ActewAGL Distribution

Cost Allocation Methodology

November 2012

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Contents

1. Introduction

The purpose of this submission is to set out ActewAGL Distribution's proposed electricity network cost allocation methodology *(CAM)* for the 2014-19 regulatory control period, as required by the Australian Energy Regulator *(AER)* in its Cost Allocation Guidelines (*the Guidelines)*.[1] The Guidelines set out arrangements for DNSPs to manage the attribution of direct costs and the allocation of shared costs between different categories of distribution services. Clause 6.15.4 of the National Electricity Rules (NER) requires that the cost allocation method proposed by ActewAGL Distribution must give effect to and be consistent with the Guidelines.

In February 2008, ActewAGL submitted its CAM for the regulatory control period 2009-14 to the Australian Energy Regulator (AER) under transitional provisions in the *National Electricity Amendment Rules* (the transitional Rules). The transitional Rules required ActewAGL Distribution's CAM to be consistent with the cost allocation principles for the ACT,[2] and to be prepared using, as far as practicable, the same cost allocation method as it last used when preparing its regulatory accounts for submission to the Independent Competition and Regulatory Commission (ICRC). ActewAGL's cost allocation method was approved by the AER in March 2008.[3]

This is the first time that ActewAGL has developed its CAM in accordance with the AER Guidelines. As such, ActewAGL Distribution has reviewed some aspects of its current methodology to improve the allocation of some shared corporate costs from 1 July 2014, and to address a concern previously raised by the AER in relation to the allocation of some costs associated with services provided by ActewAGL Retail.

Clause 2.2 of the Guidelines sets out the requirements of ActewAGL Distribution's principles and policies for attributing costs directly to, or allocating shared costs between categories of distribution services. The format and content of ActewAGL's cost allocation methodology is governed by clause 3.2(a).

1.1 Overview of ActewAGL's approach

This CAM is largely based on ActewAGL Distribution's current CAM, with some revisions to the allocation of shared network overheads, corporate costs and some costs associated with services provided by ActewAGL Retail.

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[1] AER 2008, *Electricity distribution network service providers: Cost allocation guidelines*, June.
[2] The cost allocation principles for the ACT are set out in clause 6.15.7 of the transitional Rules.
[3] AER 2008, *Final decision: ActewAGL cost allocation method*, March.

The method involves allocating costs directly to projects wherever possible. Project costs are then aggregated into regulated and unregulated activities and services. Where costs are shared between services, appropriate drivers are used to allocate these across the various business divisions.

ActewAGL Distribution's current CAM has been subject to detailed review in past price reviews, not only as part of the electricity network reviews but also in the context of the AER and ICRC's reviews of ActewAGL's gas network and ACTEW's water and wastewater network businesses respectively.

Clauses 2.1 and 2.2.1 of the Guidelines require ActewAGL Distribution to develop detailed principles and policies for attributing costs directly to, or allocating costs between categories of distribution services. These must be sufficiently detailed to enable the AER to replicate the reported outcomes through the application of those principles and policies, and for ActewAGL Distribution to be able to demonstrate that it is meeting the requirements of the Guidelines.

ActewAGL considers that Tables 1 to 3 in attachment 2 to this submission provide sufficient information on the nature of costs and where and how they are allocated, to enable the cost allocation to be replicated by the AER.

As background to the detailed description of cost allocation in sections 3 and 4, section 2 provides an overview of the electricity distribution services provided by ActewAGL Distribution and the types of costs incurred in delivering electricity distribution network services.

1.2 Corporate Profile

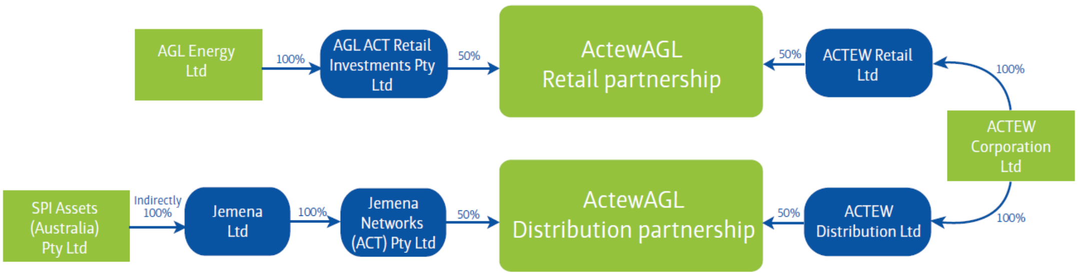
Clause 3.2(a)(4) of the Guidelines requires ActewAGL Distribution to provide a description of its corporate and organisational structure to enable the AER to understand how the DNSP is organised to provide its distribution services.

ActewAGL comprises two partnerships—the ActewAGL Distribution partnership and the ActewAGL Retail partnership.

The Distribution partnership is owned equally by SPI (Australia) Assets Pty Ltd and ACTEW Corporation Ltd via their respective subsidiary companies, Jemena Networks (ACT) Pty Ltd and ACTEW Distribution Ltd.

The ActewAGL Retail partnership is owned equally by AGL Energy Ltd and ACTEW Corporation Ltd via their respective subsidiary companies, AGL ACT Retail Investments Pty Ltd and ACTEW Retail Ltd. This ownership structure is shown in Figure 1 below.

Figure 1 ActewAGL ownership structure



ActewAGL's organisational structure is provided in attachment 1.

ActewAGL Distribution owns and operates the electricity distribution network in the ACT and the gas distribution network in the ACT, Shoalhaven and Queanbeyan regions. ActewAGL Distribution's electricity distribution network comprises 2,402km of overhead lines, 2,650km of underground cables and 14 zone substations and it supplies electricity to around 174,000 customers in the ACT.

1.3 Scope and Application

Clause 3.2(a)(9) of the Guidelines requires that the cost allocation methodology include a commencement date. ActewAGL Distribution proposes that the CAM will apply from the start of the next regulatory control period.

Pursuant to clause 3.2(a)(3) of the AER guidelines, ActewAGL Distribution confirms that this CAM applies to the attribution of all direct costs, and the allocation of all shared costs incurred by its electricity network business in its role as a distribution network service provider (DNSP). This methodology has been prepared in accordance with the requirements of the NER and the AER Guidelines.

In accordance with clause 5.1(b), this CAM will be applied by ActewAGL in preparing:

- forecast operating expenditure to be submitted to the AER in accordance with clause 6.5.6 of the NER;
- forecast capital expenditure to be submitted to the AER in accordance with clause 6.5.7 of the NER;
- prices for a negotiated distribution service determined in accordance with clause 6.7.1;

- annual statements to be submitted to the AER in accordance with a future regulatory information instrument; and
- actual or estimated capital expenditure for the purposes of increasing the value of its regulatory asset base under NER schedule 6.2.1(f).

