



# **Jemena Gas Networks (NSW) Ltd – Further response to the draft decision**

## **Attachment 6**

**Ernst & Young: Expert report  
demonstrating how JGN's  
capitalisation policy complies with the  
relevant accounting standards  
submitted on 19 April 2010**

28 April 2010



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19 April 2010

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Mr Mike Buckley  
General Manager, Network North Branch  
Australian Energy Regulator  
23 Marcus Clarke Street  
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**JGN access arrangement revision proposal: Additional expert report on JGN's capitalisation policy**

Dear Mike

Jemena Gas Networks (NSW) Ltd (**JGN**) provides this submission in addition to the materials provided in confidential Appendix 3.b4<sup>1</sup> of JGN's initial response to the Australian Energy Regulator's (**AER**) draft decision and it forms part of JGN's response to the draft decision.

This submission provides an independent expert accounting opinion report from Ernst & Young (**EY**): *Expert Report in relation to accounting standards applicable to the capitalisation of costs*.

This report complements Appendix 3.b4 by providing an expert assessment JGN's capitalisation policy against the relevant accounting standards. This report has been prepared in accordance with the Federal Court guidelines for expert witnesses.

This report does not alter the actual or forecast expenditure reported in JGN's revised access arrangement revision proposal. Instead, the report provides further detailed expert evidence on why expenditure that JGN has capitalised under its capitalisation policy is appropriately characterised as being capital expenditure, that is, that they are costs and expenditure of a capital nature incurred to provide, or in providing pipeline services.

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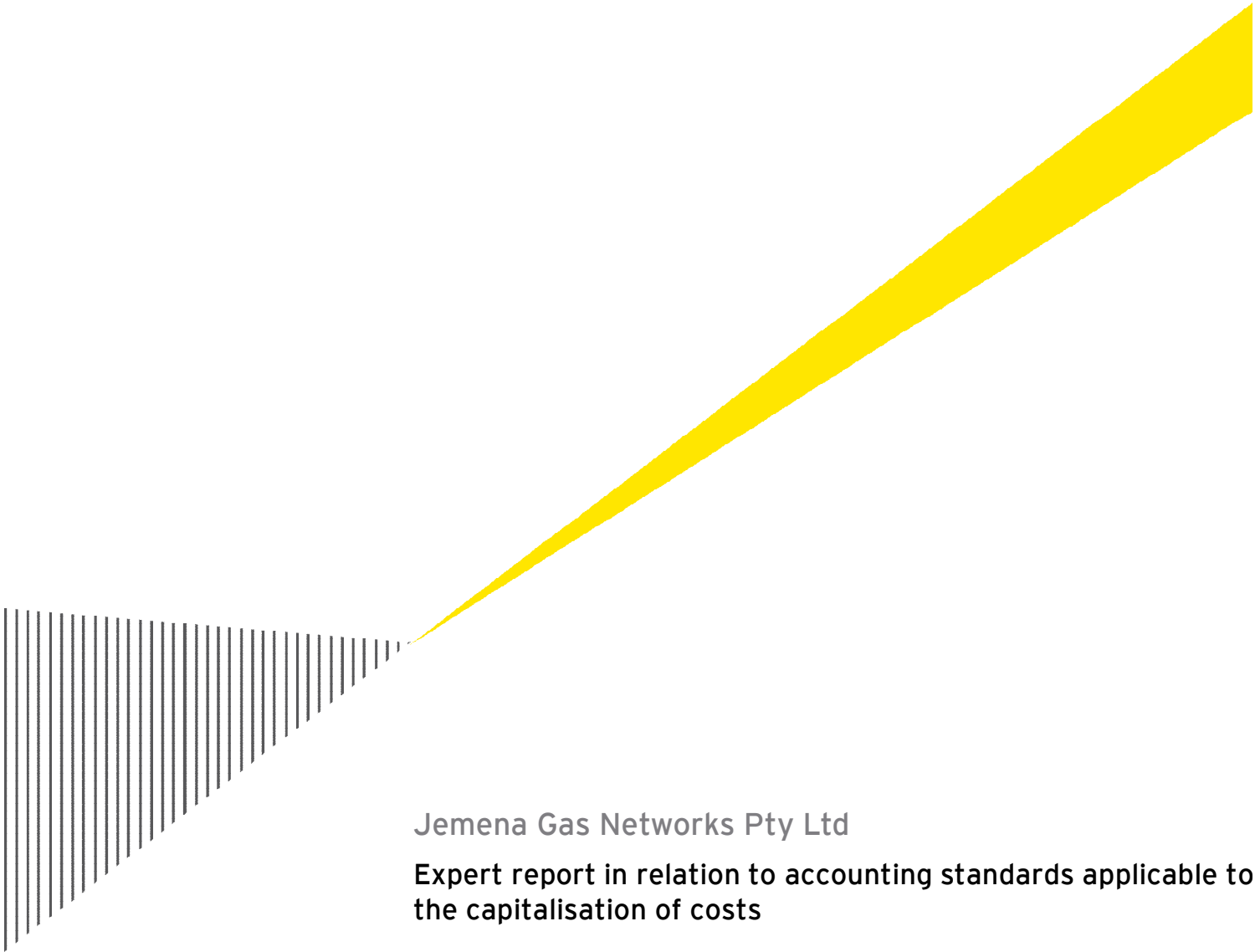
<sup>1</sup> JGN, *Initial response to the draft decision*, 19 March 2010, Appendix 3.b4, *Ernst & Young – Review of Capitalisation Policy*.

