

SPI PowerNet Pty Ltd

**Electricity Transmission
Revenue Proposal
2014/15 – 2016/17**

**Appendix 2C:
Cost Allocation Methodology**

Submitted: 28 February 2013

SP AusNet Transmission

Cost Allocation Methodology

August 2008

Version 1.0



Version History

Version No.	Issue Date	Authorised By	Details of Amendment
0.0	31 March 2008	N Ficca / P Adams (Directors)	Proposed Methodology. Submission to AER Version 0.0.
1.0	1 August 2008	N Ficca / P Adams (Directors)	Amendments at request of AER. Updated version for AER approval.

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1 Introduction

The National Electricity Rules (NER) requires Transmission Network Service Providers (TNSPs) to submit their proposed transmission network services cost allocation methodology (CAM) to the Australian Energy Regulator (AER) by 31 March 2008 for approval. This document sets out SP AusNet's methodology for the allocation of costs to, and between, its electricity transmission network services.

The methodology has been developed in accordance with the requirements of the NER and the AER's Cost Allocation Guidelines for electricity TNSPs, dated September 2007.

1.1 Purpose and scope of the cost allocation methodology

SP AusNet's cost allocation methodology documents the approach to allocating costs to the electricity transmission network business and between categories of electricity transmission network services, as required in clause 2.2 of the AER's Cost Allocation Guidelines. The documented methodology will be used in the preparation of capital and operating expenditure forecasts for revenue proposals and for annual regulatory reporting obligations (regulatory accounts).

The document also provides guidance for SP AusNet management and staff in relation to cost allocation principles, policy and ongoing obligations as they relate to the operations and delivery of transmission network services. The electricity transmission services provided by SP AusNet, the nature of costs associated with those services and the methodology for allocating these costs is set out in sections 2 and 3.

In recent years, SP AusNet has undertaken a number of integration and process review projects associated with bringing together its Transmission and Distribution businesses. While the cost allocation methodology described in this document reflects the arrangements currently in place, SP AusNet is committed to the ongoing review and enhancement of all processes, procedures, systems and tools associated with this critical element of its business performance. In this regard, SP AusNet recognises its obligations and the process, under the NER, for seeking future amendments to its cost allocation methodology once approved by the AER.

This methodology is consistent with the principles that SP AusNet has used in managing and reporting transmission network service costs through the regulatory reporting period ending 31 March 2008 and is consistent with current practices.

1.2 Accountabilities and responsibilities for the cost allocation methodology

Clause 3.2(3) of the AER's Cost Allocation Guidelines requires SP AusNet to include, within the cost allocation methodology document, details of the accountabilities for the document and responsibilities for updating, maintaining, applying and monitoring the cost allocation methodology (CAM).

The following table sets out these accountabilities and responsibilities:

	Accountability and/or Responsibility
Board	<ul style="list-style-type: none"> Review and approve the CAM
Internal Audit	<ul style="list-style-type: none"> Monitor compliance with the requirements of the CAM and report to the Audit & Risk Management Committee (ARMC) Recommend improvements to the CAM as identified
Finance Division	<ul style="list-style-type: none"> Implement the CAM and provide associated costing procedures and guidelines for staff Update and maintain the CAM as required Apply the CAM in the preparation of all financial information, including reporting of actual results and development of forecasts Provide advice, education and support to staff in regard to the requirements of the CAM
Regulatory & Business Strategy Division	<ul style="list-style-type: none"> Provide advice on design and implementation of the CAM Monitor and advise of changes to the NER and CA Guideline impacting on the CAM
Operational Managers	<ul style="list-style-type: none"> Comply with the CAM and support its application within relevant area of responsibility
All Staff	<ul style="list-style-type: none"> Comply with all relevant costing procedures and guidelines issued by Finance Division to ensure that SP AusNet complies with the approved CAM

While significant responsibility lies with Finance Division for the application of the CAM, all SP AusNet management and staff share responsibility for compliance and for the provision of costing inputs and information (e.g. activity surveys) used within the cost allocation process.

