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Jemena

Submission to the Australian Energy Regulator

Issues Paper Electricity Distribution Network Service Providers

Annual Information reporting requirements

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1 Introduction

The Australian Energy Regulator (AER) proposes to introduce a number of detailed reporting requirements (Requirements). The requirements are meant to enable the AER to collect information the it needs to carry out its regulatory functions. The AER intends to use the information when assessing future regulatory proposals.

Jemena Electricity Networks (JEN) agrees with the general intent of introducing the Requirements. JEN supports the principle that a regulator should have access to information that is necessary for the regulator to perform its functions under the relevant laws and rules. However, in developing the Requirements, it is also important to be conscious of the cost burden on the business of providing too much information. In our view, the Requirements, as contemplated in the issues paper, will require the businesses to provide too much detail. We do not believe that this level of detail is necessary to assess future regulatory proposals.

In order for JEN to provide information at the level of detail proposed in the Issues Paper, JEN would have to make costly changes to internal business processes and systems. At that level of detail, the information would also cease to be meaningful, as it would require costs allocations to categories far removed from underlying cost drivers.

JEN notes that the categories in the proposed templates may be a legacy of the Victorian regime, where similar templates have been completed on an annual basis. To the best of our knowledge the detailed Victorian templates have never been used to establish revenue requirements—higher level information was used instead. Likewise, the Issues Paper does not appear to explain why the AER requires this level of detail to set future revenue allowances.

We recommend that the AER establish a working group (or groups), comprising AER staff and state-based representatives of the Electricity Networks Association (ENA), to agree on high level reporting principles. These principles would establish the type of financial and technical information that the AER requires to set future revenue allowances. Based on these principles, the working group can then develop the level of detail necessary in the Requirements. This process would also allow JEN (and other distributors) to reconcile the scope of information the AER proposes to gather with the information that JEN uses to manage its business—having reviewed the Issues Paper as it stands, we found such a reconciliation difficult to do.

The remainder of this submission addresses the detailed questions in the Issues Paper.

2 Proposed information requirements

2.1 Capital Expenditure (CAPEX)

Are the proposed capex templates appropriate for the AER's regulatory functions?

Please provide comments regarding the cost categories and definitions included in the capex templates.

The proposed capital expenditure (CAPEX) templates use a format that appears to be sourced from Victorian Guideline No.3 issue 6 (GL3). Specifically, they seek to categorise expenditure by:

- expenditure type (load management, network extensions)
- geographic nature (CBD, urban, rural);
- voltage type (sub-transmission, distribution HV, distribution LV);
- asset class (lines and cable, meters, public lighting) although the split of capital costs is over a greater number of asset classes than in GL3; and
- broad asset category (overhead or underground) although GL3 presently does not require assets to be reported by these categories

JEN currently has recording systems that automatically capture data for only two of the above five headings (expenditure type and asset class). JEN does not have the systems in place to support the other headings and relies on allocations that have not been updated since the 2000 price review.

Establishing systems that allocate and report the same dollar spent under five different headings is costly and problematic. There is also no underlying business need for such an allocation. While there may be a sound underlying regulatory need for such an allocation, this has not been explained in the Issues Paper. In our view, as a general principle, the AER should rely on accepted accounting standards and management reporting standards to establish relevant categories, rather than creating more detailed categories that are not used by businesses for day–to–day management. Where a tangible and justifiable regulatory need exists to depart from generally accepted standards, the AER should explain this need when proposing alternative information categories, as well as considering the benefits of having the information against the costs that the businesses will incur in providing it.

2.1.1 Expenditure type

JEN is able to report expenditure at the proposed detail level. Systems are in place to capture costs based on the proposed categories. The categories represent real cost drivers and have been recognised internally for over a decade.

2.1.2 Geographic nature and voltage type

There is no underlying management need for JEN to break down expenditure by:

- urban or short rural
- high voltage, (HV), low voltage (LV) or sub transmission.