If you have any questions regarding this letter please contact Sandra Gamble on (02) 9270 4512 or [sandra.gamble@jemena.com.au](mailto:sandra.gamble@jemena.com.au).

Yours sincerely

A handwritten signature in black ink, appearing to be 'Alf Rapisarda', enclosed in a thin black rectangular border.

**Alf Rapisarda**  
Group Manager Energy Networks  
Jemena Limited



Jemena Gas Networks Pty Ltd

**Expert report in relation to accounting standards applicable to  
the capitalisation of costs**

15 April 2010

Mr Louren Edwards  
Group Manager, Finance Reporting  
Jemena Gas Networks Pty Ltd  
321 Ferntree Gully Road  
Mount Waverley  
VIC 3149

15 April 2010

*Private and confidential*

Dear Louren

## **Expert report in relation to accounting standards applicable to the capitalisation of costs**

Please find attached a draft of my expert witness report for your review and consideration.

In preparing this report, I have relied on instructions from you, which are identified in Section A. I would appreciate it if you could please confirm that these are your final instructions and that, to your knowledge and belief, nothing material has been omitted.

If you instruct us to finalise the report, I will take that as confirmation that nothing material has been omitted.

Please do not hesitate to contact me on 03 8650 7623 should you have any queries.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Brett Croft'.

Brett Croft  
Partner

Attachment  
Copy to: Robert McMillan  
Bill Fletcher

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## A. Introduction

1. I am a Partner of Ernst & Young. My curriculum vitae is at Appendix A.
2. In this report, I have adopted the abbreviations set out in Appendix B.

### Background

3. I understand that this report is prepared in respect of Jemena's 2011-2015 Gas Access Arrangement ("GAA"). In completing this report, I have been instructed by Louren Edwards - Group Manager - Finance Reporting - Jemena Gas Networks Pty Ltd.
4. I am instructed that the following is the relevant background to this matter.
5. Jemena is currently engaged with the Australian Energy Regulator ("AER") in the AER's review of Jemena's GAA. Jemena submitted an initial GAA in August 2009 and a further revised GAA on 19 March 2010 which, if approved, will cover the period 2011-2015 (July to June financial years).
6. In its draft decision, the AER concluded that the costs incurred in relation to the following capital works for both the current (2006-2010) and forecast access periods were not capital in nature:
  - Appin mine subsidence;
  - Integrity digs;
  - Pigging;
  - Adhoc mains and service renewals.
7. I have been informed that in doing so, the AER relied upon its own findings and those of Wilson Cook, an engineering firm. In rejecting Jemena's capital expenditure proposal, I understand that the AER adopted a Wilson Cook notion that expenditure is not 'capital in nature' if it does not create a new asset or extend the life of an existing asset.

### The assignment

8. I have been instructed to provide an opinion as to what accounting standards, and authoritative guidance, are relevant in determining whether expenditure is capital in nature and whether Jemena's accounting policy for the capitalisation of costs is in accordance with the relevant accounting standards and authoritative guidance. The terms of reference are attached at Appendix D.
9. Due to existing relationships between Ernst & Young and entities associated with Jemena Gas Networks Pty Ltd (principally the Global Crossing Limited Group, a company which is also owned by the Temasek Group, but is subject to US SEC regulations), I am prohibited from considering whether Jemena's capitalisation policy has been correctly applied to the costs incurred on the specific projects referred to in A.6 above.

## Information

10. The documents that I have relied upon for the purposes of completing this report are listed in Appendix C.
11. I have not conducted an audit or other verification of any information supplied to me. I have assumed that the information supplied to me is accurately stated.
12. Neither Ernst & Young, or I warrant the accuracy or reliability of any of the information supplied to me.
13. The opinions set out in this report may alter if there are any changes to the information supplied to me.
14. I have received all relevant information requested during the course of preparing this report.

## Qualifications

15. My opinion is based on my interpretations of Australian Accounting Standards, and authoritative guidance, as at the date of this report and on the information provided to me by Jemena management. Should any of these facts and circumstances and/or the relevant accounting pronouncements change, my conclusion may change.

## Pre-existing relationship

16. Ernst & Young prepared an accounting treatment letter covering the treatment of the relevant costs on 17 March 2010.
17. Ernst & Young is the auditor of the Global Crossing Limited Group, a company within the same group as Jemena.