1.4 Accountabilities and Responsibilities

Clause 3.2(a)(3)(A) requires ActewAGL Distribution to provide details of the accountabilities for implementing the CAM.

ActewAGL Distribution confirms that the Chief Executive Officer (CEO) and the Chief Finance Officer (CFO) of ActewAGL are accountable for implementing this CAM at the commencement of the next regulatory period.

Clause 3.2(a)(3)(B) requires ActewAGL Distribution to provide information on the responsibilities within ActewAGL Distribution for updating, maintaining and applying the CAM and for internally monitoring and reporting on its application.

ActewAGL Distribution confirms that these functions are currently the responsibility of ActewAGL Distribution's Commercial Manager – Networks, and will continue to be so under this CAM over the next regulatory control period. These functions are discussed in more detail in section 5 of this submission.

1.5 Nature and scope of the cost allocation method

ActewAGL Distribution's CAM has been prepared in accordance with the *Cost Allocation Principles* contained in section 6.15.2 of the NER. Specifically:

- the principles and policies used by ActewAGL Distribution to allocate costs between the different categories of distribution services are contained in this document (NER – 6.15.2(1));
- allocation of costs has been determined according to the substance of a transaction or event rather than its legal form (NER – 6.15.2(2));
- costs allocated to a particular category of distribution services are either:
    - costs which are directly attributable to the provision of those services (NER – 6.15.2(3)(i)); or
    - costs not directly attributable are allocated using an appropriate allocator (NER – 6.15.2(3)(ii));

- the reasons for using the method of the chosen allocator are clearly described in this document (NER – 6.15.2(4));
- the same costs are not allocated more than once (NER – 6.15.2(5));
- the principles, policies and approach used to allocate costs are consistent with the *Distribution Ring-Fencing Guidelines* (NER – 6.15.2(6)); and
- costs which have been allocated to a particular service will not be reallocated to another service during the course of a *regulatory control period* (NER – 6.15.2(7)).

ActewAGL's proposed CAM covers the allocation of costs *between* different categories of electricity distribution services, as required by clause 2.2.1 of the Guidelines. The electricity distribution services provided by ActewAGL Distribution, the costs associated with those services and the method for allocating the costs is set out in sections 2 and 3 below.

The proposed CAM also covers the allocation of costs *to* the electricity network business from other parts of ActewAGL. As previously mentioned, ActewAGL comprises two partnerships—ActewAGL Distribution and ActewAGL Retail. ActewAGL's electricity distribution services are provided by the network divisions, comprising Asset Management and Network Services. The costs of providing the electricity distribution services include some costs for corporate services which are provided by other divisions of ActewAGL Distribution, and services provided by ActewAGL Retail.

Clause 3.2(a)(4) requires a description of ActewAGL's corporate and organisational structure to enable the AER to understand how the DNSP is organised to provide its distribution services.

Section 4 below explains the structure of ActewAGL, the nature of the services provided to ActewAGL Networks by other parts of ActewAGL and the basis for allocating the costs associated with those services. ActewAGL Distribution's organisational structure is also provided in Attachment 1 to this document.

2. ActewAGL's electricity network services and costs

2.1 ActewAGL's electricity distribution services

Clause 3.2(a)(5) of the Guidelines requires ActewAGL Distribution to provide a "specification of the categories of distribution services that the *DNSP* provides to which costs are to be attributed or allocated and the types of persons to whom those services are provided."

ActewAGL Distribution's electricity network customers are predominately residential in number. In 2011/12, 91 per cent of customers were residential, nine per cent were low-voltage non-residential customers and the remainder (23 customers) were high-voltage commercial customers. The number of high-voltage commercial customers has remained fairly stable in recent years.

ActewAGL's *distribution services* (as defined in the National Electricity Rules)[4] comprise:

- Standard control services

  Includes all network use and connection services (except the alternative control services) such as operation and maintenance of the system, capacity upgrades, asset refurbishments, vegetation management and supply restoration. Services are provided to all customers connected to the electricity network.

- Alternative control services

  Comprises metering services (for customers consuming less than 160 MWh/year with manually read meters) including meter testing, meter reading, meter checking, processing of meter data, and provision of non-standard meters.

- Unregulated services

  These include services provided in a contestable market such as street lighting, training and contestable metering services.

ActewAGL currently does not provide any services that are classified as negotiated services.

2.1.1 ActewAGL Distribution's transmission services

ActewAGL owns, controls and operates two 132 kV lines and associated network assets in its ACT electricity network that meet the definition of dual function assets in clause 6.24.2 of the NER. The assets acquired this status during the current regulatory period as a result of

[4] The AER is currently reviewing the classification of services for the 2014-19 regulatory control period and is required to make a decision by the end of November 2012.

the commissioning of the second point of supply to the ACT at the recently completed TransGrid 330kV/132kV substation at Williamsdale, following construction by ActewAGL of a 132 kV double circuit line between Williamsdale and ActewAGL's existing 132 kV network near Theodore.

On 12 September 2012, the AER announced[5] that it proposes to include in its final Framework and Approach for the 2014-19 regulatory period, due by the end of November 2012, a determination that chapter 6A of the NER will apply to ActewAGL Distribution's dual function assets instead of chapter 6.[6] That is, these assets will be regulated as transmission assets.

Consequently, from the beginning of the next regulatory control period, ActewAGL would commence providing standard control services in respect of its transmission network (known as transmission standard control services in the Rules).

The following section describes how costs are allocated between standard control, alternative control and unregulated services.

2.2 Electricity distribution network costs

ActewAGL's electricity network costs comprise the following components:

- direct project costs, including the costs of materials, contract services and other expenses that can be directly allocated to particular projects and services;
- payroll and payroll-related costs;
- leasing costs for motor vehicles, plant and computers;
- electricity networks overhead costs;
- corporate overhead costs, for services provided by ActewAGL Distribution corporate divisions; and
- charges for services provided by ActewAGL Retail.

The cost allocation principles in clause 2.2.3 and clause 2.2.4 of the Guidelines relate to the allocation of (i) directly attributable costs and (ii) those that cannot be directly attributed to a service, or costs that are shared among more than one service.

Under ActewAGL Distribution's proposed CAM, direct project costs and payroll costs are directly attributed to the different categories of distribution service. Costs are initially

[5] http://www.aer.gov.au/node/17873
[6] AER media release - http://www.aer.gov.au/node/17873

attributed to projects which are then assigned to either regulated or unregulated services. Regulated services are further split into standard control and alternative control (metering) services. This process is discussed in more detail in section 3 below.

