



## **AER 'Better Regulation'**

### **Regulatory information notices to collect information for economic benchmarking**

#### **Further Submission on Draft RIN and Explanatory Statement**

**6 November 2013**

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## **1. Introduction**

On 18<sup>th</sup> October 2013, the Energy Network Association (ENA) provided a submission to the Australian Energy Regulator (AER) on its draft Regulatory Information Notice (draft RIN or RIN) to collect information for economic benchmarking for electricity distribution and transmission network services, and the AER's associated explanatory statement.

On 23<sup>rd</sup> October 2013, the ENA and its adviser KPMG, met with the AER and its adviser RSM Bird Cameron, to discuss the matters raised by the ENA's submission. That discussion identified a number of practical matters about which the ENA believes the AER and ENA broadly agree but where the AER had not yet had the opportunity to progress its thinking about how, in practical terms, these matters could best be addressed in the RIN. The purpose of this further submission is to provide the AER with constructive input on these matters to assist the AER to reach workable means of implementing the RIN for the advantage of all stakeholders.

The particular matters this further submission addresses are:

- using Auditing and Assurance Standards to determine audit and assurance requirements that are appropriate to the AER's regulatory requirements and are consistent with cost effective regulation;
- clarifying the bases of preparation of a RIN; and
- enabling the practical implementation of 'actual' and 'estimated' information required by the draft RIN Appendices C3.1 and C3.2.

The ENA emphasises that this supplementary submission does not intend to provide comprehensive recommendations for how the AER may, in practical terms, address the concerns raised in the ENA's 18 October 2013 submission. Rather, it highlights a number of matters, which on the basis of the meeting of 23 October 2013, provide immediate practical imperatives.

## **2. Appropriate audit and assurance requirements**

The audit and assurance requirements of the RIN mandate:

- a positive assurance opinion on 'actual' financial information; and
- a limited or 'negative' assurance opinion on 'estimated' financial information, non-financial information and on processes and procedures for non-financial information.

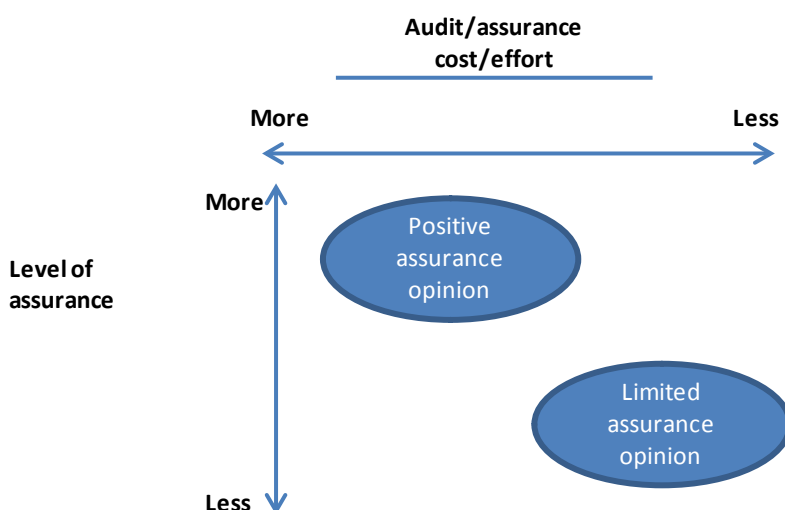
In broad terms, Auditing and Assurance Standards provide choices of three forms of assurance report, namely:

- a positive assurance opinion;
- a limited or negative assurance opinion; and
- a report of factual findings ("agreed upon procedures").

These different forms of report are intended in the standards to address different needs for assurance.

## 2.1 Assurance opinions

In general terms:



Limited assurance can be applied where:

- the level of risk or risk consequences do not merit a positive assurance report; and/or
- other forms of assurance are available, such as other sources of information available to the AER or statutory declarations, which reduce the need for independent assurance.