## Reliance on this report

18. This report has been prepared, and may be relied on, solely for the purposes of this submission. This report has been prepared specifically for Jemena and the AER. Ernst & Young does not take responsibility to any person, other than Jemena and the AER, in respect of this report, including any errors or omissions howsoever caused.
19. Neither this report nor any part of it may be published or distributed other than for the specified purpose without obtaining the written consent of Ernst & Young.

## Assistance by colleagues

20. In order to arrive at my opinions in this matter, I have selected colleagues to assist me. My colleagues carried out the work that I decided they should perform. I have reviewed their work and original documents to the extent I considered necessary to form my opinions. The opinions expressed in this report are mine.

## Fees for this assignment

21. The fees received or receivable in relation to this assignment are based upon agreed hourly rates for time incurred.



## **Conduct of this assignment**

22. I have read the Guidelines for Expert Witnesses in Proceedings in the Federal Court of Australia and agree to be bound by them.
23. I have made all the inquiries which I believe are desirable and appropriate. No matters of significance that I regard as relevant to my opinion have, to my knowledge, been withheld.

## **Structure of this report**

24. The structure of the remainder of this report is as follows.
25. In Section B, I set out a summary of my opinion and the reasons for this opinion.
26. In Section C, I set out the qualifications to my opinion.
27. In Section D, I set out my conclusion.

## B. Summary of my opinion

1. This summary should be read in conjunction with the full report.
2. In my opinion, Australian Accounting Standard AASB 116 *Property, Plant and Equipment* ("AASB 116"), and certain provisions of UIG Interpretation 1030 *Depreciation of Long-Lived Physical Assets: Condition-Based Depreciation and Related Methods* ("Int 1030") and the AASB Framework for the Preparation and Presentation of Financial Statements ("the Framework") are considered directly or indirectly relevant in determining whether expenditure is capital in nature. That is, whether and when such expenditure should be capitalised as an asset. In addition, I refer also to pronouncements by the International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC") upon which the Framework and AASB standards are based.
3. In my opinion, Jemena's accounting policy for the capitalisation of costs is in accordance with the requirements of this standard and authoritative guidance.

## C. Opinion

### Relevant accounting standards

1. AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* specifies the hierarchy an entity should consider when selecting and applying accounting policies. It states:  
  
*“When an Australian Accounting Standard specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Australian Accounting Standard and considering any relevant Implementation Guidance issued by the AASB for the Australian Accounting Standard.”*
2. In the absence of specific guidance, management of an entity should use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable. In making this judgement, management shall refer to, and consider the applicability of, the following sources in descending order:  
  
*“(a) the requirements and guidance in Australian Accounting Standards dealing with similar and related issues; and*  
  
*(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.”*
3. In considering this hierarchy, the accounting standard, interpretation and framework noted in B.2 above have been considered to be either directly relevant or provide useful related guidance on this topic, when reaching my conclusion.
4. Accounting standards, the Framework and UIG interpretations are issued by the AASB. Entities preparing financial reports in Australia are required to comply with these pronouncements in accordance with the Corporations Act 2001.
5. The relevant extracts from these accounting pronouncements and associated comments are outlined below.

### Recognition

#### Summary

6. When considering how to account for an item of expenditure, and specifically whether such expenditure represents an asset (i.e.: capitalised), the Framework provides the basic criteria to be satisfied. AASB 116 (which is the relevant accounting standard governing the treatment of costs relating to property, plant and equipment (PP&E)) also requires similar criteria to be met.
7. Paragraph 49 of the Framework defines an asset as:  
  
*“... a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.”*
8. Consistent with this AASB 116.7 states that:  
  
*“The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:*
  - a) *it is probable that future economic benefits associated with the item will flow to the entity; and*

- b) *the cost of the item can be measured reliably.*"
9. In determining what constitutes an "item" of PP&E and what is an appropriate level at which to assess and potentially capitalise expenditure, AASB116.9 states:
- "This Standard does not prescribe the unit of measure for recognition, that is, what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the criteria to the aggregate value."*
10. In addition, and in clarifying that certain components comprising an item of PP&E can be treated differently for initial recognition and depreciation purposes, AASB 116.44 states, in relation to depreciation:
- "An entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease."*
11. In relation to derecognition, alignment with the level applied for depreciation purposes is not required to be able to derecognise part of an item of PP&E. Specifically, AASB 116.70 states that:
- "If, under the recognition principle in paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed."*
12. While not necessarily directly relevant, another source of analogous guidance is Int 1030. While Int 1030 specifically considers the issue as to what, if any, characteristics of condition-based depreciation (as had previously been applied to long-lived assets, including infrastructure assets, in both the public and private sectors) and other similar methods of depreciation contravene the requirements of AASB 116, it does discuss concepts that are relevant here. Specifically it considers that there is a difference between subsequent expenditure on an asset which is capable of being capitalised and that which is more akin to repairs and maintenance and hence should be expensed. Specifically paragraph 19 states that:
- "This Interpretation prohibits the use of the renewals method of accounting for financial reporting purposes. The renewals method of accounting assumes that the asset is in a steady state and that subsequent expenditure on the asset will not increase future economic benefits of the asset, but will maintain the future economic benefits at existing levels. As such, all expenditure on the asset is treated as maintenance expenditure and recognised as an expense in the period in which it is incurred, and an additional depreciation expense is not recognised. This Interpretation reflects the view that rarely, if ever, will it be possible to reliably determine that an asset is in a steady state. In addition, such a steady state is likely to change at any time as, for example, consumer demand and entity objectives change. Whether an asset is maintained in a steady state as a consequence of expenditure on the asset during the period will be reflected by:*
- (a) *an analysis of whether the future economic benefits provided by the asset have been consumed during the reporting period and whether expenditure on the asset has restored or increased those future economic benefits; and*
- (b) *the recognition of maintenance and depreciation expense in accordance with the requirements of AASB 116.*

