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Transpower New Zealand Limited

21 December 2007

David Caygill
Chair
Electricity Commission
PO Box 10041
WELLINGTON

Dear David

VERIFICATION OF TRANSPower'S TRANSMISSION PRICES

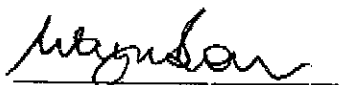
This statement is provided to you as the body responsible for ensuring consistency with the Transmission Pricing Methodology and is given pursuant to rule 9.2.2 of the Electricity Governance Rules 2003.

To the best of the Directors' knowledge and belief the Directors' are satisfied that:

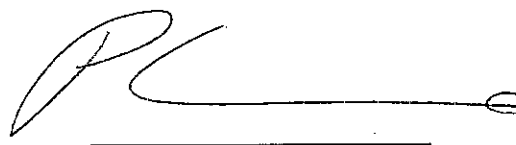
- (a) the transmission prices are consistent with the Transmission Pricing Methodology; and
- (b) the design and implementation, and reporting of the outcome, of the internal audit, are in accordance with best practice.

The audit report has noted some process improvements that Transpower will need to implement to ensure a fully robust process in future. We accept this finding, which we believe to be a reflection of the substantial process changes that have been made this year to accommodate the new pricing methodology and including the translation to pricing on a physical, rather than an optimised, grid configuration.

Yours sincerely


Wayne Brown, Director

21/12/2007


Paul Cochrane, Director

21/12/2007

INDEPENDENT ASSURANCE REPORT

To: The Directors of Transpower New Zealand Limited

Introduction

Transpower is required to calculate and publish Transmission Charges for the pricing year from 1 April 2008 to 31 March 2009 in accordance with the Transmission Pricing Methodology.

Directors' Responsibilities

The Directors are solely responsible for the calculation of Transmission Charges and the maintenance and integrity of underlying records, models and application systems supporting the calculation of Transmission Charges.

Auditors' Responsibilities

Our responsibility is to express an opinion on whether the calculation of 2008/09 Transmission Charges have been calculated consistent with the Transmission Pricing Methodology dated 25 October 2007 (the 'TPM') such that any errors or inconsistencies do not have a material impact on the prices. We are also asked to express an opinion on whether supporting processes adopted by Transpower, with respect to these calculations, are robust.

Basis of Opinion

Our approach is in accordance with the International Standard on Assurance Engagements (ISAE) 3000 '*Assurance Engagements other than audits of reviews of historical financial information*', developed by the International Federation of Accountants. We planned and carried out our work to obtain reasonable, rather than absolute, assurance on the reliability of the Transmission Charges advised to customers.

We planned and performed the audit so as to obtain all the information and explanations we considered to be necessary in order to obtain reasonable assurance that the written assertions contained in the letter from Transpower's Directors to the Electricity Commission are free from material misstatements, whether caused by fraud or error. This report is provided solely for Transpower New Zealand Limited for the purpose of the Transmission Charge setting process for the 2008/09 pricing year.

We provide Internal Auditor, Tax and Advisory services to Transpower.

Our procedures included examining, on a test basis, evidence supporting the calculation of 2008/9 Transmission Charges as advised to customers, examination of internally and externally generated documents and records, interviewing selected personnel and such other procedures as we considered necessary in the circumstances.

Our specific procedures have included:

- Reviewing the processes implemented by management to calculate Transmission Charges and ensure the consistency and robustness of this process. Specifically that appropriate management controls are in place over:
 - the appropriateness of inputs into the calculation process including the completeness, accuracy and validity of these inputs
 - the integrity of underlying systems and models used to determine customer specific Transmission Charges including changes made to reflect the requirements of the TPM
- Recalculating connection charges, interconnection charges and HVDC charges in accordance with the TPM
- Identifying underlying inputs into these charges and reconciling these inputs to underlying application systems and business records of Transpower

- Confirming the Revenue Requirement and related EV adjustment used within the Transmission Charge calculations has been determined in accordance with the terms of the Transpower's proposed 'Formal Settlement Proposal' submitted to the Commerce Commission on 31 August 2007
- Verifying, on a sample basis, the classification of connection and interconnection assets
- Recalculating, on a sample basis, individual customer Transmission Charges based on the customer specific asset allocation recorded by Transpower.