The advantage of a limited assurance report is that it can significantly reduce the time, cost and effort that would be otherwise required to provide a positive assurance report, particularly where in practical terms, a positive assurance report is unlikely to provide a material increase in the overall level of confidence or assurance that a user of the report (in this case the AER) would gain. Table 1 below summarises the factors that the AER should take into account in determining the form of audit or assurance report it may require.

*Table 1 - Matters to be taken into consideration in choosing form of report*

Criteria	Indicative criteria for choice of report by AER		
	Positive Assurance Report	Limited Assurance Report	No requirement for an assurance report
Are there material consequences of the information being misstated?	Significant	Limited	None
Are the figures material?	Yes	Potentially	No
Does independent evidence exist, which the user can refer to, to corroborate the information?	No	Limited or partial	Yes

	Indicative criteria for choice of report by AER		
Criteria	Positive Assurance Report	Limited Assurance Report	No requirement for an assurance report
Is the information or data subject to inherent variability.	Yes – could vary significantly from year to year	No	No
Is the information or data estimated or forecast?	Not applicable	Yes	Yes
Is the information or data inherently imprecise?	No	No	Yes
	Where data is inherently imprecise because, for example, it is based on assumptions or incomplete data (such as back cast information for earlier years in particular) assurance can only confirm that imprecision and therefore is likely to be of little or no value		
Has a strong onus of responsibility, such as a statutory declaration or responsibility statement, been placed on management and on independent board members in particular?	No	Yes (NSP may be expected to undertake its own assurance procedures to allow Board sign off)	Yes (NSP may be expected to undertake its own assurance procedures to allow Board sign off)
Is the production of the figures relatively straight forward required limited account judgement (eg direct extraction from underlying accounting records)?	No	Yes	Yes
Does the reporting entity have a history of materially misstated reporting?	Yes	No	No

The above table does not provide deterministic considerations that mean to suggest that all of the criteria in each column need to be met in order for the form of report represented in that column to apply. Rather, the choice of level of independent assurance is a matter of judgement of the risks and consequences of potential misstatement for each NSP and RIN template, each year, which takes into account the criteria set out above. This should involve the AER weighing the relevance and importance of the different criteria to each NSP and RIN template, each year.

The AER could develop a risk assessment framework based on the above considerations to assist and evidence these judgements and how they may translate into assurance requirements.

It also follows that obtaining the same form of opinion each year may not be necessary or efficient. For example, within a risk assessment framework, an assessment of low risk and a requirement for limited or no assurance opinion could be confirmed with a positive assurance opinion every, say, three or four years.

## **2.2 Report of factual findings (“agreed upon procedures”).**

Independent assurance opinions provide opinions on whether information accords with a basis of preparation or other criteria provided to the auditor or assurance practitioner.

In a report of factual findings an assurance practitioner will report his or her factual findings in response to procedures provided to the assurance practitioner by an engaging party and for which the engaging party is responsible. The assurance practitioner expresses no opinion and it is the responsibility of the party to whom the assurance practitioner reports to draw conclusions from the report.

This provides a more selective mechanism that could further obviate the need for more costly, time consuming and less focussed assurance opinions, where a particular item within a RIN templates may be of interest to the AER or of higher risk. This is an option that could be included in a regulatory assurance framework.

### ***Recommendation 1***

The AER should apply a risk based framework such as that described above, to ensure that its audit and assurance requirements are both relevant and efficient.

## **3. Basis of preparation**

The ENA’s submission of 18<sup>th</sup> October 2013 highlighted that a range of practical difficulties with the draft RIN could be addressed by the RIN template being accompanied by a basis of preparation document. Recommendation 7 of the 18<sup>th</sup> October 2013 submission focused on this matter. The ENA expands on this matter below, including by providing commentary on requirements in the current draft RIN template.