13. Int 1030.20 gives further guidance in relation to capitalising costs incurred in relation to inspection:

*“Some condition-based depreciation and similar methods propose that a provision for future maintenance be recognised. However, AASB 137 Provisions, Contingent Liabilities and Contingent Assets indicates that a provision for future maintenance cannot be recognised as a liability. Furthermore, AASB 116 states that when each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied.”*

#### **Future Economic Benefits**

14. In considering the concept of “future economic benefits”, which are not defined in AASB 116, paragraph 53 of the Framework provides some guidance:

*“The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.”*

15. Given this, in relation to subsequent expenditure on an already existing asset, it is considered within the Framework and by AASB 116 that contribution of future economic benefits may therefore arise either from:

- extending an asset’s useful life;
- improving the quality of output or capacity of another asset; or
- reducing operating costs associated with an asset - which may include activities that would reduce future expenditure on repairs and maintenance.

#### **Environmental and safety equipment**

16. While the need to give rise to future economic benefits is an essential feature to enable most items of expenditure to be capitalised, AASB 116 does acknowledge that there may be expenditures forced upon an entity by legislation that require it to buy 'assets' or incur expenditure items that do not meet the recognition criteria because the expenditure does not directly increase the expected future benefits expected to flow from the asset.

17. Specifically AASB 116.11 states that:

*“Items of property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in excess of what could be derived had it not been acquired. For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because, without them, the entity is unable to manufacture and sell chemicals. However, the resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with AASB 136 Impairment of Assets.”*

#### **Subsequent expenditure - capitalise or expense?**

18. AASB 116 is based on the international standard IAS 16. While previous versions of IAS 16, had separate recognition principles for subsequent expenditure, the IASB

decided that different recognition principles were not appropriate and therefore amended the standard (which in turn is then the basis for AASB 116). Paragraph 10 of AASB 116 now makes it clear that it deals with costs incurred initially upon acquisition or construction of an item of PP&E and those subsequently incurred and the same recognition principles apply.

*“An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it.”*

19. AASB 116 does therefore draw a distinction between servicing and further major expenditure.

#### **Repairs and maintenance**

20. Day-to-day servicing, by which is meant the repair and maintenance of PP&E, and which largely comprises labour costs and minor parts, should be recognised in profit or loss as incurred. AASB 116.12 states:

*“Under the recognition principle in paragraph 7, an entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.”*

#### **Replacements**

21. AASB 116 identifies two particular types of parts of assets. The first is an item that requires replacement at regular intervals during the life of the asset. The second type involves less frequently recurring replacements. In relation to such costs, AASB 116.13 notes:

*“Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a nonrecurring replacement. Under the recognition principle in paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard (see paragraphs 67-72).”*

#### **Major inspections**

22. The standard also allows recognition of costs where an entity is required to perform regular major inspections for faults, regardless of whether any physical parts of the asset are replaced. Paragraph 14 deals with this:

*“A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be*

*used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed*

23. It is important to note, with replacements and major inspections, the need to satisfy the recognition criteria set out above (paragraph 7) still exists i.e., future economic benefits and reliable measurement.

### **Elements of Cost**

24. After establishing the principles relating to recognition, AASB 116 then contains provisions regarding the elements that may comprise the "cost" of an item of PP&E. These are applied to both assets acquired from third parties and self-constructed assets and the principles are relevant to expenditure incurred subsequent to initial recognition.
25. Paragraph 16 sets out the elements of cost of an item of PP&E on its initial recognition and includes:
- "(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;*
  - (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management; and*
  - (c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period."*
26. Within these elements, one of the key issues is the determination of "directly attributable costs". However, there is no guidance provided in AASB 116 (or elsewhere throughout the accounting standards framework or authoritative guidance) to precisely define "directly attributable costs". The standard does however provide examples of the types of expenditure that are considered to be "directly attributable costs", and hence may be included in cost of an item of PP&E (paragraph 17):
- "(a) costs of employee benefits (as defined in AASB 119 Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;*
  - (b) costs of site preparation;*
  - (c) initial delivery and handling costs;*
  - (d) installation and assembly costs;*
  - (e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and*
  - (f) professional fees."*
27. Other examples might include:
- (a) Project overheads such as rental of floor space, printing and stationery, telephones, facsimiles and local travelling expenses
  - (b) Borrowing and foreign exchange costs.
28. Paragraph 19 of AASB 116 also provides some examples of other costs that are not considered to be part of the cost of an item of PP&E. Amongst these are training costs and administration and other general overhead costs. This means

