Company Name	Vector gas distribution business
For Year Ended	30 June 2019

Schedule 14 Mandatory Explanatory Notes

(Guidance Note: This Microsoft Word version of Schedules 14, 14a and 15 is from the Gas Distribution Information Disclosure Determination 2012 – as amended and consolidated 3 April 2018. Clause references in this template are to that determination)

1. This schedule requires GDBs to provide explanatory notes to information provided in accordance with clauses 2.3.1, 2.4.21, 2.4.22, and subclauses 2.5.1(1)(e) and 2.5.2(1)(e).

2. This schedule is mandatory—GDBs must provide the explanatory comment specified below, in accordance with clause 2.7.1. Information provided in boxes 1 to 11 of this schedule is part of the audited disclosure information, and so is subject to the assurance requirements specified in section 2.8.

3. Schedule 15 (Voluntary Explanatory Notes to Schedules) provides for GDBs to give additional explanation of disclosed information should they elect to do so.

Return on Investment (Schedule 2)

4. In the box below, comment on return on investment as disclosed in Schedule 2. This comment must include information on reclassified items in accordance with subclause 2.7.1(2).

Box 1: Explanatory comment on return on investment

Relative to Vanilla WACC, ROI is down significantly due to the Commission’s exaggerated forecast for CPI revaluation, which had forecasted CPI at 2% for the year. This forecasting methodology supposes inflation will linearly track towards the mid - range of the RBNZ target. The actual CPI was however at 1.67% for the disclosure year, which impacted ROI by $1.1m. Vector in submissions has advocated strongly for the Commission to review its forecasting approach by giving greater regard to market-based forecasts or to allow suppliers to choose not to revalue and therefore remove the forecasting error risk the suppliers face.

Regulatory Profit (Schedule 3)

5. In the box below, comment on regulatory profit for the disclosure year as disclosed in Schedule 3. This comment must include-

   5.1 a description of material items included in other regulated income (other than gains / (losses) on asset disposals), as disclosed in 3(i) of Schedule 3.

   5.2 information on reclassified items in accordance with subclause 2.7.1(2).

Box 2: Explanatory comment on regulatory profit

There has been no re-classification of items in the disclosure year.

The value of "other regulated income (other than gains / (losses) on asset disposals)" is nil.

Merger and acquisition expenses (3(iv) of Schedule 3)

6. If the GDB incurred merger and acquisitions expenditure during the disclosure year, provide the following information in the box below:

    6.1 information on reclassified items in accordance with subclause 2.7.1(2)

    6.2 any other commentary on the benefits of the merger and acquisition expenditure to the GDB.

Box 3: Explanatory comment on merger and acquisition expenditure

No merger and acquisition expenditure has been incurred during the disclosure year.

There has been no re-classification of items in the disclosure year.

Value of the Regulatory Asset Base (Schedule 4)

7. In the box below, comment on the value of the regulatory asset base (rolled forward) in Schedule 4. This comment must include information on reclassified items in accordance with subclause 2.7.1(2).

Box 4: Explanatory comment on the value of the regulatory asset based (rolled forward)

The value of the regulatory asset base has been determined by rolling forward the initial regulatory asset base with allowance made for commissioned assets, disposals, depreciation and revaluation in accordance with the Gas Distribution Services Input Methodologies Determination 2012 (consolidated 3 April 2018).

An additional box in schedule 4(i) has been added to reflect adjustments required as a result of the split of the Auckland and Non-Auckland gas distribution networks as a result of the sale to First Gas in 2016.

Reclassified items

Vector adopted the NZ IFRS 16 *Leases,* effective from 1 July 2018. NZ IFRS 16 introduces a new class of assets – Right of Use assets (ROU). As a result, the operating leases allocated to the gas distribution network ($2.6m) are now classified as non-network assets on the basis that ROU assets do not constitute a separate class of network assets.

Regulatory tax allowance: disclosure of permanent differences (5a(i) of Schedule 5a)

8. In the box below, provide descriptions and workings of the material items recorded in the following asterisked categories of 5a(i) of Schedule 5a-

   8.1 Income not included in regulatory profit / (loss) before tax but taxable

   8.2 Expenditure or loss in regulatory profit / (loss) before tax but not deductible

   8.3 Income included in regulatory profit / (loss) before tax but not taxable

   8.4 Expenditure or loss deductible but not in regulatory profit / (loss) before tax

Box 5: Regulatory tax allowance: permanent differences

There are no material items in the disclosure year requiring disclosure in accordance with paragraphs 8.1 to 8.4 above.

Regulatory tax allowance: disclosure of temporary differences (5a(vi) of Schedule 5a)

9. In the box below, provide descriptions and workings of material items recorded in the asterisked category ‘Tax effect of other temporary differences’ in 5a(vi) of Schedule 5a.

Box 6: Tax effect of other temporary differences (current disclosure year)

There are no material items in the disclosure year requiring disclosure in accordance with paragraph 9 above.