### **3.1 Principles**

The basis of preparation is inevitably the responsibility of the NSP preparing the information to which it relates. This is because it is the NSP that is being held responsible for the contents of the RIN and therefore the preparation of the information presented in the template. Also, in practical terms, it is the party preparing the information (i.e. the NSP in this case) who is the only person in a position to properly explain the basis on which the information has been presented.

Because this is a responsibility of a NSP which is also responsible for meeting the AER’s RIN requirements, it is incumbent on the AER to provide guidance on the criteria by which it will gauge a basis of preparation, and hence the information in a RIN template, to be acceptable.

### ***Recommendation 2***

The AER should provide guidance that is consistent with Appendix A of this document, whereby the basis of preparation would be:

- focused on the qualities and characteristics of the information reported in a RIN template. Matters of accounting procedures and process such as those raised by draft RIN

Appendix 3.4(b) are both subsidiary to the information being reported and not the purpose or subject of the information being sought by a RIN template. Therefore, they are not relevant to a basis of preparation. Furthermore, the AER is not in a position to determine what comprises an acceptable accounting process for each NSP. The integrity of the reported information is of paramount importance. This matter was also addressed under paragraph 4.3.4 on page 27 of the ENA's submission of 18<sup>th</sup> October 2013;

- concise. For the reasons set out above, the AER's guidance should have outcome based objectives and provide 'acceptability' criteria within which a NSP and its auditor can report, not prescriptive approaches. At the same time, an outcome based approach should not limit the disclosure that a NSP (and its auditor) may feel is necessary to present an understanding of the information presented by a NSP in a RIN template. Appendix A sets out a pro forma of the key points that this guidance may cover; and
- be of general application to RINs submitted to the AER, since it seems reasonable to expect that the AER outcome standards should be applied consistently.

### 3.2 Requirements of the draft RIN template

The ENA notes the current detailed requirements for disclosure in Template 9 of the draft RIN. The provision of a basis of preparation in accordance with the suggested guidance at Appendix A is more wide ranging in scope than Template 9. It would both facilitate the provision of audit and assurance opinions, as described in the ENA's submission of 18<sup>th</sup> October 2013, and obviate the necessity for detailed line-by-line disclosures contemplated by Template 9 of the RIN template.

This is because an auditor, in reporting on both the RIN template and basis of preparation (as described in this document), would among other things, need to assess whether the data in the template was presented using the sources set out in the basis of preparation (e.g. 'statutory accounting records'). It is not clear however, what purpose a *detailed* line by line disclosure contemplated by Template 9 would serve. It does not appear to be information that the AER will use in undertaking economic benchmarking. At the same time, it does not comprise or substitute for a basis of preparation, such as that outlined at Appendix A of this document. Template 9's disclosures do not add or assist the audit or assurance processes. Template 9 takes no regard of materiality of disclosure yet an auditor is likely to examine sources of material data in at least as much detail as that envisaged by Template 9, regardless of the level of disclosure in Template 9.

#### **Recommendation 3**

The Template 9 disclosures should not be mandatory. However, Template 9 could retain the provision for **non-mandatory** disclosures on a line-by-line basis in Template 9, if a NSP believes that this should be necessary to provide a proper understanding of specific figures in a RIN template.

## 4. Actual and estimated data

### 4.1 Definitional issues

Appendix C1.1 of the draft RIN indicates that the data which is subject to audit may comprise either **actual** or **estimated** financial or non-financial data. In particular, Appendices C3.1 and C3.2 distinguish different audit or assurance requirements for **actual** and **estimated** historical financial information.

These requirements make definitions of **actual** and **estimated** historical financial information vitally important. In order to fulfil the requirements of Appendix C of the draft RIN, an auditor will be required to make an independent judgement of whether historical financial information presented

to him or her by an NSP, comprises **actual** or **estimated** information. As with other aspects of the basis of preparation of information that an auditor is required to attest to, an auditor requires a definition to provide a basis of attestation, in order to form an opinion on whether historical financial information is **actual** or **estimated**.