that costs not related to a specific asset such as strategic activities relating to the site selection, and general management time, do not qualify for capitalisation.

### Cessation of capitalisation

29. After establishing the rules for initial recognition and what comprises “cost” AASB 116.20 then requires that the recognition of costs in the carrying amount of an item of PP&E ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management.
30. While capitalisation is required to cease at the point noted above, the standard does not preclude the capitalisation of costs subsequent to that point provided that such expenditure meets the recognition criteria or represents safety and environmental expenditure (as discussed above).

### Comparison of relevant accounting standard with Jemena capitalisation policy

31. Jemena’s accounting policy (FIN-ACC-012 Property, Plant and Equipment) includes the following requirements for capitalisation of costs incurred in relation to network activity:

*Jemena recognises the cost of an item of PP&E as an asset when it is probable that future economic benefits associated with the item will flow to the Group, and where the costs of the item can be measured reliably.*

*Jemena includes the initial purchase price and all costs directly attributable to the acquisition of an item of PP&E in that item’s cost. Costs recognised in the quantum of PP&E items are discussed in detail in APPENDIX 1 [to the policy]. In the case of PP&E items constructed by the Group, the items’ cost includes:*

- *The cost of any materials;*
- *Direct labour costs;*
- *Any other costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by Jemena’s Management;*
- *Where applicable, the costs of dismantling and removing the item and restoring the site on which the item was located (the costs of retiring / decommissioning the asset). Note, these costs are calculated by expert estimators engaged by Jemena to perform such calculations; and*
- *An appropriate proportion of any directly attributable production overheads.*

*Items acquired by Jemena to address environmental or safety concerns held with PP&E assets shall themselves be recognised as PP&E where the items acquired were necessary to obtain future economic benefits from the assets. While such items do not necessarily increase the flow of future economic benefits to Jemena, they do enable the flow of future economic benefits and as such meet the recognition criteria.*


32. Jemena’s accounting policy is practically identical to the wording contained in AASB 116 to the extent of content currently included in that accounting policy.



## D. Conclusion

1. I conclude that, given the information presented, and subject to the qualifications noted in Section A above, at the time of this report, in my opinion:
  - The accounting standards relevant in determining whether expenditure is capital in nature are:
    - AASB 116 Property, Plant and Equipment
    - UIG Interpretation 1030 Depreciation of Long-Lived Physical Assets: Condition-Based Depreciation and Related Methods
    - AASB Framework for the Preparation and Presentation of Financial Statements
  - Jemena's capitalisation policy is consistent with these relevant accounting standards to the extent of content currently included in that accounting policy.
2. I declare that:
  - I have made all enquiries which I believe are desirable and appropriate; and
  - No matters of significance which I believe are relevant have, to my knowledge, been withheld.

## Appendix A: Curriculum vitae

	<p><b>Experience</b></p> <p>Brett is a Partner of Ernst &amp; Young in Melbourne. Brett is the Oceania leader of the Power &amp; Utilities team and provides assurance and business advisory services to a number of clients in the energy industry, including clients in our Melbourne office and previously, with some of our largest energy clients in the London and Houston offices and a variety of clients in our Chicago and San Francisco offices.</p> <p>Brett is also the Oceania markets leader for the Assurance practice, which involves working across the region to improve the firms Assurance market footprint.</p> <p>Brett is Board member of the EY Foundation and is a past State Chair of the Institute of Chartered Accountants.</p>
<p><b>Brett R.E. Croft</b>  <b>Partner</b>  <b>Oceania Leader -</b>  <b>Power &amp; Utilities</b>  <b>Tel 61 3 8650 7623</b>  <b>Fax 61 3 8650 7711</b>  <b>Email:</b>  <a href="mailto:brett.croft@au.ey.com">brett.croft@au.ey.com</a></p>	<p><b>Utilities Industry Credentials</b></p> <ul style="list-style-type: none"> <li>▪ <i>SP AusNet</i>  Regulatory audits associated with the retail and network operations  Sustainability report  Accounting advisory projects  Various risk management and internal audit projects</li> <li>▪ <i>Jemena</i>  Review of certain costs associated with the Jemena business.  Accounting advisory projects  Various risk management and internal audit projects</li> <li>▪ <i>Origin Energy</i>  Regulatory audits associated with the retail operations</li> <li>▪ <i>Aurora Energy</i>  Audit of Tasmanian integrated energy company</li> <li>▪ <i>Pacific Hydro Limited</i>  Audit of the ASX Listed Hydro Electricity Generation Company</li> <li>▪ <i>Australian Competition and Consumer Commission</i>  Review of certain reference tariff price variables - gas transmission pipeline system</li> <li>▪ <i>Energy 21/Stratus Networks</i>  Audit of the former stapled gas retail and distribution business</li> <li>▪ <i>Project "Storm"</i>  Due diligence review and associated accounting advice in connection with the acquisition of a Victorian generator</li> <li>▪ <i>Pulse Energy Pty Ltd</i>  Due diligence review and associated accounting advice in connection</li> </ul>