The costs for services provided by ActewAGL Retail are allocated to standard control services, consistent with the current approach and previously approved by the ICRC and the AER. The basis for this approach is that the retail services are not related to unregulated services, or to the alternative control (ie metering) services, and so the costs are fully attributed to standard control.

Electricity network overhead costs, corporate overhead costs and leasing costs for motor vehicles, plant and computers that cannot be directly attributed to projects are shared across different categories of service using an appropriate non-causal allocator. This process is discussed in section 3 below and summarised in table 1.

2.3 Electricity transmission network costs

As discussed in section 2.1.1 above, it is anticipated that the AER will determine that ActewAGL Distribution's dual function assets will be regulated as transmission rather than distribution assets when the Framework and Approach for the next regulatory period is determined by the AER by the end of November.

Consistent with this proposal, ActewAGL Distribution proposes to remove the dual function assets from its distribution regulatory asset base. Operating and capital expenditures associated with these assets are already directly attributed to the assets wherever possible. Any shared costs, such as divisional support costs would be allocated using an appropriate driver, and in accordance with ring-fencing guidelines.[7]

[7] ICRC 2002, *Ring-fencing guidelines for gas and electricity network service operators in the ACT*, November. Whilst the 2002 ICRC guidelines currently apply to ActewAGL Distribution, the AER intends to develop national guidelines. In its September 2012 Position Paper the AER did not indicate an intention to include specific requirements for dual function assets.

3. Allocation of costs between electricity distribution network services

ActewAGL's electricity network costing is carried out in the Works and Assets Management System (WASP) and Oracle Project Accounting (OPA). Costs are attributed to multiple projects in OPA which then feed into summary level activities attached to cost centres in the general ledger.

The cost centre in the general ledger identifies the business division that is responsible for the cost. The activity recorded in the general ledger is a summary of the multiple projects that make up that activity. The activity also provides a link between the general ledger and the OPA.

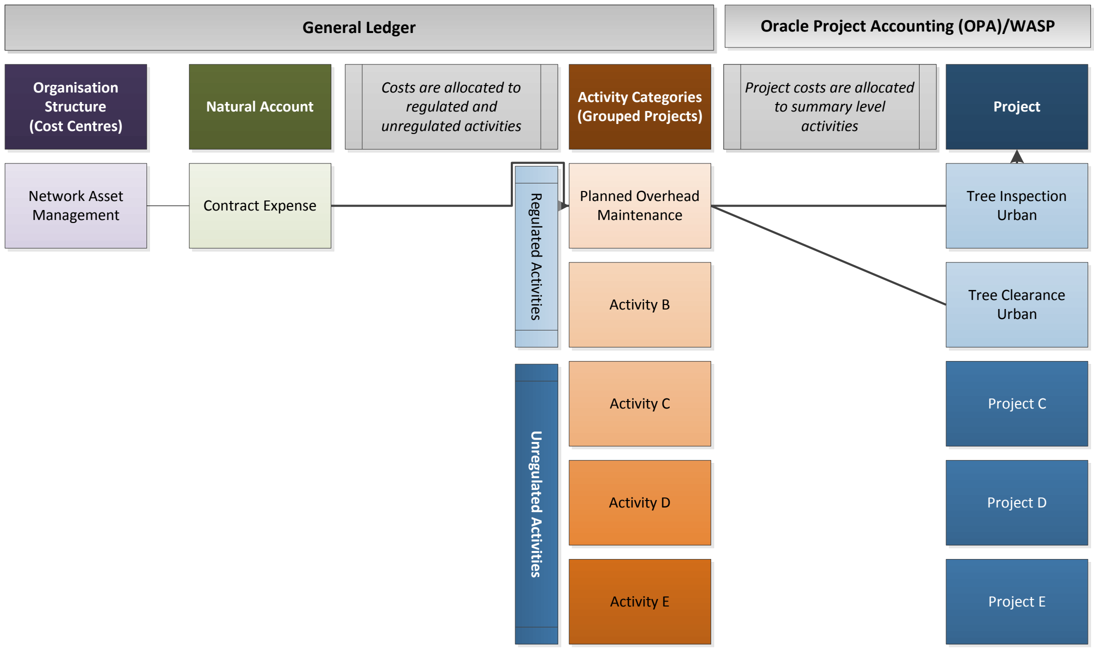
The classification of projects and activities involves a clear separation of business functions and a segregation of the costs associated with the provision of regulated and unregulated services. Regulated services are then further split into standard control and alternative control (metering) services.

The regulated activities categories are as follows:

- Maintenance activities
- Operations activities
- External business—this covers works carried out in the networks for external parties and miscellaneous services such as special meter reads
- Capital expenditure activities

Activities associated with metering (alternative control services) are separated out in each of these categories. The process for allocating projects to activities and cost centres in the general ledger is set out in Figure 2 which includes as an example how tree inspection and clearance (project) costs would be attributed to a regulated activity (planned overhead maintenance), account (contract expense) and cost centre (Network – Asset Management).

Figure 2 Allocating project costs to regulated and unregulated activities



Clause 2.2.3 of the Guidelines requires that ActewAGL Distribution only directly attribute costs to categories of distribution services if they are directly attributable to the provision of the services. To the greatest extent possible, ActewAGL Distribution's CAM directly attributes costs to projects and divisions. In performing this attribution, only those costs that are directly attributable to the provision of a distribution service are directly attributed to that service. For example, material, labour and contractor costs associated with line maintenance and repairs are directly attributed to standard control services because they are used in the provision of distribution services.

Furthermore, ActewAGL Distribution's CAM is consistent with the cost allocation principles set out in Australian Accounting Standard 116: Property, Plant and Equipment. Clause 16 of AASB 116 defines the cost of an item of property, plant and equipment, as comprising, amongst other things, '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.'[8] Clause 17 provides examples of directly attributable costs such as employee benefits, site preparation costs, installation and assembly costs, and testing costs. Although this standard covers the treatment of capital (property, plant and equipment)

[8] AASB 116, *Property, Plant and Equipment*, 2010, p.16

costs, ActewAGL Distribution applies the same cost allocation principles, when directly attributing operating costs.

Clause 2.2.2 of the Guidelines requires ActewAGL Distribution to attribute costs directly to, or allocate costs between, categories of distribution services based on the substance of the underlying transaction or event. This clause emphasises the economic substance of an event, even though its legal form may provide a different result.[9] ActewAGL Distribution's CAM allocates costs across divisions using a number of cost allocation drivers. The nature of the costs, and the activities involved are key to selecting each causal (and non-causal) driver and there must be a proven relationship between activity and cost. The cost allocation drivers are set out in tables 1 to 3 in attachment 2.