1.3 Compliance monitoring

Associated with the preparation of annual regulatory financial information, SP AusNet engages external auditors to audit the statutory financial statements (base accounts), internal controls and the regulatory accounts, derived from the application of the CAM.

SP AusNet will further monitor its compliance with the CAM and the AER's cost allocation guidelines through the following:

- in processing and approving costing entries, Finance Division staff review the coding of costs;
- the annual review of templates, documentation and work-papers by the Finance and Regulatory Divisions during the preparation of regulatory accounting statements;
- cost allocation models and management costing surveys are subject to annual review by Finance Division and external audit scrutiny during the preparation and audit of the annual regulatory accounting statements;
- direct cost attributions, overhead capitalisation and the allocation of shared costs are subject to Internal Audit review, on a cyclical basis, within the approved annual Internal Audit Plan;
- the Directors will make such enquiries as may be necessary to allow them to sign the Responsibility Statements for regulatory financial information submitted to the AER;
- SP AusNet's Regulatory Compliance Data-Base will be used to systematically schedule key CAM activities, assign responsibility for their completion, monitor progress and formally report their completion; and
- where required by the AER, financial information prepared under the cost allocation methodology and guidelines shall be subject to independent audit.

1.4 Records management

Accounting records

SP AusNet records its costs in accordance with all applicable accounting standards and Corporations Law. The annual internal and external audit programs, reviewed and approved by the ARMC, ensure that all accounting records are subject to appropriate audit scrutiny before they are submitted to relevant authorities. Covering audit opinions are included with all submitted statutory and regulatory accounts. All submissions are prepared in accordance with the necessary accounting, legislative and regulatory standards and guidelines, and audit opinions report on compliance.

Working papers

As part of SP AusNet's external audit of the regulatory accounts all supporting working papers are submitted and subsequently reviewed by the audit team. Each working paper is provided with supporting calculations, where appropriate, and cost allocation models are cross checked to assure the veracity of the information supplied.

Record retention

In accordance with clause 3.2(7) of the Cost Allocation Guidelines, SP AusNet will maintain the following records in order to demonstrate compliance with the guideline and to facilitate audit/verification as required:

- source documents, general ledger, trial balances, transaction listings and cost allocation working papers for a minimum of seven years; and

- supporting work papers showing the attribution or allocation of costs to, or between, categories of transmission services in accordance with the approved cost allocation methodology.

SP AusNet will maintain these records within its integrated financial and asset management systems, including Oracle, Maximo and supporting analytical spreadsheet packages.

1.5 Commencement date, version history and availability

Commencement date

Subject to AER approval, the cost allocation methodology will commence from the date of publication and will apply to SP AusNet's regulatory accounting information for regulatory periods commencing with the financial year ended 31 March 2008.

Version history and date of issue

The NER provides for the amendment of the methodology from time to time, and requires that the history and date of issue of the document be updated accordingly. As such, this document includes a version control table, located on the second page, to detail version number, effective date and details of the amendment.

Minor updates will be designated as iterations of the approved document, e.g. minor wording changes to supporting text will be designated as version 1.1. More comprehensive changes will be given a new version number, e.g. significant changes to corporate structure or the allocation of particular costs will be designated as version 2.0.

Availability

In accordance with the requirements of clause 6A.19.4(h) of the NER, SP AusNet will maintain a current copy of the approved cost allocation methodology on its website www.sp-ausnet.com.au.