with the development of a multi-fuel retail start-up entity

- *Project "Starfish"*

Due diligence review and certain valuation work associated with a proposed multi-fuel retail entity

- *Other Clients*

In addition to the above, Brett also undertakes work with a number of the firm's largest clients including the BHP Billiton Group and one of the world's largest integrated oil and gas majors. Brett also acts as the signing partner for a number of clients in the mining and oil & gas industries and serves (or has served) as the independent review partner on a number of engagements.

**Memberships/Activities**

- Fellow, Institute of Chartered Accountants in Australia
- Registered Company Auditor

**Qualifications**

Brett holds a Bachelor of Business (Distinction), Royal Melbourne Institute of Technology and is a fellow of the Institute of Chartered Accountants in Australia.

Brett commenced work in late 1988, was promoted to Manager in 1994 and became a Partner in 2000.

## Appendix B: Abbreviations

**Table 1:**

Abbreviation

AAS	Australian Accounting Standards
AASB	Australian Accounting Standard Board
AER	Australian Energy Regulator
IAS	International Accounting Standard
IASB	International Accounting Standards Board
PP&E	Property, plant and equipment
UIG	Urgent Issues Group (the previous interpretations body of the AASB - now disbanded)

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## Appendix C: Documents that I have relied on

### Documents:

- 1 Jemena accounting policy FIN-ACC-012 *Property, Plant and Equipment*
- 2 AASB's Framework for the Preparation and Presentation of Financial Statements (as obtained from the Members handbook of the Institute of Chartered Accountants in Australia)
- 3 AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors (as obtained from the Members handbook of the Institute of Chartered Accountants in Australia)
- 4 AASB 116 Property, Plant and Equipment (as obtained from the Members handbook of the Institute of Chartered Accountants in Australia)
- 5 UIG Interpretation 1030 Depreciation of Long-Lived Physical Assets: Condition-Based Depreciation and Related Methods (as obtained from the Members handbook of the Institute of Chartered Accountants in Australia)

## Appendix D: Terms of reference

### JEMENA GAS NETWORKS (NSW) ACCESS ARRANGEMENT 2010

ASSET & PROJECT

### EXPERT TERMS OF REFERENCE— COST CAPITALISATION

DOCUMENT TITLE

**AA10-SF**

DOCUMENT NUMBER

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## Background

Jemena Gas Networks (JGN) is the major gas distribution service provider in New South Wales (NSW). JGN owns 24,000 kilometres of natural gas distribution system, delivering approximately 100 petajoules of natural gas to over one million homes, businesses and large industrial consumers across NSW. Jemena Asset Management (JAM) undertakes the majority of JGN's operating, maintenance, and capital works activity.

The relevant provisions relating to the economic regulation of natural gas distribution networks in NSW are set out in the National Gas Law and National Gas Rules, which are available at [www.aemc.gov.au](http://www.aemc.gov.au).

JGN is currently engaged with the Australian Energy Regulator (AER) in the AER's review of its Access Arrangement (AA). JGN submitted an initial revised AA in August 2009 and a further revised AA on 19 March 2010 which, if approved, will cover the period 2010/11-2014/15 (July to June financial years).

Under the National Gas Rules, total revenue for a relevant service provider is determined for each regulatory year of the access arrangement using a "building blocks" methodology (Rule 76). The building blocks include, amongst others, a return on the projected capital base for the year and a forecast of operating expenditure for the year (Subrules 76(a) and (e)).

The National Gas Rules (Rule 69) define 'capital expenditure':

capital expenditure means costs and *expenditure of a capital nature* incurred to provide, or in providing, pipeline services.

In its proposed access arrangement dated 25 August 2009, JGN reported historic expenditure on mines subsidence and forecast expenditure on mine subsidence, integrity digs and pigging, and ad hoc service renewals as capital expenditure.

On 10 February 2010 the AER published its draft decision on JGN's AA revision proposal.<sup>1</sup> JGN revised its proposal in response to the AER's draft decision in a 19 March 2010 submission. Submissions on the AER's draft decision close on 28 April 2010.