FInally, clause 2.2.5 of the Guidelines requires that ActewAGL Distribution does not allocate the same cost more than once. ActewAGL Distribution's financial systems include a number of controls that ensure costs are not allocated more than once. For example, to ensure duplicate payments do not occur, accounts payable systems include an alert which will be raised if an invoice number with the same unique identifier is entered more than once in the invoice field. On a monthly basis a review is undertaken to ensure that there is no significant over or under allocation of indirect costs that have been allocated to projects. An annual review of the corporate cost allocation is undertaken to ensure that there is no over or under recovery of shared corporate costs by any divisions.

Wherever possible, costs are directly attributed to projects and activities through OPA and WASP. Payroll and payroll related costs (superannuation, payroll tax, long service leave and workers compensation) are allocated on the basis of time booked against projects in electronic or manual time sheets. Some payroll costs must be shared across projects and services, as part of cost centre overheads. These costs are minimal and comprise the costs of administration and managerial roles that cannot be easily charged to defined projects.

A range of other costs is also directly attributed to projects. These include the costs of materials and contract services and other project specific costs. Most contractor costs, including large items such as payments for pole inspection services and underground boring, are attributed directly to projects. Where contractors are engaged for longer term works that span multiple projects, their costs are collected in a special cost centre and allocated by way of timesheet entry. All plant and equipment is leased, with a few minor exceptions, and as far as possible these costs are attributed directly to projects and activities.

Electricity network overheads include those remaining costs that cannot be directly attributed to projects, but are shared across all services. These include the leasing costs of sedans, utilities and line trucks, some contract payments such as depot security, consumable

[9] AER, 2008, Cost Allocation Guidelines, June, p.9

items such as gloves and miscellaneous small hardware items (nuts and bolts), computing equipment leases, rates, insurances, staff training costs, stationary, electricity and protective clothing.

These electricity network cost centre overheads, or divisional support costs, are fully allocated to all projects (regulated and unregulated), directly using labour as the driver.

The electricity network division’s share of ActewAGL Distribution’s corporate overhead costs (for corporate services provided by other divisions within ActewAGL Distribution) are allocated across all projects, and then regulated and unregulated activities and services, based on total direct (labour, materials and contractor) costs. Warehouse associated costs are allocated 100 per cent to direct materials.

The final component of the costs of providing ActewAGL Distribution’s electricity network services is the cost of services provided by ActewAGL Retail, comprising customer services and communications (see further discussion in section 4.3 below).

Retail costs are fully allocated to standard control services. The nature of the retail services, mainly billing and related functions, means that they are not supplied to unregulated services, or to the alternative control (ie metering) services, so no retail costs are allocated to these services.

Metering (alternative control) services include: meter testing, meter reading, meter checking, processing of meter data, and the provision of non-standard meters. These do not require any retail services.

4. *Allocation of shared costs to electricity network*

Clause 2.2.4 of the AER Guidelines sets out the principles that ActewAGL Distribution must follow in allocating shared costs. Clause 2.2.4(a) requires that, where shared costs are incurred in providing several categories of distribution services, costs must be allocated between categories using an appropriate *causal* allocator, except to the extent that the costs are immaterial, or a causal relationship cannot be established without undue cost and effort.

The corporate overhead costs discussed above are shared across ActewAGL Distribution's distribution businesses (electricity and gas) as well as ACTEW Water and ActewAGL Retail. Other shared costs allocated include those for services provided by ActewAGL Retail.

Section 4.2 below explains how these shared costs are allocated to ActewAGL Distribution's electricity distribution network services. As background, section 4.1 provides a description of the structure of ActewAGL and the services provided by ActewAGL Distribution's corporate areas.

Clause 2.2.6 of the AER Guidelines requires that the detailed principles, policies and approach that a DNSP uses to attribute costs directly to, or to allocate costs between, categories of distribution services must be consistent with clause 6.17 of the NER, which requires all DNSPs to comply with the distribution ring-fencing guidelines prepared by the AER.

The AER intends to publish draft national ring-fencing guidelines in November 2012, with a final version planned for March 2013.[10] Until then, ActewAGL Distribution will continue allocating costs in accordance with existing ACT guidelines.[11] In dealing with a related business, these guidelines require ActewAGL Distribution to allocate costs using a methodology that is 'consistent with generally acceptable accounting standard and is otherwise fair and reasonable.' ActewAGL Retail is a related business (as defined in the ICRC's ring-fencing guidelines). Section 4.3 below explains the basis of the allocation of ActewAGL Retail costs to electricity networks.

4.1 Services provided by ActewAGL Distribution and ActewAGL Retail

In order to understand the allocation of costs to electricity network services it is necessary to understand the structure of ActewAGL and the services provided by ActewAGL Distribution and ActewAGL Retail.

[10] AER 2012, *Electricity distribution ring-fencing guidelines, Position paper*, September
[11] ICRC 2002, *Ring-fencing guidelines for gas and electricity network service operators in the ACT*, November

Furthermore, clause 3.2(a)(4) of the AER's Guidelines requires ActewAGL Distribution to provide a description of its corporate and organisational structure to enable the AER to understand how the DNSP is organised to provide its distribution services.

As discussed previously, ActewAGL comprises two partnerships—ActewAGL Distribution and ActewAGL Retail. ActewAGL Distribution provides electricity distribution services and gas distribution services. ActewAGL's electricity distribution services are provided by ActewAGL Distribution's network division, comprising Asset Management and Network Services. The organisational structure of ActewAGL is shown in Attachment 1.

Some of the costs of providing ActewAGL's electricity distribution services relate to services provided by other divisions of ActewAGL. These include corporate services (provided by ActewAGL Distribution) and retail services (provided by ActewAGL Retail).

Corporate services provided by ActewAGL Distribution include:

- Office of the Chief Executive
- Human Resources (HR)
- Property and Security
- Legal and Secretariat and Internal Audit
- Corporate Finance
- Contracts and Procurement
- Environment, Health, Safety and Quality (EHSQ)
- Accounts Payable
- Logistics and Facilities
- Business Systems Division (BSD)

Services provided by ActewAGL Retail include:

- Customer services and billing
- Communications

An annual cost allocation is undertaken for all joint costs arising from the provision of the above services. The methodology is reviewed and the cost drivers for each activity are applied. The allocation of these joint costs is known as the Fixed Price Service Charge (FPSC). In addition, and separate to the FPSC, the cost of insurance premiums is allocated across the businesses on the basis of cost drivers specific to insurance.