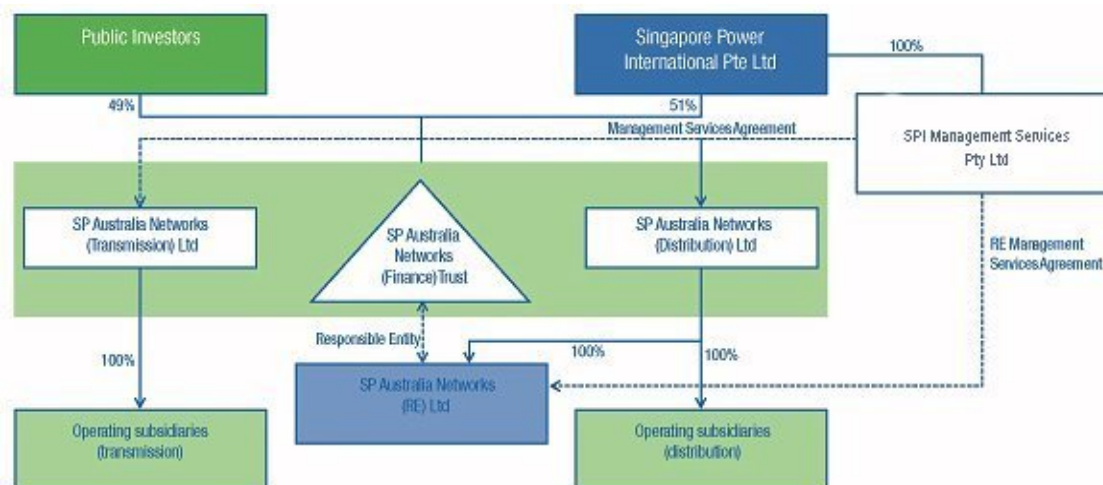
2 SP AusNet’s electricity transmission services

2.1 Corporate structure

Clause 3.2(4) of the AER’s cost allocation guidelines requires that a description of the TNSPs corporate and organisational structure be provided within the CAM.

SP AusNet’s current structure provides clear separation between Transmission and Distribution (electricity and gas) assets. This separation is required for a number of reasons, including market, funding and regulatory requirements. SP AusNet’s corporate structure is shown in figure 1.

Figure 1: SP AusNet’s corporate structure



SP AusNet’s transmission services, and associated transmission regulatory reporting, are contained within the operating subsidiaries of SP Australia Networks (Transmission) Ltd.

Management and strategic services are provided to SP AusNet’s Transmission and Distribution businesses by SPI Management Services Pty Ltd, under a service agreement which commenced on 1 October 2005. The agreement is for 10 years and is subject to review and oversight by the ARMC as it is a related party transaction. SPIMS charges to SP AusNet comprise:

- Management service charges, which are cost reflective charges for the management personnel and management services provided; and
- Performance Fees, which are incentive-based fees determined in accordance with the Agreement, but are not allocated into the regulatory accounts of Transmission and Distribution.

2.2 Operational structure

SP AusNet’s integrated operational structure provides the full range of asset management, network operations and corporate services to the group’s three regulated network businesses.

Spanning across both Transmission and Distribution, SP AusNet’s services and costs are captured in the following Divisions:

- Network Development
- Network Services
- Corporate Service Divisions
 - Regulatory & Business Strategy
 - Chief Financial Officer
 - Business Systems & Services
 - Human Resources & Communications
 - Corporate Development & Investor Relations
 - General Counsel & Company Secretary
 - Office of the Managing Director & Internal Audit

2.3 Categories of electricity transmission services

Clause 3.2(5) of the AER's cost allocation guidelines requires that SP AusNet specify the categories of transmission services that it provides, to which costs are to be attributed or allocated, and the types of persons to which the services are provided.

In accordance with this requirement the transmission services that SP AusNet provides and the customers of those services are set out below:

- Regulated services:
 - Prescribed transmission services are shared transmission services at standard service levels and connection services provided to generators, distribution networks and high voltage customers;
 - Excluded prescribed transmission services, which differ from prescribed transmission services only in terms of timing. They represent services that are commissioned within the current regulatory period and, as such, they are not reflected within the current period's revenue determination (ie. they are 'excluded' from the regulated asset base and revenue determination until the next regulatory period); and
 - Negotiated transmission services are connection services provided to transmission users (generators and customers), and shared transmission services provided at levels exceeding standard service levels.
- Non-regulated transmission services are those that SP AusNet is not obliged to provide and which are capable of being provided on a contestable basis.
- 'Not-Allocated' costs are those that are not required to be allocated to the transmission service segments in the regulatory financial statements (e.g. financing costs and taxation expense).

