregone for the Terrey Hills project (TerryHills PFC Revenue Forgone 1112.xlsx). The auditor queried the figure with Ausgrid and it was confirmed that the spread sheet contained an error. Ausgrid subsequently provided the auditor with revised documents to reflect the corrected figure. Using this subsequent information the auditor was able to verify the relevant figures using the following documents:
  - (i) Ausgrid Final RIN 201112 Worksheet 14b\_for audit V2.xlsx
  - (ii) D factor calcs 201112\_draft for audit V2.xlsx
  - (iii) TerryHills PFC Revenue Forgone 1112 V2.xlsx
  - (iv) D-Factor Annual Report 2011-12\_draft for audit V2.docx.

The auditor also verified Ausgrid's updates of the following RIN tables:



- (i) Table 14b.3 Foregone Revenues – ‘Terrey Hills PFC & Generation’ and ‘Total estimate of foregone revenue (\$t-2)’
- (ii) Table 14b.6 – ‘Total costs claimed (\$t-2)’ and ‘Total costs claimed (\$t)’
- (iii) Table 14b.7 – ‘DM cost pass through amount (t) (\$t), ‘AF revenue (t-2)’ and ‘D-factor’

In addition, the auditor verified the updated figures above with those stated in D-Factor Annual Report 2011-12\_draft for audit V2.docx.<sup>2</sup>

Note that Tables 2.1 to 2.7 in this audit report reflect the values contained in the revised (version 2) Annual Report.

- The auditor notes that Ausgrid has stated that the ‘partial demand management costs’ (RIN Table 14b.4) did not apply during the audit period.
- The auditor notes that Ausgrid has stated that the ‘economic value of loss management investments’ (RIN Table 14b.5) did not apply during the audit period.
- The auditor positively verified the ‘Audit costs’ (RIN Table 14b.6) against the SAP report for the project ‘D-Factor Independent Review’ (129190062).
- The auditor positively verified the RIN data for ‘Smooth Revenue Requirement (SRR) (t-1)’ and ‘SRR (t-2)’ (RIN Table 14b.7) against Table 16.23, page 320, of the 2009 Ausgrid Final Determination. The data for ‘AF revenue (t-2)’ was found to be correctly translated from the total estimate of foregone revenue in RIN Table 14b.3. The data for ‘AF revenue (t-3)’ was positively verified against the ‘Ausgrid D-factor Submission for 2010/11 Costs and Foregone Revenues’ (D factor Submission for 201011\_v2 (for audit).doc) and ‘D factor calcs 201011 v4 (for audit).xls’.
- The auditor sighted a copy of Ausgrid’s audited statutory accounts and was able to reconcile the data presented in the SAP report ‘Demand Management Total Monthly Expenditure by Internal Order Jun-12’ for all D-factor projects. The audited accounts contain a line item for D-factor projects of \$2,233,445 of which \$2,219,449 is for projects listed in RIN tables 14b.1, and \$13,996 is for other projects (including the independent review).
- The RIN data for the D-factor projects was prepared in accordance with the AER approved Cost Allocation Methodology in that these are a direct allocation to the Network line of business (distribution). They are inclusive of direct and indirect costs and have been prepared in accordance with Ausgrid’s standard accounting practices, which allocates indirect costs by causal factors appropriate to each type of cost.

<sup>2</sup> Note that there was a \$1 variation between ‘Total costs claimed(\$t-2)’ in RIN Table 14b.1(\$2,207,720) and ‘Total D Factor Claim amount’ in Table 11 of D-Factor Annual Report 2011-12\_draft for audit V2.docx (\$2,207,719). This was carried through to the inflated figure (‘Total costs claimed (\$t) and ‘Total Claimed’). This \$1 discrepancy is an immaterial rounding error and does not change the auditor’s findings.

<sup>3</sup> Note that RIN Table 14.1 includes this cost as \$2,219,450. This \$1 discrepancy is negligible as a proportion of this cost. This is an immaterial rounding error and does not change the auditor’s findings.



# **Appendix A**

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## Schedule of Meetings

<b>Day</b>	<b>Area of Interest</b>	<b>Location</b>
15 Jan 2013	▪ Meeting with Lisa Mai - Senior Financial Analyst to discuss audited statutory accounts	Ausgrid Head Office, George Street Sydney
16 Jan 2013	▪ Meeting with Paul Myers - Manager - Demand Management & Sustainability to discuss calculations and reporting practices.	Ausgrid Head Office, George Street Sydney