The drivers used to allocate costs to electricity networks and the other parts of ActewAGL Distribution, ACTEW Water and ActewAGL Retail are described in the following sections.

4.2 Corporate services

The choice of driver to allocate corporate services costs to the electricity network business depends on the type of service provided. Clause 2.2.1(b)(2) of the Guidelines requires that for the allocation of shared costs, ActewAGL Distribution must include amongst other things, information regarding the allocator/s used, the reasons for selecting the allocator/s, and for each cost item, an explanation of why it is the most appropriate available allocator/s.

For some components of corporate services there is a clear causal basis for the allocation. For example, human resources costs are largely based on the number of employees in each division. The cost of helpdesk services provided by BSD is allocated on the basis of the number of helpdesk queries (email, phone, facsimile) received from each business division. Some of the costs of facilities management services are allocated directly to the relevant business (eg maintenance costs). Civic and Fyshwick facilities management costs are allocated on the basis of square meterage used by each division. The costs of IT development are allocated on the basis of the usage of software applications used by each division.

The estimated time spent in providing services is the appropriate allocator in some cases. For example, some corporate finance costs, including the cost of regulatory services are allocated on the basis of estimated time spent on work for each business. Logistics and Facilities costs associated with warehousing, processing and support and fleet management are allocated on the basis of hours worked per division, except where costs can be directly attributed for warehouse rent, where floor area utilised is the driver.

For some corporate service costs there is no ideal causal allocator, because a causal relationship between the cost and a particular division cannot be established. In these cases, ActewAGL Distribution's approach is to apply a non-causal allocator known as the 'indirect driver' based on operating expenditure and full-time equivalent (FTE) employee numbers for each division. That is:

- 50 per cent of the cost is allocated on the basis of operating expenditure (ie. the share of each division's opex as a proportion of total opex); and
- 50 per cent is allocated on the basis of employee numbers (ie. the share of each division's FTEs as a proportion of total FTEs).

These weightings will remain unchanged throughout the regulatory control period. The percentage of shared costs allocated to each division will vary over the regulatory period in line with changes in their operating expenditure and FTEs.

Importantly, corporate capital and operating costs are allocated to the greatest extent possible using causal drivers. Where this cannot be done, the indirect driver is applied.

The following table is provided as an indicative example only to demonstrate ActewAGL Distribution's approach to allocating shared corporate costs. In this instance, *EHSQ – safety management* costs are directly attributed wherever possible. Remaining costs are allocated using a combination of causal (FTE) and non-causal (indirect) drivers.

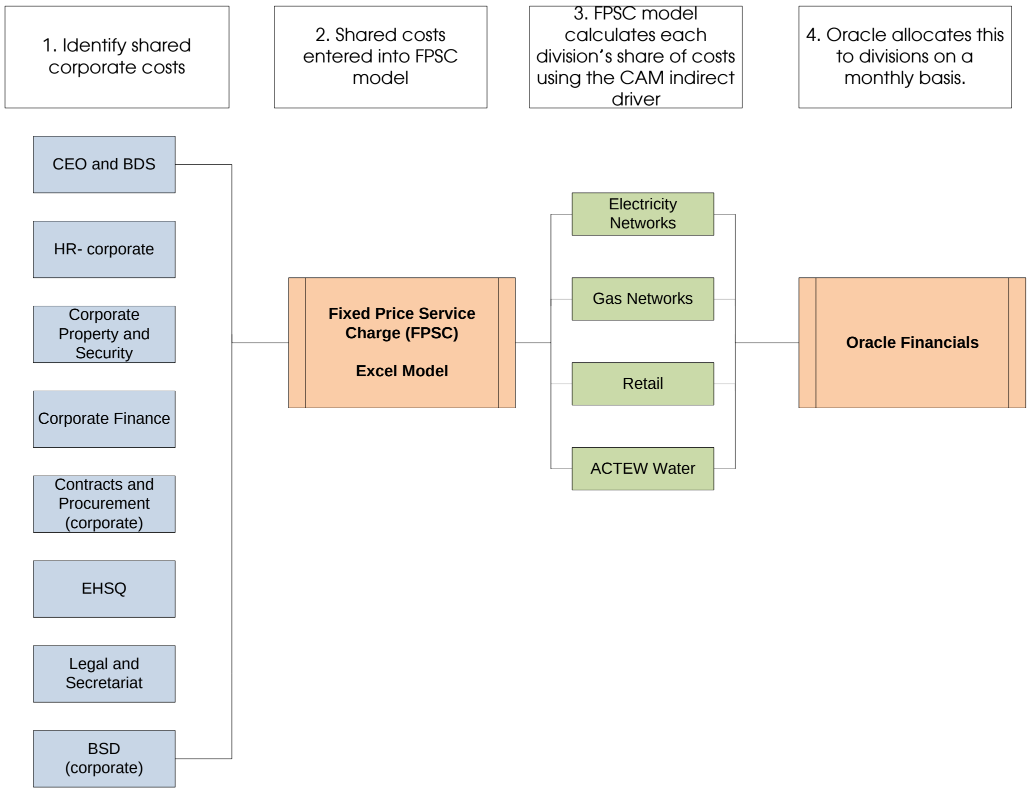
Table 1 Indicative approach to allocating shared corporate costs

Division	*Costs to allocate*	*Driver*	*Unallocated*	*Gas Network*	*Electricity Network*	*ACTEW Water*	*Retail*	*Total*
EHSQ–Safety Management	Division specific employee	Direct	0.0%	0.0%	0.0%	0.0%	100.0%	100.0%
	Residual overheads	Indirect driver	0.0%	5.7%	42.6%	33.5%	18.1%	100.0%

The indirect driver is used to allocate the following corporate costs:

- CEO (Office of the Chief Executive and Business Development and Strategy)
- HR costs for corporate service employees
- Corporate property and security costs
- Corporate finance costs (excluding Regulatory and Treasury services)
- Contracts and procurement costs for corporate service contracts
- Environment, Health, Safety and Quality (EHSQ)
- Legal and Secretariat (net of external legal costs which can be directly attributed to particular business divisions)
- BSD costs (excluding division specific costs and costs with a clear causal driver).

ActewAGL Distribution's approach to allocating the above corporate costs is illustrated in the diagram below and summarised in table 2.



