



Independent Appraiser's Reasonable Assurance Report to the Directors of Vector Limited and the Commerce Commission New Zealand

Opinion

Our reasonable assurance opinion has been formed on the basis of the matters outlined in this report.

In our opinion, in all material respects:

- the Information in schedule 5b of the Information Disclosure Schedules on Related Party Transactions has complied with the Electricity Distribution Information Disclosure Determination 2012 section 2.3.6 and the Input Methodologies section 2.2.11(1)(g) and 2.2.11(5) (together 'the determination') for the period ending 31 March 2020; and
- the steps undertaken by Vector Limited, as specified under "*Overall scoping and steps undertaken in testing compliance*" are considered to be, in all material respects, reasonable in the circumstances.

As far as appears from an examination of them, in all material aspects:

- proper records to enable the complete and accurate compilation of the Information Disclosure Schedules on Related Party Transactions as at 31 March 2020 have been kept by Vector Limited; and
- the information used in the preparation of the Information Disclosure Schedules on Related Party Transactions as at 31 March 2020 has been properly extracted from Vector Limited's accounting system and other records and has been sourced, where appropriate, from Vector Limited's financial and non-financial systems.

Information subject to assurance and criteria

We have performed an engagement to provide reasonable assurance that Vector Limited's Information Disclosure Schedules on Related Party Transactions are, in all material respects, in compliance with the determination for the period ending 31 March 2020 and that the steps undertaken by Vector Limited are considered to be, in all material respects, reasonable in the circumstances.

Our procedures

Materiality

Our engagement is designed to provide reasonable assurance that Vector Limited is in compliance, in all material respects with the Determination. Based on our professional judgement, we determined certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our assurance engagement, the nature, timing and extent of our assurance procedures and to evaluate the effect of misstatements, both individually and in aggregate on gross related party information. Quantitative materiality level was determined as 2% of the gross related party revenue and expense transactions. Qualitative factors were also considered when assessing the arm's length valuation rules on related party transactions.

Key assumptions

In carrying out our procedures we have relied on Vector Limited's internal controls relating to the identification of related party transactions and the valuation of related party transactions that were tested, and relied upon, during the independent audit of Vector Limited's financial statements for the year ended 31 March 2020, in relation to our work on this assurance engagement.



In building on this assumption, we have carried out specific tests, to assess if Vector Limited has identified related parties and related party transactions during the disclosure year ending 31 March 2020.

Overall scoping and steps undertaken in testing compliance

- Obtained an understanding of Vector Limited's approach to identify all related party relationships in accordance with the determination, and that these are disclosed in the 2020 Information Disclosure Schedules as prepared and published;
- Obtained an understanding of all Vector Limited's Related Party Transaction Flows and determine that each of the flows met the definition of a related party transaction per the determination, as detailed in the transactions below:

From	To	Related party transactions	Valuation amount (\$ millions)	Basis to support market value assessment
Vector Limited	Vector Auckland Property Limited and Vector Northern Property Limited	Sale of substation land and building portfolio	\$324m	Independent valuation
Vector Auckland Property Limited and Vector Northern Property Limited	Vector Limited	Long term lease of substation land and building portfolio	\$294m	Market value supported by independent expert assessment of key assumptions
Vector Limited	Vector Auckland Property Limited	Sale of Auckland CDB tunnel	\$305m	Two Independent valuations
Vector Auckland Property Limited	Vector Limited	Long term lease of tunnel access rights	\$275m	Market value supported by Independent expert assessment of key assumptions and comparable transactions
Vector Digital division	Vector Limited	Cyber services	\$2m	Independent assessment
Vector Limited	Vector Digital Limited	Distributed energy resource management system ("DERMS") asset sale	\$8m	Depreciated replacement cost
Vector Communications Limited	Vector Limited	Indefeasible right of use for the dark fibre	\$9m	Independent assessment
Vector Communications Limited	Vector Limited	Network communications and SCADA services	\$5m	Standard rate card
Tree Scape Limited	Vector Limited	Vegetation services	\$11m	Price comparison
Powersmart Limited	Vector Limited	Battery Solutions	\$1m	Price comparison



- Checked that the value of the related party transaction was consistent with the criteria and supported by either;
 - An open tendering process;
 - Comparable pricing;
 - Independent market valuations;
 - Published price lists; or a
 - Consolidation approach.
- For each related party who provided, or acquired a material value of goods and services to or from Vector Limited, respectively, we assessed that each related party transaction was valued in accordance with the requirements of the determination; and
- Reconciled Vector Limited's related party transactions to the Information Disclosure Schedules.