JEN does not manage expenditure at this level of detail. While these categories may be relevant to the technical management of the network, they are not related to cost-drivers and are thus not used for managing expenditure. For example, JEN does not manage budgets or order materials based on whether expenditure is required in the short rural or urban areas of its network. JEN sets budgets and manages expenditure based on how many new connections are forecast or the number of poles to be replaced.

2.1.3 Asset class

Reporting of asset classes has long been established in statutory reporting requirements. JEN therefore accepts that asset class categories are relevant for reporting expenditure. No system changes will be required to provide this information.

2.1.4 Definitions

Due to time constraints, JEN has not completed a thorough analysis of the proposed definitions. However, it appears that some definitions have been transferred from jurisdictions without additional review. For example, the definition of LV refers to low voltage. Technical definitions should be sourced from the latest technical codes, where the states have already agreed or have a process in place to have standard definitions.

2.2 Operating Expenditure (OPEX)

Please provide comments regarding the cost categories and definitions included in the opex templates.

Are the proposed opex templates appropriate for the AER's regulatory functions?

Please refer to our comments in section 2.1 above.

Currently JEN does not split OPEX in its financial records by underground and overhead, nor does JEN split maintenance expenses by condition-based, emergency and routine maintenance categories. In order to split expenses by these categories, JEN will need to develop new allocators (at a cost). Also, the proposed template requires distributors to disclose variances of actual expenditure from compared to the revenue cap allowance, along with explanations for the variances. JEN may not be able to provide such a break down, due to the aggregated nature of revenue cap allowance data provided in regulatory determinations.

2.2.1 Material projects and programs

Is 2 per cent of the DNSPs anticipated revenue in the final year of the current regulatory control period an appropriate threshold?

Is the information collected in the template appropriate for the AER's regulatory functions?

The AER proposes that DNSPs report CAPEX disaggregated to the level of projects for which expenditure exceeds 2 percent of revenue. There are two issues:

- whether it is appropriate and necessary for the AER to request that level of disaggregation; and
- whether the threshold of 2 per cent is an appropriate level (in the case that the AER proceeds with reporting at the project level)

2.2.2 Appropriateness of reporting

In assessing whether the AER is justified in seeking annual details of CAPEX at such a detailed level, it is important to consider the National Electricity Rules (Rules). The Rules require the AER to:

- assess forecast CAPEX in a regulatory proposal; and
- use actual CAPEX in rolling forward the capital base from one regulatory period to the next

The relevant requirements are in the Rules are as follows:

- 6.5.7—Forecast capital expenditure. Clause 6.5.7(e) lists the ten 'capital expenditure factors' that the AER must have regard to; and
- Schedule 6.2—Regulatory Asset Base. Clause S6.2.1(e)(1) refers to 'all capital expenditure incurred during the previous control period'.

Forecast CAPEX is therefore stringently assessed and then locked into the building blocks for the forthcoming regulatory period and actual CAPEX is subsequently rolled into the RAB. To the best of our knowledge, there is no project-by-project compliance requirement. Given the above, it is not clear why AER requires annual CAPEX information on a project-by-project basis.

In making price submissions, JEN has previously provided asset management plans that set out forecast expenditure against asset categories and expenditure types. As a matter of principle, JEN considers that annual reporting should be consistent with the level of detail required for pricing submissions, rather than at individual project level.

2.2.3 Threshold is too low

Notwithstanding our comments in section 2.2.2 above, JEN considers the threshold arbitrary and too low for reporting requirements. We also query the use of a percentage, rather than dollar value, threshold. For example, a project to install $5 million dollars of equipment (for example a new zone substation) will be the same cost for two distributors, irrespective of whether distributor A earns $300 million of revenue or distributor B earns $150 million. Under the AER's proposal, Distributor B would be required to report on this project, whereas distributor A would not be required to report (due to the percentage threshold).

Similarly, the proposed requirement is unclear in relation to programs with cumulative expenditure. For example, replacing poles over a five year regulatory period could potentially be considered a program of expenditure which, if over 2 per cent of revenue, would require annual reporting under this proposal. Replacing poles is not a material project or program, but rather a normal day-to-day activity that should not be caught by this requirement.