4.3 Retail services costs

The retail services costs allocated to the electricity network business cover the costs of communications and customer services. These services are the subject of detailed Service Level Agreements between ActewAGL Retail and ActewAGL Distribution, and are summarised in Table 3. Importantly, the Service Level Agreements set out the obligations of ActewAGL Retail while undertaking activities on behalf of ActewAGL Distribution, and require both parties to have due regard to any applicable regulatory ring-fencing rules or guidelines in requesting and/or performing services.

The customer services provided to the electricity network business by ActewAGL Retail include: billing, cash collection, contact centre, business systems, and customer services management and overheads.

The costs of billing and cash collection systems are shared with ACTEW Water. Costs associated with billing and cash collection for the gas networks are captured separately and fully allocated to gas.

The costs of retail business systems are also allocated on this basis to ACTEW Water and electricity networks. Gas business system services are outsourced.

The costs of customer services management and overheads are shared among electricity, gas and ACTEW Water.

Contact centre costs are shared between electricity and ACTEW Water. Gas contact centre functions are outsourced.

The costs of communication services undertaken by ActewAGL Retail are directly attributed to electricity networks wherever possible. Examples of these types of costs include those relating to network specific brochures and network communications campaigns (including vegetation management, dial before you dig and public safety). Corporate communications services that are directly attributable to the provision of network services include the preparation and placement of media releases, the provision of crisis communications, press advertisements (including for recruitment), and the publication of relevant fact sheets.

Where these costs cannot be directly attributed, they are shared between different divisions within ActewAGL.

5. Compliance and documentation

5.1 Audit and records management

Clause 3.2(a)(7) requires ActewAGL Distribution to provide a description of how it will maintain records of cost allocation such that it can be demonstrated to the AER how the cost allocation methodology has been applied; and audited or otherwise verified by a third party, including the AER, as required.

ActewAGL Distribution maintains financial source documentation and financial records in a manner that is consistent with Australian Accounting Standards and other statutory requirements. ActewAGL Distribution submits financial information to the AER on an annual basis in response to the AER's Annual Reporting Regulatory Information Notices (RINs). This information is audited by an external auditor, in accordance with the RIN requirements.

ActewAGL's business management systems are the means through which all ActewAGL expenditure is recorded and maintained for a minimum of seven years. These systems, including TM1, Oracle, Excel financial models and common drives are used by ActewAGL Distribution to maintain records of all directly attributable costs, and allocated shared costs to, or between, categories of distribution services. These records form the basis for independent verification of the annual regulatory accounts.

When preparing reports for submission to the AER, ActewAGL will continue to make available any information required to substantiate compliance with the CAM.

ActewAGL maintains all source documents and records (time sheets, invoices etc.) for a minimum period of five years. General ledger trial balances are maintained for a minimum of seven years, and cost allocation work papers for a minimum of four years.

In relation to services provided by ActewAGL Retail to ActewAGL Distribution, Service Level Agreements between the two parties require both to maintain records and supporting documentation sufficient to permit a complete audit of the provision of services, and of payments made in connection with the agreements. This also demonstrates compliance with 3.2(a)(7) of the Guidelines.

5.2 Regulatory Compliance

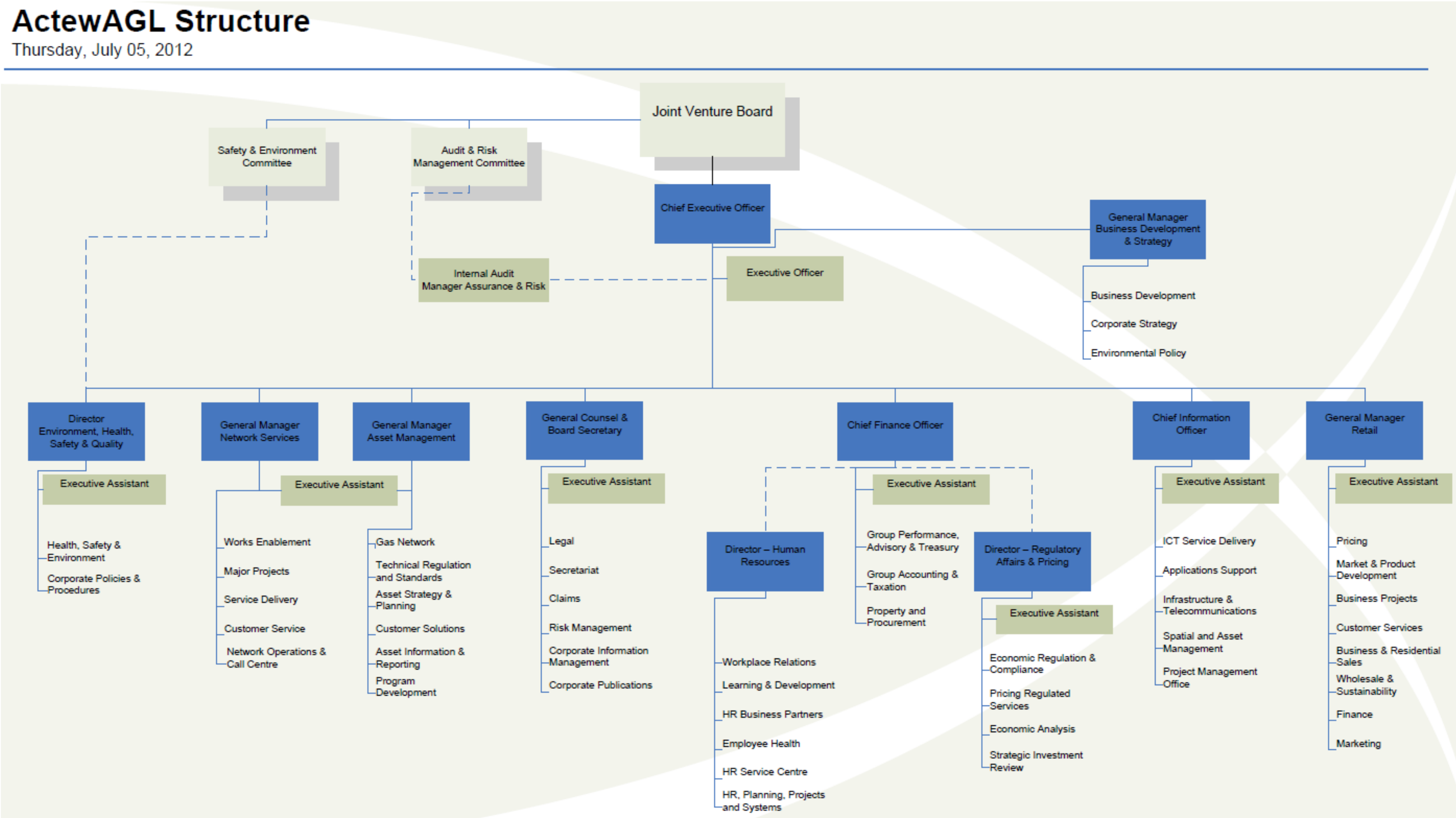
Clause 3.2(a)(8) of the AER Guidelines requires ActewAGL Distribution to provide information about how it will monitor its compliance with the cost allocation method and the guidelines.