Cost allocation (Schedule 5d)

10. In the box below, comment on cost allocation as disclosed in Schedule 5d. This comment must include information on reclassified items in accordance with subclause 2.7.1(2).

Box 7: Cost allocation

There has been no re-classification of items in relation to cost allocation in the disclosure year.

Accounting-based allocation approach (ABAA) has been applied to allocate not directly attributable costs in the disclosure year in accordance with the current IM determination.

The "Property, Plant and Equipment (PPE)" asset and labour hours allocators are the key proxy allocators used to allocate not directly attributable corporate shared costs as causal factors are not available. A causal relationship cannot be established for the non-directly attributable costs because the shared nature of these services. This means there is no single cost driver leading to a cost being incurred.

Labour hours

Vector has undertaken a survey of estimated time spent on regulatory activities for the purpose of regulatory cost allocation. Not all shared service functions are able to estimate time spent servicing each business due to their activities being ever changing or because activities are primarily provided on a group only basis.

PPE

A significant proportion of Vector's activities are focused on managing physical assets. Therefore, an assumption can be made that the greater the amount of physical assets a business has (measured by value) the greater share of corporate shared costs required to support that business.

The rationale behind the use of each proxy allocation is based on a thoughtful analysis of each cost item.

Asset allocation (Schedule 5e)

11. In the box below, comment on asset allocation as disclosed in Schedule 5e. This comment must include information on reclassified items in accordance with subclause 2.7.1(2).

Box 8: Commentary on asset allocation
There has been no re-classification of items in relation to asset allocation in the disclosure year. Vector applied the ABAA to allocate non-directly attributable corporate shared asset values in the disclosure year in accordance with the current IM determination. The PPE asset allocator and labour hours are the key proxy allocators. The change from the use of the ACAM to the ABAA did not result in adjustments to any of the corporate shared assets. Network assets are directly attributable and are hence unaffected by the change from allocation method from the ACAM to the ABAA. Determining the non-network fixed assets for the regulated and non-regulated businesses follows a similar process to the operating cost allocation.

Capital Expenditure for the Disclosure Year (Schedule 6a)

12. In the box below, comment on expenditure on assets for the disclosure year, as disclosed in Schedule 6a. This comment must include-

    12.1 a description of the materiality threshold applied to identify material projects and programmes described in Schedule 6a;

    12.2 information on reclassified items in accordance with subclause 2.7.1(2).

Box 9: Explanation of capital expenditure for the disclosure year
The materiality threshold applied to identify material projects and programmes is $1.8m which is consistent with the audit materiality level. There are no projects that have exceeded this level of materiality. <u>Reclassified items</u> Vector adopted the NZ IFRS 16 *Leases,* effective from 1 July 2018. As a result, operating leases allocated to the gas distribution business are now classified as non-network asset expenditures. Vector has also reclassified some non-material project related costs between the sub-categories of “total reliability, safety and environment”.

Operational Expenditure for the Disclosure Year (Schedule 6b)

13. In the box below, comment on operational expenditure for the disclosure year, as disclosed in Schedule 6b. This comment must include-

13.1 Commentary on assets replaced or renewed with asset replacement and renewal operational expenditure, as reported in 6b(i) of Schedule 6b

13.2 Information on reclassified items in accordance with subclause 2.7.1(2)

13.3 Commentary on any material atypical expenditure included in operational expenditure disclosed in Schedule 6b, including the value of the expenditure, the purpose of the expenditure, and the operational expenditure categories the expenditure relates to.

Box 10: Explanation of operational expenditure for the disclosure year

There are no asset replacement or renewal costs included in 6b(i) of Schedule 6b.

Atypical expenditure:

There was no atypical expenditure during the period which exceeded our materiality threshold of $1.8m.

Reclassified items

Vector adopted the NZ IFRS 16 *Leases,* effective from 1 July 2018. As a result, these operating leases allocated to the gas distribution business are now classified as non-network asset expenditure.

Variance between forecast and actual expenditure (Schedule 7)

14. In the box below, comment on variance in actual to forecast expenditure for the disclosure year, as reported in Schedule 7. This comment must include information on reclassified items in accordance with subclause 2.7.1(2).

Box 11: Explanatory comment on variance in actual to forecast expenditure

CAPEX

Overall expenditures on assets was 1% ($0.2m) higher than forecast with key drivers being:

- Customer driven activity increased by $0.9m, or 5%, largely due to an increase in residential connections partly offset by lower subdivisions/mains extensions.
- Non-network expenditure increased by $2.4m, or 171%, mainly due to the changes in the accounting treatment of leases (NZ IFRS 16).
- System growth decreased by $1.5m, or 69%, due to new pipeline work delayed as a result of third parties and deferral of District Regulator Stations upgrades.
- Asset relocations has decreased by $1.4m, 38% which is third party driven.

OPEX

Actual operational expenditure is $0.9m or 8% higher than forecast mainly due to an increase in routine and corrective maintenance costs and higher personnel costs directly attributable to the gas distribution business.