In its draft decision, the AER concluded that certain capital works from both the current and forecast access periods were *not capital in nature*. In doing so, it relied upon its own findings and those of Wilson Cook. In rejecting JGN's capex proposal the AER adopted a Wilson Cook notion that expenditure is not 'capital in nature' if it does not create a new asset or extend the life of an existing asset<sup>2</sup>.

JGN seeks the services of a suitably qualified accounting expert to opine on whether its capitalisation policy is consistent with the relevant accounting standards.

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<sup>1</sup> Australian Energy Regulator, *Draft decision, Jemena, Access arrangement proposal for the NSW gas networks*, 1 July 2010 – 30 June 2015 (**draft decision**), February 2010, can be found at <http://www.aer.gov.au/content/index.phtml/itemId/730676>.

<sup>2</sup> Wilson Cook, *Review of Expenditure of ACT & NSW Gas Distributors, Jemena Gas Networks (NSW)*, December 2009, p. 52.

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## Scope of Work

The independent expert will provide an opinion report that is suitable for reliance by the AER detailing:

1. what accounting standards are relevant to determining whether expenditure is capital in nature; and
2. whether JGN's capitalisation policy complies with the relevant accounting standards identified in item 1.

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## Information from JGN

The expert is encouraged to draw upon the following information which JGN will make available:

- JGN's capitalisation policy

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## OTHER Information TO BE CONSIDERED

The expert is also expected to draw upon the following additional information:

- Australian Accounting Standards
- such information that, in expert's opinion, should be taken into account to address the questions outlined above.

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## Deliverables

At the completion of its review the expert will provide an independent expert report which:

- is of a professional standard capable of being submitted to and relied upon by the AER for the purpose of assessing JGN's AA revision proposal
- is prepared in accordance with the Federal Court Guidelines for Expert Witnesses set out in Attachment 1 and acknowledges that the expert has read the guidelines<sup>3</sup>
- summarises the expert's experience and qualifications and attach your curriculum vitae
- identifies any person and their qualifications, who assists you in preparing the report or in carrying out any research or test for the purposes of the report

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<sup>3</sup> Available at: [http://www.fedcourt.gov.au/how/prac\\_direction.html](http://www.fedcourt.gov.au/how/prac_direction.html).



- summarises JGN's instructions and attaches these term of reference
- (without limiting the points above) carefully sets out the facts that the expert has assumed in putting together his or her report and the basis for those assumptions.

The expert report will include the findings for each of the parts defined in the scope of works (Section 2).

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## **Timetable**

The independent expert will deliver the final report to JGN by 9 April 2010.

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## **ATTACHMENT 1: FEDERAL COURT GUIDELINES**

### **Guidelines for Expert Witnesses in Proceedings in the Federal Court of Australia**

This replaces the Practice Direction on Guidelines for Expert Witnesses in Proceedings in the Federal Court of Australia issued on 11 April 2007.

Practitioners should give a copy of the following guidelines to any witness they propose to retain for the purpose of preparing a report or giving evidence in a proceeding as to an opinion held by the witness that is wholly or substantially based on the specialised knowledge of the witness (see - **Part 3.3 - Opinion** of the [Evidence Act 1995](#) (Cth)).

M.E.J. BLACK  
Chief Justice  
6 June 2007

### **Explanatory Memorandum**

The guidelines are not intended to address all aspects of an expert witness's duties, but are intended to facilitate the admission of opinion evidence ([footnote #1](#)), and to assist experts to understand in general terms what the Court expects of them. Additionally, it is hoped that the guidelines will assist individual expert witnesses to avoid the criticism that is sometimes made (whether rightly or wrongly) that expert witnesses lack objectivity, or have coloured their evidence in favour of the party calling them.

Ways by which an expert witness giving opinion evidence may avoid criticism of partiality include ensuring that the report, or other statement of evidence:

- (a) is clearly expressed and not argumentative in tone;
- (b) is centrally concerned to express an opinion, upon a clearly defined question or questions, based on the expert's specialised knowledge;
- (c) identifies with precision the factual premises upon which the opinion is based;
- (d) explains the process of reasoning by which the expert reached the opinion expressed in the report;
- (e) is confined to the area or areas of the expert's specialised knowledge; and
- (f) identifies any pre-existing relationship (such as that of treating medical practitioner or a firm's accountant) between the author of the report, or his or her firm, company etc, and a party to the litigation.

An expert is not disqualified from giving evidence by reason only of a pre-existing relationship with the party that proffers the expert as a witness, but the nature of the pre-existing relationship should be disclosed. Where an expert has such a relationship the expert may need to pay particular attention to the identification of the factual premises upon which the expert's opinion is based. The expert should make it clear whether, and to what extent, the opinion is based on the personal knowledge of the expert (the factual basis for which might be required to be established by admissible evidence of the expert or another witness) derived from the ongoing relationship rather than on factual premises or assumptions provided to the expert by way of instructions.

All experts need to be aware that if they participate to a significant degree in the process of formulating and preparing the case of a party, they may find it difficult to maintain objectivity.