Each related party transaction is considered a key assurance matter. Key assurance matters are those matters that, in our professional judgement, were of most significance in our reasonable assurance engagement in relation to Vector Limited's Disclosure Schedules on Related Party Transactions in the current regulatory period ended 31 March 2020. We summarise below those matters and our key procedures to address those matters in order that the Directors of Vector Limited and the Commerce Commission New Zealand may better understand the process by which we arrived at our opinion. Our procedures were undertaken in the context of and solely for the purpose of providing our reasonable assurance opinion in relation to Vector Limited's Information Disclosure Schedules on Related Party Transactions in compliance with the determination.

The related party transaction

Procedures performed

Sale of substation land and building portfolio by Vector Limited to Vector Auckland Property Limited and Vector Northern Property Limited for \$324 million

The related party transaction is the sale by Vector Limited of its substation land and buildings portfolio to Vector Auckland Property Limited and Vector Northern Property Limited.

Due to the specialised nature of the transaction there was an inherent absence of publicly available information about pricing and terms of similar transactions.

As a result, the market value could not be supported with evidence of an open tender process, price list or examples of comparable pricing for other similar transactions.

An Independent Valuation was obtained from Telfer Young to support the market value of the substation land and buildings portfolio sale transaction.

Telfer Young determined the market value of the freehold substation land

Our procedures focused on assessing the methodology and key assumptions used by the Independent Valuers in determining the market value of the transaction.

As part of our procedures to assess the market value of the substation land and building portfolio sale we:

- Assessed if the sale met the definition of an asset disposal under the determination including the review the external legal advice obtained;
 - Obtained the sale agreement and agreed the land and buildings included in the agreement were in the Vector Limited RAB;
 - Obtained a copy of the Independent Valuation report prepared by Telfer Young;
 - We have performed the following procedures:
 - Assessed the valuation methodology used by Telfer Young to determine Land values using a market value approach and Building values using an optimised depreciated replacement cost ("ODRC") approach;
 - Assessed the mathematical accuracy of the Telfer Young valuation model;
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The related party transaction

Procedures performed

and buildings portfolio to be \$324 million at 28 February 2020.

As the transaction occurred on 31 March 2020 there is additional uncertainty in relation to the market value due to COVID 19 which is unable to be estimated at this time.

- Verified that the completeness of the properties included in the Telfer Young valuation were consistent with those included in the sale agreement;
- Assessed the key assumptions used by Telfer Young in determining the market value of the substation land and buildings were reasonable as follows:
 - Assessed the building residual lives to the Vector Limited fixed asset register;
 - Assessed the cost to construct used by Telfer Young;
 - Assessed the implied borrowing cost to actual borrowing costs and compared the gearing ratio to audited Vector Limited information;
 - Agreed a sample of land areas to legal titles; and
 - Assessed the implied consent fees for land and buildings.
- Recalculated the estimated building replacement using a cost indexation approach and compared this to the replacement cost determined by Telfer Young;
- Engaged a third-party property expert to determine the market value for a sample of land titles and compared this to the land values determined by Telfer Young; and
- Compared a sample of land properties less than 100 square metres to QV data sources.

Long term lease of substation land and building portfolio by Vector Auckland Property Limited and Vector Northern Property Limited to Vector Limited \$294 million

Vector Limited entered a long-term lease of the rights to use the substation land and buildings from Vector Auckland Property Limited and Vector Northern Property Limited.

Due to the specialised nature of the transaction there was an inherent absence of publicly available information about pricing and terms for similar transactions.

As a result, the market value could not be supported through evidence of an open tender process, price lists or examples of directly comparable pricing for other similar transactions.

Our procedures focused on assessing the key assumptions used, in determining the market value of the substation land and buildings, leases where appropriate.