An auditor's independent view could lead to historical financial information being reclassified by a NSP between **actual** and **estimated** to avoid a qualified audit opinion. Estimated historical financial information can potentially arise in any year, especially where the AER may introduce new or changed cost categorisations or where data collection systems may not have been designed or exist, to meet the AER's requirements. Estimated historical financial information is unlikely to arise solely as a result of back casting requirements.

The draft RIN defines neither the terms **actual** nor **estimated**. Appendix C1.1 of the draft RIN indicates that **estimated** (financial or non-financial) data is that based on reasonable management judgement and assumptions. However, historical financial information includes estimates, assumptions and reasonable management judgements in the normal course of events. Examples of this include the application of accruals, prepayments provisions and accounting policies concerning the presentation of information and recognition of costs and income. This is one reason why auditors are required to express opinions on the truth and fairness of information presented in accordance with stated bases of preparation, rather than 'certify' the 'correctness' of financial information. The implication of this is that, absent a definition by the AER of what it means by **actual** and **estimated**, there could be significant uncertainty among both Network Service Providers (NSPs) and their auditors of how to report information and the AER could receive information and associated audit or assurance reports that does not meet its intent or expectations. This holds the potential for otherwise avoidable uncertainty, disagreement, cost and delay.

#### **Recommendation 4**

The RIN should provide the following definitions:

*“Actual information presented in a RIN template comprises information whose presentation is materially dependent on information recorded in an NSP accounting records or other records used in the normal course of business, and whose presentation for the purposes of the RIN is not contingent on judgements and assumptions for which there are valid alternatives, which could lead to a materially different presentation in the RIN template.”*

and

*“Estimated information comprises both:*

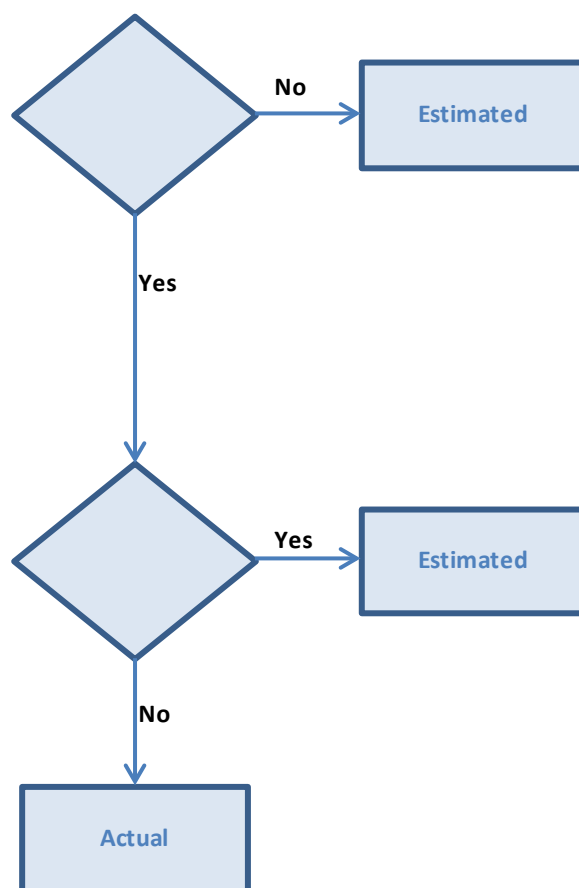
- *Information presented in a RIN template whose presentation is materially dependent on estimated or assumed information that is not recorded on an NSP's historical accounting records or other historical records used in the normal course of business; and*
- *Information which is materially contingent on a basis of preparation for the purposes of the RIN, which requires assumptions or judgements for which there are valid alternatives, which could provide materially different outcomes.”*

These definitions are consistent with the following decision tree.



Is the information presented in the RIN template materially dependent on information recorded in the NSP's accounting records or other records used in the normal course of business?