2.3 Disaggregation statements

2.3.1 Income statement

JEN has no comment at this stage on the income statement or the proposed disaggregated information.

2.3.2 Balance sheet

In JEN's view, the AER does not require a detailed or disaggregated balance sheet in order to assess pricing proposals. The only relevant components for establishing revenue benchmarks are capital expenditure and the regulatory asset base.

A detailed and disaggregated schedule of current assets, other non-current assets and liabilities does not assist the primary purpose of the AER. Such a schedule does, however, places an incremental reporting burden on business and thus increases the cost of preparing and auditing the regulatory accounting statements. These costs will need to be recovered via higher network tariffs. Consistent with our earlier comments, unless a demonstrable regulatory need exists, and unless this need outweighs the costs of gathering and reporting the information, we suggest that this proposed requirement be removed. If such a need does exist, the AER should put this forward for consultation.

2.3.3 Cash flow statement

JEN's position on the cash flow statement is the same as our position on the balance sheet. Since the cash flow statement represents aggregated cash flows from entities that form the distribution business (including corporate areas and related parties) the cash flow statement cannot be automatically produced from existing costing systems. It will be an onerous and expensive task to produce and audit the statement. Consistent with our earlier comments, unless a demonstrable regulatory need exists, and unless this need outweighs the costs of gathering and reporting the information, we suggest that this proposed requirement be removed. If such a need does exist, the AER should put this forward for consultation.

Furthermore, JEN notes that the AER states in 2.3.3 that it intends to use the cash flow statement to verify the true and fair view of the DNSP's operations and establish a view on its ability to continue to meet its distribution obligations into the future. JEN's view is that a regulatory cash flow statement is unnecessary for AER's stated purpose, as external auditors provide assurances regarding the statutory financial data that is used in preparing the regulatory accounts, and the auditors' opinions regarding the viability of the business are supported by signed Directors assurances.

Should the AER, require specific additional information leading into a price review period, that information should be separately sought from the Distribution Business and not be part of an annual reporting requirement.

2.3.4 Working papers

The AER makes the statement that the regulatory adjustment journal will assist the AER to assess whether the certified annual statements give a true and fair statement of the DNSP's financial performance. JEN believes that this task is the role of the board and the auditors, and not of the AER.

JEN notes that the various templates require a support reference (presumably a supporting worksheet or similar) to be noted. In past regulatory submissions, it has proven to be more practical to provide a clear statement explaining how the costs have been determined and the costing methodologies adopted in preparing the regulatory accounts. JEN proposes that this approach be adopted by the AER.

JEN does not maintain a separate general ledger system for regulatory accounts, but rather produces these based on direct cost assignment or the application of allocators to financial data obtained from the statutory accounts of the business. Therefore, while individual allocation journals are not processed through a ledger based system, all the financial data is subject to external audit and is traceable back to statutory accounting records and therefore the general ledger of the business.

2.3.5 Asset schedules

JEN does not maintain the data that would be required to support a number of the proposed schedules. Significant cost would be incurred to establish and keep the required records on an annual basis. The asset ageing schedule, for example, is updated at the time of each price review, rather than annually. It is timely to review once every five years in order to confirm an asset management plan, rather than update annually. Asset ageing has no relevance on an annual basis, however it is an important review point when establishing five yearly forecasts. The production of asset reports that show the ageing of assets by asset class and in 2 yearly blocks will be costly to implement and maintain, particularly as a part of the assets in each 2 yearly asset segment "roll forward" from one segment to another each year, and will be of no use to the business in managing asset utilisation. Presumably, written down values are being sought which would require the associated depreciation to be tracked as well.

The AER also proposes to require details of network characteristics on an annual basis. Apart from the difficulty of providing the characteristics across the various categories there is generally little annual movement in the actual numbers that requires reporting at this level of detail.

2.3.6 Relationships with other entities

The exact nature of information that the AER proposes the businesses to disclose under this category is not immediately clear from the Issues Paper and the attached templates. JEN will contact the AER directly in order to inform any future response on this issue.