ActewAGL Distribution’s Chief Finance Officer is responsible for monitoring ActewAGL Distribution’s compliance with the approved cost allocation method.

ActewAGL Distribution’s Commercial Manager – Networks is responsible for ensuring the preparation and maintenance of the CAM across the organisation and regularly reports to ActewAGL Distribution’s Chief Finance Officer on the CAM and its application in preparing annual financial and regulatory statements. The Commercial Manager – Networks works closely with ActewAGL Distribution’s Finance Division to ensure that any financial information prepared for the AER is compliant with the CAM.

Finally, external auditors are required to audit financial data contained in the RIN for compliance with the CAM prior to it being sent to the AER. This process is also overseen by the Commercial Manager – Networks.

Attachment 1—ActewAGL corporate structure



Attachment 2—Cost allocation summary tables

Table A2.1 Allocation of costs between electricity distribution services

Cost	*Description*	*Service(s) allocated to*	*Basis of allocation (driver)*
Direct project costs	Materials, contracted services and other costs that can be directly attributed to projects	Standard control Alternative control Unregulated	All directly attributed via Oracle Project Accounting (OPA) and Works Management System (WASP)
Payroll and payroll related costs	Salaries and wages and other payroll related costs (superannuation, payroll tax, workers compensation and long service leave.	Standard control Alternative control Unregulated	All directly attributed via OPA and WASP Based on time booked against projects.
Leasing costs	Motor vehicles, plant, computers	Standard control Alternative control Unregulated	Attributed directly to projects, based on hours booked against projects. There are some shared leasing costs but they are included in electricity networks overheads (see row below).
Electricity network overhead costs	Includes all the miscellaneous cost centre costs not allocated directly to projects. They include: motor vehicle leases, computing equipment leases, consumables, rates, insurance, staff training costs, stationary, electricity, protective clothing.	Standard control Alternative control Unregulated	Allocated between regulated and unregulated services against projects in proportion to direct labour.
Corporate overheads	See list in table 2 below	Standard control Alternative control Unregulated	Allocated between regulated and unregulated services against projects in proportion to direct labour, material and contractor costs.
Retail services	Customer services and communications	Standard control only	All directly attributed to standard control services, as the retail services are not relevant to unregulated and alternative control (metering) services.

Where corporate operating and capital costs cannot be directly attributed to a particular division or project, they are shared across the organisation using the indirect driver. This is because there is no ideal causal driver for allocating these costs, most of which are associated with activities undertaken on behalf of ActewAGL as a whole, and not division specific. As discussed in section 4.2, this indirect driver is based on the share of operating expenditure and employee numbers (FTEs) in each division. Calculation of the indirect driver is set out in attachment 3.

Table A2.2 Allocation of corporate costs to Electricity Network

Cost	*Description*	*Costs allocated to*	*Basis of allocation (driver)*
CEO	Includes the office of the Chief Executive and Business Development & Strategy	Electricity Network Gas Network ACTEW Water Electricity Retail	There is no ideal causal allocator for these costs as CEO activity varies from week to week. Costs are allocated to each division on the basis of the indirect driver. Approximately 50% of BDS costs are directly attributed to divisions. The remaining non division-specific costs areallocated using the indirect driver.
Human Resources	Includes HR Planning & Projects; HR Service Centre; Employee Health; Organisational Capability; HR Business Partners; and Workplace Relations.	Electricity Network Gas Network ACTEW Water Electricity Retail	HR costs are allocated to divisions based on FTE numbers (excluding Corporate Services). Salary and HR costs for Corporate Services employees are allocated using the indirect driver because of the corporate, non-division specific nature of their work.
Property and Security	Includes the management of property and security at all ActewAGL and ACTEW Water related sites.	Electricity Network Gas Network ACTEW Water Electricity Retail	Leasing and occupancy costs, or a share of costs are attributed directly to the division to which the costs relate, or their relative portions. The remaining costs that cannot be directly attributed (e.g. salaries, corporate floor space and head office security) are allocated across relevant divisions using the indirect driver.

Cost	Description	Costs allocated to	Basis of allocation (driver)
Legal, Secretariat and Internal audit	Legal advice, Compliance, Assurance and Risk services, Corporate Publications, Assurance, Internal audit and Secretariat service to the Board and Executive.	Electricity Network Gas Network ACTEW Water Electricity Retail	Internal audit is allocated to divisions based on time spent working on each. All other costs are allocated to the divisions on the basis of the indirect driver because there is no ideal causal driver. These are corporate, non-division specific activities that vary from week to week.
Corporate Finance	Group Performance, Advisory & Treasury, Accounting and Tax, Accounts Payable, Regulatory Affairs and System support, Interest Revenue.	Electricity Network Gas Network ACTEW Water Electricity Retail	Regulatory Affairs costs are allocated to the divisions based on time spent working on each. All other corporate finance costs are allocated to the divisions using the indirect driver because of the corporate, non-division specific nature of these costs. Interest revenue is directly allocated to the divisions (where applicable) as a percentage of annual revenue.
Contracts and Procurement	Contracts and Procurement	Electricity Network Gas Network ACTEW Water Electricity Retail	Costs are allocated to divisions (excluding Corporate Services) according to the number of contracts held by each division. Costs relating to contracts for Corporate Services are allocated across the divisions using the indirect driver.

Cost	*Description*	*Costs allocated to*	*Basis of allocation (driver)*
EHSQ	Environment, Health, Safety and Quality,	Electricity Network Gas Network ACTEW Water Electricity Retail	Staff costs are allocated across the divisions according to the time spent working on each. Remaining EHSQ costs associated with activities that are ofan organization wide nature are allocated across the divisions based on the indirect driver.
Accounts Payable	Accounts Payable	Electricity Network Gas Network ACTEW Water Electricity Retail	Costs are allocated according to the number of invoices processed for each division as a percentage of total invoices.
Logistics and Facilities	Management of the warehouse, systems spares, the catalogue and fleet management.	Electricity Network Gas Network ACTEW Water Electricity Retail	Warehousing costs are allocated according to floor space occupied for inventory belonging to each division. Purchasing costs are allocated according to the number of purchase orders raised for each division. Fleet management costs are allocated to each division based on the number of motor vehicles per division.
Business Systems Division (BSD): BSD Executive	Office of the BSD Executive	Electricity Network Gas Network ACTEW Water Electricity Retail	The BSD Executive works on a variety of projects across all divisions. Therefore, costs are allocated on the basis of the indirect driver.