The above categories of transmission services reflect the segments reported in SP AusNet's annual regulatory accounts.

3 Cost Allocation Principles and Policies

3.1 Overview

Clause 3.2(6) of the AER's cost allocation guidelines requires details of the principles and policies used by SP AusNet for attributing costs directly to, or allocating costs between, categories of transmission services. These principles and policies must meet the requirements of clause 2.2 of the guidelines.

In accordance with this requirement, SP AusNet confirms that the following principles underpin the proposed cost allocation methodology and are used to attribute costs directly to, or to allocate costs between, categories of transmission services:

- costs are directly attributed to, or allocated between, categories of transmission services based on the substance of the underlying transaction or event rather than its legal form;
- only costs that are directly attributable to the provision of a particular transmission service will be attributed to that service;
- shared costs incurred in providing several categories of transmission services will be allocated between these categories using a causal allocator, except to the extent that the cost is immaterial or a causal relationship cannot be established, in which case a non-causal allocator will be used, subject to AER approval;
- costs will not be allocated more than once;
- the principles, policies and approach used to attribute costs directly to, or allocate costs between, categories of transmission services are consistent with the transmission ring-fencing guidelines; and
- costs that have been attributed or allocated to prescribed transmission services have not and will not be reattributed or reallocated to negotiated transmission services.

3.2 SP AusNet's principles for Cost Allocation

SP AusNet allocates costs directly to projects, assets and services where possible and appropriate. Where costs are shared, the use of activity based costing and appropriate allocators are used to allocate costs across projects, assets and services, to satisfy the needs of internal management reporting, statutory reporting and regulatory information requirements.

SP AusNet's cost allocation methodology and processes have been developed in line with the following guiding principles:

- direct costing/attribution will be used wherever a clear 'line of sight' exists between the cost incurred and the network assets /network service;
- ongoing review will seek to increase the level of direct costing and reduce the level of costs subject to allocation;
- cost allocations will be automated wherever possible;

- cost allocation methodology and controls will be subject to regular review; and
- cost allocation methodology must maintain consistency between reporting periods.

3.3 Summary of cost types

The following categories represent the key types of operating costs for SP AusNet:

- Labour costs – through the payroll are either directly costed / attributed to asset related work types and activities (maintenance and capital expenditure) via the asset management system and labour timesheets, or allocated (for corporate services) on the basis of an activity based costing approach (causal basis);
- Invoiced contract and services costs – through direct costing / attribution to asset related work types and activities via the accounts payable system, or allocated on an activity based costing approach, referencing the causal drivers of the cost;
- Directly costed items – through system-based attribution (direct coding) due to the consistent nature of the cost, e.g. property taxes, licensing fees, network charges; and
- Management charges (SPIMS) – allocated to each SP AusNet business via an activity based costing approach, and in turn to business segments, activities and services on the basis of direct expenditure.

A high level flow diagram for these cost types, and the processes for their attribution, is provided in Appendix A.

3.4 Cost allocation processes

The following processes and tools are used to support SP AusNet's cost allocation methodology:

Directly Attributable Costs

- Direct Cost Attribution;
- Manual Project Journals; and
- Timesheets.

Shared Costs

- Activity Based Costing analysis (including ABC Management Surveys and causal cost allocators).

3.4.1 Direct cost attribution

Wherever possible, costs are directly attributed to assets and service categories where the cost is directly related to the management (ie. operation, maintenance, construction) of the asset or the delivery of the service. In other words, where there exists a clear 'line of sight' between the 'spender' and the particular assets and/or service, then these costs

are directly attributed to those assets and/or services. Within this context, the closer the officer and/or activity is to the asset or category of service, the stronger the causal relationship and simpler the cost attribution to that particular asset. This applies irrespective of the type of expense.