Information relating to revenues and quantities for the disclosure year

15. In the box below, please explain reasons for any material differences between target revenue disclosed before the start of the pricing year in accordance with clause 2.4.1 and subclause 2.4.3(3), and total billed line charge revenue for the disclosure year as disclosed in Schedule 8.

Box 12: Explanatory comment relating to revenue for the disclosure year

In accordance with clause 2.4.3(3) of the current ID Determination, Vector's gas pricing methodology disclosure for the pricing year target revenue was $48.1m.

The total line change revenue in Schedule 8 relates to the disclosure year (ending 30 June) for the gas distribution network. The total line charge revenue is $47.1m.

As the disclosure year (ending 30 June) and pricing year (ending 30 September) reported on, are different, target revenue and total line charge revenue may differ.

16. If price category codes or consumer groups (as applicable) have been changed in a disclosure year, please explain in the box below the effect of this on the allocation of ICPs, quantities and revenues between consumer groups disclosed in Schedule 8.

Box 13: Explanatory comment relating to changed price category codes or consumer groups

This disclosure year referred to is the year ending 30 June 2019. During this period, prices changed on 1 October 2018. There were no changes to price category codes or consumer groups as part of this price change.

Network Reliability for the Disclosure Year (Schedule 10a)

17. In the box below, comment on network reliability for the disclosure year, as disclosed in Schedule 10a.

Box 14: Commentary on network reliability for the disclosure year

Vector's overall SAIDI and SAIFI results were slightly higher (9.6% and 4.3% respectively) than those for the previous year; note that an increase in the SAIDI or SAIFI result indicates a decline in performance over the period and a decrease indicates an improvement in performance.

Planned interruptions

The SAIDI result for planned interruptions was 1.7% higher than that for the previous year whereas the SAIFI result was 5.7% lower than that for the previous year.

Unplanned interruptions (excluding third party damage)

The SAIDI result for unplanned interruptions (excluding third party damage) was approximately 70% higher than that for the previous year whereas the SAIFI result was approximately 30% lower than that for the previous year.

The higher SAIDI was mainly due to two outages. The first interruption relates to a bank slip in Warkworth, where 2 ICPs were affected; the outage duration was 149.3 hours. The second incident was due to a passing riser valve and an aging corroded riser pipe which required replacement using specialist welding resources and affected 1 ICP; the outage duration was 164.5 hours. Both incidents accounted for approximately 60% of the total unplanned SAIDI result.

Unplanned interruptions caused by third party damage

The SAIDI result for unplanned interruptions caused by third party damage was 16.7% lower than that for the previous year whereas the SAIFI result was 30.8% higher; the higher SAIFI result was due to a contractor who excavated through a 50mm main in East Tamaki Road, Papatoetoe. As the damaged main is on a single-feed system, 75 customers were affected (outage duration of 4 hours).

Insurance cover

18. In the box below, provide details of any insurance cover for the assets used to provide gas pipeline services, including-

    18.1 The GDB's approaches and practices in regard to the insurance of assets, including the level of insurance;

    18.2 In respect of any self insurance, the level of reserves, details of how reserves are managed and invested, and details of any reinsurance.

Box 15: Explanation of insurance cover

Vector Limited takes insurance cover for a large number of group assets. These policies cover material damage, business interruption and contract works insurance.

In relation to the GDB these policies cover only the Auckland distribution networks gate stations and district pressure reducing stations. Vector self insures the remainder of the assets in the GDB. Insurance costs are allocated to the GDB using the proportion these assets represent relative to Vector's overall insured assets.

In respect of the insurance cover the information reflects "insurance years" running from 1 September to 31 August each year and premium costs are allocated to the appropriate regulatory years to derive the premium values.

Amendments to previously disclosed information

19. In the box below, provide information about amendments to previously disclosed information disclosed in accordance with clause 2.12.1 in the last 7 years, including:

    19.1 a description of each error; and

    19.2 for each error, reference to the web address where the disclosure made in accordance with clause 2.12.1 is publicly disclosed.

Box 16: Disclosure of amendment to previously disclosed information

No amendments are required.

Company Name	Vector gas distribution business
For Year Ended	30 June 2019

Schedule 15: Voluntary Explanatory Notes

(In this Schedule, clause references are to the Gas Distribution Information Disclosure Determination 2012 – as amended and consolidated 3 April 2018.)

1. This schedule enable GDBs to provide, should they wish to:

   1.1 additional explanatory comment to reports prepared in accordance with clauses 2.3.1, 2.4.21, 2.4.22, 2.5.1, and 2.5.2.

   1.2 information on any substantial changes to information disclosed in relation to a prior disclosure year, as a result of final wash-ups.

2. Information in this schedule is not part of the audited disclosure information, and so is not subject to the assurance requirements specified in section 2.8.

3. Provide additional explanatory comment in the box below.

Box 1: Voluntary explanatory comment on disclosed information
N/A