Cost	***Description***	***Costs allocated to***	***Basis of allocation (driver)***
BSD: Service Delivery and Operations	Daily support for the IT systems. Facilitate identification, design and implementation of business and systems solutions. Procurement, leasing and asset tracking of all IT equipment.	Electricity Network Gas Network ACTEW Water Electricity Retail	In relation to IT support, costs are allocated according to the number of calls made to IT support by each division. Remaining costs are allocated across the divisions on the basis of the indirect driver. This is because activities vary from week to week, and cannot always be attributed to specific divisions.
BSD: Information and Communication	Supports in-house and external software applications.	Electricity Network Gas Network ACTEW Water Electricity Retail	Where the software is used by a specific division, the costs are attributed directly to that division. Where all divisions use a particular software, the costs are allocated using the indirect driver.
BSD: Project Management Office	Delivery of Information Communication Technology projects and programs operating within BSD.	Electricity Network Gas Network ACTEW Water Electricity Retail	The BSD PMO works on a variety of projects across all divisions. Therefore, costs are allocated on the basis of the indirect driver.
BSD: Spatial and Assets Services	Drawing Management System (DMS) team provide administration, training and subject matter expertise for ActewAGL's Drawing Management System.	Electricity Network Gas Network ACTEW Water Electricity Retail	The BSD Spatial and Assets Services group works on a variety of projects across all divisions. Therefore, costs are allocated on the basis of the indirect driver.

Cost	*Description*	*Costs allocated to*	*Basis of allocation (driver)*
BSD: IT Applications	Software Developers	Electricity Network Gas Network ACTEW Water Electricity Retail	Costs are allocated on the basis of time spent on specific divisions' software development requirements. Remaining costs are allocated across the divisions using the indirect driver. This is because these costs are associated with corporate activities that cannot be attributed to particular divisions.

Table A2.3 Allocation of retail costs to Electricity Networks

Cost	*Description*	*Costs shared between*
Customer services	Includes billing services, cash collection, contact centre, business systems and overheads.	Electricity network and ACTEW Water for billing, cash collection and business systems (these services are outsourced for gas networks). Electricity network, gas network and ACTEW Water for management and overheads. Electricity network and ACTEW Water for contact centre costs (these services are outsourced for gas networks).
Communications	Network specific costs: • Network specific brochures • Dial Before You Dig campaign • Scan before you plant campaign • Vegetation Management • Safety Campaign Other communication costs include • Internal staff newsletter • Staff safety campaign • Media Monitors • Yellow and white pages • Internet development • website maintenance overheads	Network specific costs are directly allocated to the relevant network (electricity network, gas network or ACTEW Water). Remaining costs are shared between electricity network and gas network.

Attachment 3—Indirect Driver

Clause 2.2.4(c)(3) of the Guidelines states that where a shared cost is immaterial or a causal relationship cannot be established, then a DNSP may allocate shared costs to a particular category of distribution services using a non-causal allocator.

Pursuant to this clause, ActewAGL Distribution provides this work paper to the AER documenting for each shared cost:

- the basis of allocation;
- the reason chosen for that basis;
- a demonstration that the shared cost is immaterial or an explanation of why no causal relationship could be established without undue cost and effort; and
- a numeric quantity or percentage of the non-causal allocator applied to each category of distribution service and in total.

As discussed in section 4.2 of the submission, the following corporate costs are allocated across ActewAGL divisions using a non-causal driver known as the 'indirect driver.'

- CEO (Office of the Chief Executive and Business Development and Strategy)
- HR costs for corporate service employees
- Corporate property and security costs
- Corporate finance costs (excluding Regulatory and Treasury services)
- Contracts and procurement costs for corporate service contracts
- Environment, Health, Safety and Quality (EHSQ)
- Legal and Secretariat (net of external legal costs which can be directly attributed to particular business divisions)
- BSD costs (excluding division specific costs and costs with a clear causal driver).

There is no ideal causal allocator for these costs, as activities vary frequently depending on business requirements and often cannot be linked back to any particular project or business division.

ActewAGL considers that it would be very difficult to establish a causal relationship between shared corporate costs and their direct drivers because of the significant resource commitment required to record, monitor, and analyse the consumption of shared services. For example, this would require that all ActewAGL Distribution corporate staff commence filling out detailed time sheets. ActewAGL Distribution considers this a significant and costly administrative burden that may or may not result in a superior allocation of shared costs across the organisation. ActewAGL's non-causal 'indirect driver'

ActewAGL proposes to allocate shared capital and operating corporate costs that cannot be otherwise allocated directly, or via a causal allocator, across the organisation using an indirect driver that is calculated as the weighted average of opex and employee numbers for each division. That is:

- 50 per cent of the cost is allocated on the basis of operating expenditure (ie. each division's opex as a proportion of total opex); and
- 50 per cent is allocated on the basis of employee numbers (ie. each division's FTEs as a proportion of total FTEs).

These weightings will remain unchanged throughout the regulatory control period. The percentage of shared costs allocated to each division will vary over the regulatory period in line with changes in their operating expenditure and FTEs.

The following table is provided as an example only, and demonstrates how the indirect driver is calculated. The information contained in it should not be relied upon for any other purpose. In this instance, the indirect driver to be used in allocating a share of corporate costs to electricity networks is calculated to be 42.6 per cent. That is, 42.6 per cent of shared corporate costs (that cannot be directly attributed, or via a causal driver) should be allocated to the electricity distribution network.

Table A3.1 indicative example of calculation of the indirect driver

*Electricity Network Share of Corporate Costs using Indirect Driver**				
	Electricity Networks	*ActewAGL*	*Electricity Network Share*	*Formula*
Opex**	92,500	251,500	36.80%	A
FTE	437	902	48.40%	B
Indirect Driver			42.60%	(A+B)/2

Justification

ActewAGL Distribution considers that the indirect driver is the most appropriate allocator for sharing corporate costs across the organisation. It comprises operating expenditure and employee numbers which both have a well established causal relationship with the consumption of corporate services. Operating expenditure is generally considered a good proxy for the consumption of corporate overheads and has the added advantage of providing an incentive for business divisions to reduce operating expenditure. Employee numbers has a strong causal relationship with corporate services, particularly as these relate to human resources, information technology and facilities management costs. In essence, more people generate more cost pressure on corporate services.