As part of our procedures to assess the market value of the substation land and building portfolio right of use lease we:

- Assessed if right of use assets meets the definition of a commissioned asset under the Determination;
- Assessed the appropriateness of the methodology used to determine the value of the right of use asset;
- Verified that the land and buildings included as a right of use asset excluded land considered excess and were consistent with those included in the lease agreement between Vector Auckland Property Limited/ Vector Northern Property Limited and Vector Limited;
- Reviewed the lease agreement for any unusual or uncommercial terms;
- Assessed the key inputs in calculating the market value of the right of use asset net present value model, including lease term, rental payments, market yield, are the same as those

The related party transaction

Procedures performed

included in the lease agreement entered into between Vector Auckland Property Limited/ Vector Northern Property Limited and Vector Limited and consistent with normal commercial terms for this type of transaction; and

- Due to the sensitivity of the right of use asset value to the yield in the present value calculation we used external experts to provide a market comparable yields which ranged from 6.0% to 7.5% compared to the 5.0% yield used.

Sale of Auckland CDB tunnel by Vector Limited to Vector Auckland Property Limited for \$305 million

During the period Vector Limited completed the sale of the Penrose to Hobson Street tunnel infrastructure to a property owning company, Vector Auckland Property Limited.

Due to the specialised nature of the transaction there was an inherent absence in publicly available information about pricing and terms for similar transactions.

As a result, the market value could not be supported through evidence of an open tender process, price lists or examples of directly comparable pricing for other similar transactions.

Two Independent Valuations were obtained to support the replacement cost of the tunnel.

Our procedures focused on assessing the key assumptions used by the Independent experts in determining the market value of the transaction.

As part of our procedures to assess the market value of the Auckland CDB tunnel sale we:

- Assessed if the sale meets the definition of an asset disposal under the determination including the review of external legal advice;
- Obtained the sale agreement and agreed the tunnel assets included in the agreement were in the Vector Limited RAB;
- Obtained a copy of the independent report prepared by third-party experts Rider Levett Bucknall who were engaged to determine a replacement cost, estimated for the tunnel at \$450 million;
- Assessed whether the valuation methodology used by the independent expert Rider Levett Bucknall to determine the replacement cost of tunnel is appropriate. Additionally, we reviewed the report obtained from PwC to support the valuation approach used to determine the market value was appropriate for the purpose of establishing arm's length;
- Obtained a copy of the independent report prepared by third-party experts Tonkin Taylor Limited who were engaged to peer review the replacement cost of the tunnel. Tonkin Taylor provided a valuation range of \$320 million to \$475 million;
- Assessed any adjustments to the replacement cost made;
- Recalculated the estimated building replacement using a cost indexation approach and compared this to the replacement cost determined by the independent valuers;
- Recalculated the optimised depreciated replacement cost of the tunnel from the valuer's replacement cost adjusted for the asset useful life per the fixed asset register; and
- Compared the cost per km of the tunnel transaction price to other publicly available and privately attained information for other New Zealand tunnel projects. The average cost was identified as being in the lower quartile.



The related party transaction

Procedures performed

Long term lease of tunnel access rights by Vector Auckland Property Limited to Vector Limited \$275 million

During the period Vector Limited entered into a lease for capacity rights for a proportion of the Penrose to Hobson street tunnel infrastructure from Vector Auckland Property Limited.

Due to the specialised nature of the transaction there was an inherent absence in publicly available information about pricing and terms for similar transactions.

As a result, the market value could not be supported through evidence of an open tender process, price lists or examples of recent directly comparable pricing of other similar transactions.

Our procedures focused on assessing the key assumptions used in determining the market value of the tunnel access rights where appropriate.

As part of our procedures to assess the market value of the tunnel right of use lease we:

- Assessed if the right of use assets met the definition of a commissioned asset under the determination;
- Assessed the appropriateness of the methodology used to determine the value of the tunnel right of use asset;
- Agreed that the tunnel access rights and other key inputs, including lease term and lease payments included in the right of use lease calculation are the same as those included in the lease agreement entered between Vector Auckland Property Limited and Vector Limited;
- Assessed the key inputs, including lease term, lease payments, lease yield, to normal market terms including a third-party arrangement for a separate portion of the asset;
- Due to the sensitivity of the value of the right of use asset to the yield we compared the 5.5% yield used to comparable yields provided to us by external experts, which ranged from 4.0% to 7.5%; and
- Reviewed the lease agreement for any unusual or uncommercial terms.