2.3.7 Service performance requirements

JEN, together with the ENA have recognised that it would be beneficial to formulate a set, or toolbox, of harmonised and clearly-defined reliability reporting measures. Subsequently, the ENA's Reliability and Power Quality Committee was commissioned to develop nationally consistent high level reliability performance cause codes.

These developed cause codes are supported by clear definitions that ensure consistent interpretation across distributors and jurisdictions and allow for appropriate reporting of targeted activities as a basis for improving the network's performance.

ENA and its members will provide further information on this body of work to the AER in November 2008. work has had input from all DNSPs in the National Electricity Market.

3 Other information requirements

3.1 Network planning and demand management

Is the proposed information required for network planning appropriate for the AER's regulatory functions?

It is unclear how operating expenditure is dealt with in relation to network planning and demand management. Further, some of the information is sensitive in relation to the company's critical infrastructure plan and should not be made public.

4 Timing

4.1 Implementation of the RIO

Does the implementation of the RIO for all relevant jurisdictions from the first regulatory year following the release of the RIO present particular issues for DNSPs?

JEN generally supports a process of genuine consultation, with the business agreeing to high-level reporting principles and the detailed data required to support those principles. As noted above, JEN recommends that the AER establish a working group in conjunction with state-based representatives of the ENA to agree on high-level reporting principles and the level of detail necessary to comply with the principles. This process would also allow JEN (and other distributors) to reconcile the scope of information the AER proposes to gather with the information that JEN uses to manage its business—having reviewed the Issues Paper as it stands, we found such a reconciliation difficult to do.

JEN does not object to starting the annual requirements in 2011 (this being the first year in the new regulatory period). However, we do object to providing the information within four months. Based on the information requirements contained in the Issues Paper, we envisage a number of system and process changes. Like any new requirements, there will be teething issues that will require additional time to implement and/or rectify. JEN recommends that businesses be allowed six months to submit reports for the first two years, so that they can establish the necessary process to produce a robust annual report, rather than one that is produced simply to meet a timeline.

If the level of data required by the AER was to remain significantly unaltered from the proposed draft (and therefore in excess of information presently being reported to the ESC), then after the expiry of the proposed 2 year period above, the submission date should be within six months of the end of the reporting period. This provides the time needed for the statutory accounts to be produced at the end of December. The statutory accounts need to be audited, followed by the regulatory accounts being prepared, audited and reviewed and signed off by Directors. In the past, the ESC's GL3 allowed 4 months. However, the requirements proposed in the Issues Paper introduces significantly more extensive data reporting requirements.

4.2 Back casting templates

Are the proposed back casting templates for capex and opex appropriate for the AER's upcoming distribution determinations?

JEN believes the back casting templates are not appropriate. Forcing historical data into such templates will become an exercise of allocation rather than representing the actual cost driver. JEN does believe it is appropriate to hold the business retrospectively accountable for allocations made in back casting templates.

JEN has systems in place in order to manage its operations and report performance in the current regulatory period and is not able to change historical reporting and allocate costs into categories that were not relevant at the time they were incurred and reported.

5 Other matters

5.1 Compliance costs

What are the benefits of issuing the RIO? What are the costs? Do the benefits outweigh the costs?

JEN has no comment on the benefits. However, we note that the business will incur additional costs in order to establish the systems and comply annually with the proposed requirements. JEN has not calculated this cost. However, we will provide estimated costs in the future, if requested to do so by the AER.

5.2 Assurance requirements

Are the AER's proposed assurance requirements suitable?

In terms of assurance, the most efficient process is to engage the auditor of each individual business. The business already incurs a sunk cost for the audit of the statutory accounts and, therefore, the auditors are in a position to understand the underlying numbers. There will be additional costs incurred to audit annual regulatory reports. However, these costs will be significantly higher if a different auditor is introduced into the process.

The proposal is to require a positive assurance from the auditor. This will be problematic in the case of non-financial information. It is not clear from the Issues Paper whether an audit is required for the non-financial information. Audit firms do not generally audit non-financial information, because audit standards do not deal specifically with these issues. Audit firms are more likely to engage on an agreed-upon procedures level of assurance rather than a traditional audit.