Is the presentation of the information in the RIN template materially contingent on a basis of preparation for the purposes of a RIN, which requires estimates or judgements for which valid alternatives may exist?



### ***Explanation***

In the normal course of events, accounting records contain information and entries which reflect reasonable judgements made in accordance with the requirements of Accounting Standards and normally subject to statutory audit (for example accruals and prepayments). It seems reasonable to assume that this is what the AER intends to mean by 'actual' information.

Where this information does not exist, it seems reasonable to assume that any substitute information would be 'estimated'.

However, where the information does exist, it may need to be further manipulated or processed to present information for the purposes of a RIN. Cost allocations or re-categorisations would be examples. This further manipulation or processing will necessarily form part of the basis of preparation of that information when presented in a RIN template. That additional processing may be based on for example, a stated basis of allocation under a CAM for which supporting data (e.g. EFT) necessary to the allocation may be accessible from historical records. However, it may also be reasonably expected that in some cases such as:

- re-categorisation costs from the categories used by a NSP's records, to those of a RIN template; or

- cost allocations such as for back cast data where data for the basis of allocation may not be available or no longer exist (particularly data not required to be retained for statutory purposes);

the figures presented in a RIN template will be:

- contingent on reasonable management estimates and assumptions; and
- choices of reasonable estimates or assumptions could exist which could lead to materially different figures subject to those estimates or assumptions, being presented in the RIN template.

In such a case, the data will be estimated, notwithstanding that it will be based on data sourced from accounting records. The definition proposed above:

- recognises this; and
- provides clear criteria which a NSP and its auditor can use to assess and attest to, whether information presented in a RIN template is 'actual' or 'estimated'.

#### 4.2 Disclosure

To provide an audit or assurance report, an auditor needs to unambiguously identify the subject matter he or she is reporting on. At present, a RIN template for a NSP may include both "actual" and "estimate" information within the one template. Whether information is actual or estimated might be expected to vary by:

- cost or date category (e.g. some might be actual, others might be estimated); and
- year, where data is back cast (e.g. in some years data may be estimated, in others it may be actual, but a given year may include both actual and estimated information, the combinations of which are likely to vary from year to year).

This is illustrated below.

Information categories	E	A	A	A	A
	E	E	E	E	E
	E	E	E	A	A
	E	E	E	A	E

**A = Actual**  
**E = Estimated**

This presents the AER, NSPs and their auditors with significant practical challenges that will introduce further time and cost to the preparation of a RIN template and its accompanying documents.

Appendix C3.1 and 3.2 of the draft RIN lead to requirements for an auditor to opine on two separate RIN templates for financial information:

- a RIN template containing only estimated data and an associated basis of preparation in order to report under draft RIN Appendix 3.2(a); and
- a RIN template containing only actual data and an associated basis of preparation, in order to report under draft RIN Appendix 3.1(a).

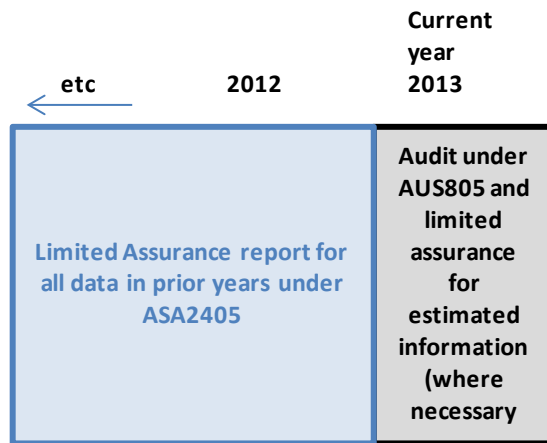
as well as reporting on the non-financial information under draft RIN Appendix 3.3(a).

It will then be the responsibility of the AER to “merge” the audited and estimated information in the two financial templates, to provide an overall picture. This will involve significant duplication of work with risks to timing, costs and data integrity of merged templates, for both the AER and NSPs.