Vector Digital division provides cyber services to Vector Limited EBD totalling \$1.7 million

Vector Digital division provided cyber security services to Vector's regulated businesses including the EDB.

A third-party specialist Accenture were engaged to provide a comparable price for the services based on their international benchmarks.

As part of our procedures over the cyber services provided, we:

- Obtained the term sheet agreement and reconciled the annual charge to the schedules;
- Assessed the competence of the third-party specialists Accenture used to determine the market value of similar services; and
- Compared the reported costs to the independent market value determined by the third-party specialist.

Distributed energy resource management system ("DERMS") asset sale by Vector Limited to Vector Technology Services Limited for \$7.6 million

Vector Limited entered into a sale of its DERMS assets to Vector Technology Services Limited.

Vector Technology Services Limited has been established as part of a strategic review carried out of Vectors assets and business activities

As part of our procedures over the DERMS sale we:

- Assessed if the sale met the definition of an asset disposal under the determination including a review of the external legal advice obtained;
 - Compared the transaction price to the carrying book value, being depreciated replacement cost of the asset; and
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The related party transaction

Procedures performed

to support the delivery of Vector's future-focused Symphony strategy.

Vector Technology Services Limited will provide DERMs to Vector Limited and potentially external parties on a go forward basis.

- Verified the date of when the original cost of the DERM assets were incurred by Vector Limited and that the majority of those costs capitalised were incurred from third party contractors.

Indefeasible right of use for Dark fibre owned by Vector Communications Limited for \$8.8 million

Indefeasible right of use ('IRU') are dark fibre strands owned by Vector Communications Limited ('Comms') and leased to Vector Limited on a long term basis for use within the Electricity Network. The result of this transaction is a right of use asset for those specific fibre strands leased from Comms.

As part of our procedures over the IRU we:

- Assessed the right of use asset met the definition of a commission asset under the Determination;
- Assessed appropriateness of the valuation method used for the right of use asset including; benchmarking the lease payments to a report prepared by third party specialists Network Strategies and agreed the lease terms to the lease agreement;
- Assessed the competence of the third-party specialists Network Strategies used to determine the market value of similar services; and
- Reviewed the lease agreement for any unusually or uncommercial terms.

Vector Communications Limited provides network communications and SCADA services to Vector Limited totalling \$4.6 million

Vector Communications provides services to Vector Limited based on a standard rate card.

Due to the nature of the services our procedures focused on ensuring the related party transaction was consistent with comparable pricing and Vector Communications price lists.

As part of our procedures over the services provided by Vector Communications we:

- Obtained a list of Vector Communications purchases from the financial records for the year ended 31 March 2020 and reconciled the communication services to the amount disclosed in the Schedules; and
- We compared the prices, where available to external benchmarks or to the price list of Vector Communications.

Tree Scape Limited provides vegetation services to the Vector Limited totalling \$10.8 million

Tree Scape Limited, a 50% owned investment, provides vegetation services to Vector Limited as part of its maintenance of the electricity distribution network.

Due to the nature of the services our procedures focused on ensuring the related party transactions were consistent with comparable pricing and price lists offered to external customers.

As part of our procedures over the vegetation services provided by Tree Scape Limited we:

- Compared Vector Limited's cost per km of overhead network that required vegetation management with those of other electricity networks. The average cost per km was identified



The related party transaction

Procedures performed

as being in the top quartile but considered statistically within an acceptable range;

- Compared Tree Scape Limited's rate card for similar services were no more than the rates offered to Vector Limited and the rates provided to external customers; and
- Compared the cost of vegetation and other similar services purchased by Vector Limited from an independent company to ensure the prices paid were similar to those paid for services purchased from Tree Scape Limited.

Sale of battery solutions by Powersmart Limited to Vector Limited totalling \$1.4 million

Powersmart Limited is a wholly owned subsidiary of Vector Limited.