An expert witness does not compromise objectivity by defending, forcefully if necessary, an opinion based on the expert's specialised knowledge which is genuinely held but may do so if the expert is, for example, unwilling to give consideration to alternative factual premises or is unwilling, where appropriate, to acknowledge recognised differences of opinion or approach between experts in the relevant discipline.

Some expert evidence is necessarily evaluative in character and, to an extent, argumentative. Some evidence by economists about the definition of the relevant market in competition law cases and evidence by anthropologists about the identification of a traditional society for the purposes of native title applications may be of such a character. The Court has a discretion to treat essentially argumentative evidence as submission, see Order 10 paragraph 1(2)(j).

The guidelines are, as their title indicates, no more than guidelines. Attempts to apply them literally in every case may prove unhelpful. In some areas of specialised knowledge and in some circumstances (eg some aspects of economic "evidence" in competition law cases) their literal interpretation may prove unworkable. The Court expects legal practitioners and experts to work together to ensure that the guidelines are implemented in a practically sensible way which ensures that they achieve their intended purpose.

## **Guidelines**

### **1. General Duty to the Court [\(footnote #2\)](#)**

1.1 An expert witness has an overriding duty to assist the Court on matters relevant to the expert's area of expertise.

1.2 An expert witness is not an advocate for a party even when giving testimony that is necessarily evaluative rather than inferential [\(footnote #3\)](#).

1.3 An expert witness's paramount duty is to the Court and not to the person retaining the expert.

### **2. The Form of the Expert Evidence [\(footnote #4\)](#)**

2.1 An expert's written report must give details of the expert's qualifications and of the literature or other material used in making the report.

- 2.2 All assumptions of fact made by the expert should be clearly and fully stated.
- 2.3 The report should identify and state the qualifications of each person who carried out any tests or experiments upon which the expert relied in compiling the report.
- 2.4 Where several opinions are provided in the report, the expert should summarise them.
- 2.5 The expert should give the reasons for each opinion.
- 2.6 At the end of the report the expert should declare that “[the expert] has *made all the inquiries that [the expert] believes are desirable and appropriate and that no matters of significance that [the expert] regards as relevant have, to [the expert’s] knowledge, been withheld from the Court.*”
- 2.7 There should be included in or attached to the report; (i) a statement of the questions or issues that the expert was asked to address; (ii) the factual premises upon which the report proceeds; and (iii) the documents and other materials that the expert has been instructed to consider.
- 2.8 If, after exchange of reports or at any other stage, an expert witness changes a material opinion, having read another expert’s report or for any other reason, the change should be communicated in a timely manner (through legal representatives) to each party to whom the expert witness’s report has been provided and, when appropriate, to the Court ([footnote #5](#)).
- 2.9 If an expert’s opinion is not fully researched because the expert considers that insufficient data are available, or for any other reason, this must be stated with an indication that the opinion is no more than a provisional one. Where an expert witness who has prepared a report believes that it may be incomplete or inaccurate without some qualification, that qualification must be stated in the report ([footnote #5](#)).
- 2.10 The expert should make it clear when a particular question or issue falls outside the relevant field of expertise.
- 2.11 Where an expert’s report refers to photographs, plans, calculations, analyses, measurements, survey reports or other extrinsic matter, these must be provided to the opposite party at the same time as the exchange of reports ([footnote #6](#)).

### **3. Experts’ Conference**

- 3.1 If experts retained by the parties meet at the direction of the Court, it would be improper for an expert to be given, or to accept, instructions not to reach agreement. If, at a meeting directed by the Court, the experts cannot reach agreement about matters of expert opinion, they should specify their reasons for being unable to do so.

#### footnote #1

As to the distinction between expert opinion evidence and expert assistance see *Evans Deakin Pty Ltd v Sebel Furniture Ltd* [2003] FCA 171 per Allsop J at [676].

footnote #2

See rule 35.3 Civil Procedure Rules (UK); see also Lord Woolf “Medics, Lawyers and the Courts” [1997] 16 CJK 302 at 313.

footnote #3

See *Sampi v State of Western Australia* [2005] FCA 777 at [792]-[793], and *ACCC v Liquorland and Woolworths* [2006] FCA 826 at [836]-[842]

footnote #4

See rule 35.10 Civil Procedure Rules (UK) and Practice Direction 35 – Experts and Assessors (UK); *HG v the Queen* (1999) 197 CLR 414 per Gleeson CJ at [39]-[43]; *Ocean Marine Mutual Insurance Association (Europe) OV v Jetopay Pty Ltd* [2000] FCA 1463 (FC) at [17]-[23]

footnote #5

The “*Ikarian Reefer*” [1993] 20 FSR 563 at 565

footnote #6

The “*Ikarian Reefer*” [1993] 20 FSR 563 at 565-566. See also Ormrod “*Scientific Evidence in Court*” [1968] Crim LR 240.

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