In performing the above procedures, we have placed reliance on the underlying application systems and business records maintained by Transpower. These include:

Source	Nature of Input
Audited Statutory Financial Statements and Economic Value Statements for the year ending 30 June 2007	Assets, liabilities, revenue and expenditure including HVAC and HVDC components
Financial Management System (FMIS)	Fixed asset replacement costs, types and characteristics (e.g. line lengths)
Maintenance Management System (MMS) as at 30 June 2007	Operating and maintenance costs associated with specific assets
Customer Billing System (TICA)	AMI, AMD quantity information and customer off-take and customer injection data for the HAMI and RCPD ¹ model
Contract Management Information System (CMIS)	Details of customer specific contracts including New Investment Agreements, Notional Embedding Agreements, Input Connection Contracts and Agreements to Alter Grid Assets
Asset Capability Information System (ACI)	Lines, circuits and span information
Forecasting model (TM1)	Fixed assets, asset categories, capital expenditure, asset disposals and depreciation calculations
Grid Configuration Register (Zemindar)	Grid and asset / switch configuration information including the allocation of specific assets to locations, between customers and classification of assets as connection / interconnection, injection / offtake
Technical network diagrams	Network diagrams recording underlying substation and line configuration information and, for each substation, the specific assets located at this substation, together with specific Line and Circuit information
Business Plan for 2007/08 as approved by the Board and related EC approvals	Forecast capital movements and expenditure, operating leases
Administrative Settlement agreed with the Commerce Commission.	Weighted average cost of capital and operating expenses.

There are a number of areas where the specific requirements of the TPM cannot currently be met by Transpower's systems. As a result Transpower has performed a number of alternate procedures:

- The TPM requires that maintenance cost information is sourced from the Maintenance Management System (MMS). MMS is unable to provide maintenance cost information at a level of detail required by the TPM. Transpower have performed this analysis and allocated maintenance costs as part of the pricing process. PricewaterhouseCoopers has reviewed this process to confirm a reasonable and consistent allocation of maintenance costs has been made
- The TICA billing system is the source application that maintains metering information. TICA does not provide aggregated demand information to meet TPM requirements in all circumstances. Transpower have identified a number of such circumstances and has recalculated aggregated volume information as part of the pricing process. PricewaterhouseCoopers has reviewed this process to confirm a reasonable and consistent determination of such aggregated volume information has been made

¹ Anytime Maximum Injection, Anytime Maximum Demand, Historical Anytime Maximum Injection, Regional Coincident Peak Demand, as defined by the Transmission Pricing Methodology 25 October 2007

- The FMIS system is the source application that maintains financial information relating to fixed assets. Asset information maintained within FMIS reflects asset balances as at 30 June 2007. As part of the pricing process, Transpower has identified and applied changes since 30 June 2007 to asset details used to determine transmission prices. PricewaterhouseCoopers has reviewed the process applied by Transpower to record asset additions and disposals from 30 June 2007 to confirm that such changes have been appropriately made.

In applying the Transmission Pricing Methodology, it is necessary to apply certain assumptions and adjustment to inputs from underlying application systems. We note that the TPM allows for some exceptions to the application of the Transmission Charge in a number of instances to reflect the specific requirements of customer contracts. These are:

- s4 – exceptions to the application to the connection charge
- s7 – adjustments to AMD, AMI, HAMI and RCPD and calculation of customer charges
- s8 – charges for Transmission Alternatives
- s9 – prudent discount policy

In these circumstances, customer specific Transmission Charges will reflect the terms of specific customer contracts (for example New Investment Contract, Input Connection Contract, Notional Embedding Agreement or Prudent Discount Agreements) or the application of discretion allowed to Transpower to alter AMI, AMD, HAMI and RCPD quantities.

We do not provide an opinion as to whether customer specific contracts have individually been completely and correctly calculated and applied or whether Transpower's discretion in altering AMI, AMD, HAMI and RCPD quantities is justified.

In our opinion a robust pricing process is one that is documented, repeatable and with appropriate controls to ensure the completeness, accuracy and validity of inputs, calculations and final transmission prices. Documentation provided by Transpower and reviewed by PwC includes:

- An overview of the pricing process including key inputs, source of inputs, assumptions and adjustments made to determine these inputs with signoffs from key staff responsible for providing these inputs
- A summary of the key controls applied by management to provide comfort over the integrity of inputs, supporting models and pricing calculations used to determine customer specific Transmission Charges.

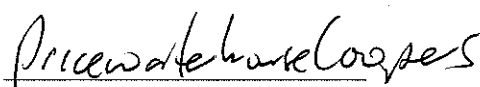
Transpower's documentation did not capture all the procedures performed by Transpower in determining Transmission Charges and addressing issues that arose through this process. Both Transpower's management review process and our audit procedures identified a number of issues that were subsequently addressed by Transpower. This resulted in an iterative approach to calculating final Transmission Charges. We have made a number of recommendations to Transpower as to enhancements to be made to the pricing process. In particular:

- That all assumptions and decisions made when applying the TPM are documented
- That queries used to extract data from underlying systems are documented with parameters clearly defined
- The rationale for manual adjustments made to data extracted from underlying application systems are documented and explicitly agreed/approved in all circumstances.

Conclusion

We conclude that, whilst the process applied initially to generate the customer specific Transmission Charges for the 2008/9 pricing year was not robust, the final prices themselves are consistent with the findings of our work, the assumptions and adjustments made by Transpower, and are reasonably supported by underlying evidence such that these charges have been calculated in all material respects consistent with the Transmission Pricing Methodology dated 25 October 2007 (the 'TPM').

We completed our work for the purposes of this report on 21 December 2007 and our opinion is expressed as at that date.



PricewaterhouseCoopers
Chartered Accountants
Wellington