As part of our procedures on the purchase of the battery storage systems we:

Vector Limited use Powersmart to design and construct network battery solutions.

- Obtained a list of Powersmart purchases from the financial records for the year ended 31 March 2020 and reconciled to the amount disclosed in the Information Disclosure Schedules; and
- Assessed the margin applied to Powersmart purchases were consistent with sales with made by Powersmart to third parties.

Standards we followed

We conducted our reasonable assurance engagement in accordance with International Standard on Assurance Engagements (New Zealand) 3000 (Revised) *Assurance Engagements other than audits or reviews of historical financial information* and Standard on Assurance Engagements SAE 3100 (Revised) *Assurance Engagements on Compliance*. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. In accordance with those standards we have:

- used our professional judgement to assess the risk of material misstatement and plan and perform the engagement to obtain reasonable assurance that the Information Disclosure Schedules for Related Party Transactions is free from material misstatement, whether due to fraud or error;
- considered relevant internal controls when designing our assurance procedures, however we do not express an opinion on the effectiveness of these controls; and
- ensured that the engagement team possesses the appropriate knowledge, skills and professional competencies.

How to interpret reasonable assurance and material misstatement

Reasonable assurance is a high level of assurance but is not a guarantee that it will always detect a material misstatement when it exists.

Misstatements, including omissions, within the Information Disclosure Schedules for Related Party Transactions are considered material if, individually or in the aggregate, they could reasonably be expected to influence the relevant decisions of the intended users taken on the basis of the Information Disclosure Schedules for Related Party Transactions.

Use of this assurance report

Our report should not be regarded as suitable to be used or relied on by any party's other than Vector Limited and the Commerce Commission New Zealand in relation to the determination for any purpose or in any context. Any party other than Vector Limited or Commerce Commission New Zealand who obtains access to our report or a copy thereof and chooses to rely on our report (or any part thereof) will do so at its own risk.



To the fullest extent permitted by law, we accept or assume no responsibility and deny any liability to any party other than Vector Limited and Commerce Commission New Zealand for our work, for this independent reasonable assurance report, or for the opinions we have reached.

Our report is released to Vector Limited and the Commerce Commission New Zealand on the basis that it shall not be copied, referred to or disclosed, in whole (save for Vector Limited's own internal purposes) or in part, without our prior written consent.

Management's responsibility for compliance with the determination

The management of Vector Limited are responsible for the preparation and fair presentation of the Information Disclosure Schedules on Related Party Transaction in accordance with the determination. This responsibility includes such internal control as management determine is necessary to enable the preparation of the Information Disclosure Schedules on Related Party Transaction that is free from material misstatement whether due to fraud or error.

Our responsibility

Our responsibility is to express an opinion to the directors and the Commerce Commission New Zealand on whether the preparation and presentation of the Information Disclosure Schedules on Related Party Transactions is, in all material respects, in compliance with the determination for the period ending 31 March 2020.

Our independence and quality control

We have complied with the independence and other ethical requirements of Professional and Ethical Standard 1 International Code of Ethics for Assurance Practitioners (Including International Independence Standards) (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

The firm applies Professional and Ethical Standard 3 (Amended) and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

David Gates is a member of Chartered Accountants Australia and New Zealand who has 25 years of audit and commercial experience, including in identification and disclosure of related party transactions. David is supported by KPMG specialists and staff who possess a range of experience and disciplines in relevant areas such as assessing the valuation of related party transactions.

Our firm has also provided other services to Vector Limited such as the annual audit and half-yearly review of the financial statements, regulatory assurance services, other assurance services, IT forensic, and compliance services in relation to R&D tax credits. Subject to certain restrictions, partners and employees of our firm may also deal with Vector Limited on normal terms within the ordinary course of trading activities of the business of Vector Limited. These matters have not impaired our independence as assurance providers of Vector Limited for this engagement. The firm has no other relationship with, or interest in, Vector Limited.

A handwritten signature in blue ink that reads 'KPMG'. The signature is stylized, with the letters 'K', 'P', 'M', and 'G' being prominent and connected by fluid strokes.

KPMG
Wellington

25 September 2020