**Recommendation 5**

The AER should re-examine the costs and benefits of its requirements in its draft RIN. The options for increasing the benefit cost ratio of the AER’s requirements in this instance are:

- reduce the number of years for which back cast data is required. The ENA’s submission of 18<sup>th</sup> October 2013 has already highlighted a number of important questions about whether the regulatory benefits of an extended period of back cast data will justify the costs and risks of that requirement. The matters outlined above exacerbate these concerns; and
- apply a requirement for a single limited assurance report to all the data or at least all data for other than the most recent year. This could significantly streamline and accelerate the processes for both the AER and the NSPs without a significant practical reduction in independent assurance gained by the AER.



A limited assurance report can be sought for both actual and estimated prior year financial information, whereas an audit report under AU805 could not be applied to estimated data.

The ENA submission of 18 October 2013 describes the assurance options open to the AER and this document expands further on these options at Section 2.

## **Appendix A: Suggested guidance on AER requirements for a basis of preparation**

- Financial information should be presented:
  - using accounting policies and bases normally employed by the NSP that are consistent with Australian Accounting Standards; except where there may be an explicit regulatory requirement to depart from policies and bases of preparation
  - using cost allocations that are consistent with a NSP's Cost Allocation Methodology.
- 'Actual' information (as defined by the AER) shall be capable of being replicated from a NSP historical records and stated accounting policies and Cost Allocation Methodology (where relevant).
- Forecasts and estimated information (as defined by the AER) shall be capable of being replicated from relevant assumptions recorded by a NSP and its stated accounting policies and Cost Allocation Methodology (where relevant).
- A NSP's basis of preparation shall disclose:
  - the accounting policies and assumptions and refer to the Cost Allocation Methodology that are material to providing an understanding of the information provided in a RIN template;
  - any accounting policies that it may have employed to present the information in the RIN template, that are inconsistent with Australian Accounting Standards, and the reasons for any such departure (e.g. explicit regulatory requirements);
  - by way of note, the material effects of any accounting policies or cost allocations methods that may have changed from the prior year, on figures in the RIN template of the prior year, as if the changed policy had applied in that prior year. This disclosure requirement shall only apply to RIN reporting periods starting on or after 1 January 2013<sup>1</sup>.
  - the principal sources of information it has drawn on to present information in a RIN template, where those sources of information do not comprise the statutory accounting records of a NSP.

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<sup>1</sup> This is requirement avoids impractical or needless reworks where one or more policy may have changed more than once over a back cast period. Multiple reworkings of prior year figures would involve significant effort, may not be practical due to information in availability (this is recognised by Accounting Standards - see page 14 of the ENA submission of 18<sup>th</sup> October) and would backshift the effect of the changes rather than implement a uniform policy or method across the back cast period

The RIN template of the prior year shall not be reissued. Rather the original RIN template and the note will allow a reader to understand any material effects of the change in policy or cost allocation methods. This is a critical distinction since replacing a RIN template with a RIN template prepared under an accounting policy or cost allocation method not ruling in the period the original RIN template was prepared, presents a risk of misstating the information disclosed for that period in the successor RIN template. This matter was also raised in page 13 of the ENA submission of 18<sup>th</sup> October.

- Nothing in this guidance shall preclude a NSP from providing basis of preparation that exceeds the minimum requirements of this guidance, where a NSP believes that this may assist a user to gain an understanding of the information presented in a RIN template.
- Information shall be presented in a RIN template in accordance with a clearly defined basis of preparation that accords with this guidance and is applied using a standard of materiality consistent with the definition of materiality set out in the current Australian Accounting Standards Board Glossary of Defined Terms.
- In reporting an audit opinion or making an attestation report on a RIN template presented by a NSP, an auditor or assurance practitioner shall opine or attest by reference to the relevant basis of preparation prepared in accordance with this guidance.