SP AusNet's financial system and works management system have been developed to assist project managers to track and report detailed project cost information, based on the use of work orders, project codes and project types. In cases where operational units or work teams perform a direct, dedicated service to end assets, then these costs are directly attributed, via default coding, to the assets or service (e.g. SCADA support team, network controllers). This method of default costing is used in place of timesheets.

3.4.2 Manual Project Journals

The Manual Project Journals are 'exception based' cost adjustments used where an employee (or specific expense such as external consultancy) is assigned to, or engaged on, a specific project for short periods. In the case of any specifically identified project related man-hours, this time is recorded and journalled directly to the specific project from the payroll costing default codes.

3.4.3 Timesheets

SP AusNet operational staff employ an on-line timesheet facility to track and charge hours worked to specific projects and activities (capital or operating / maintenance), and in turn, to service categories. Staff working on such specific projects must complete timesheets for each pay cycle, which capture work hours and charge all projects on the basis of a standard charge rate. The charge rate includes direct labour costs and applicable labour oncosts such as workcover, superannuation and payroll tax.

Timesheets apply in cases where a number of projects and activities may be worked on during the period, rather than the 'dedicated' support or service situation referred to in section 3.1.1 above.

3.4.4 Activity Based Costing

SP AusNet employs an Activity Based Costing (ABC) approach to allocate those remaining costs that are not directly attributed via the methods discussed above. These 'shared' costs are pooled and allocated between assets and services on the basis of causal cost drivers as follows:

- Significant non-labour items, such as insurance costs, stores costs and audit fees are allocated to service categories using appropriate causal cost drivers, such as asset values or inventory transactions;
- Non-project costed labour (ie. labour costs not directly charged to projects in accordance with 3.3.1, 3.3.2 or 3.3.3 above and generally of a corporate or overhead nature) is subject to allocation via a formal, business-wide, effort-based ABC survey conducted for all SP AusNet responsibility centres (ie. SPAN ABC); and
- Management service charges from SPI Management Services Pty Ltd (SPIMS) are allocated to the three SP AusNet network businesses on the basis of a formal, effort-based ABC survey of all SPIMS staff (ie. SPIMS ABC). In turn, the

service charges are allocated to business segments and service categories in proportion to the direct expenditure for each segment/service.

SPAN ABC Survey

The SPAN ABC survey requires its respondents to advise their assessment of labour effort to inform the split of those 'shared' or overhead costs remaining within their reporting cost centre, after the direct attribution of all project-costed labour and non-labour. The survey provides a service matrix covering:

- Assets (Transmission, Electricity Distribution and Gas Distribution)
- Expenditure types (Operating and capital expenditure)
- Lines of service (Regulated and Non-Regulated).

The SPAN ABC survey supports three main activities:

- To split non-project coded expenditure to meet the requirements of regulatory reporting, statutory segment reporting, and impairment testing;
- To derive, and 'true-up', the rates for capitalising reasonable business overheads to new constructed assets in accordance with accounting standards and internal policy; and
- To review the reasonableness of labour allocations generated through the payroll and timesheet systems and to identify the need for adjustments if required.

SPIMS ABC Survey

As discussed earlier in section 2.1, certain staff members, including SP AusNet's executive management team, are employed by a separate entity SPI Management Services (SPIMS), which is 100% owned by SP International. SPIMS provides management and strategic services to SP AusNet's Distribution and Transmission businesses.

The SPIMS ABC survey is based on estimated management effort and is completed by employees of SPIMS to inform, and support the allocation of the cost reflective management service charges within SP AusNet (ie. to electricity transmission, electricity and gas distribution).

The subsequent allocation of service charges down to business segments and service categories is informed by the direct operational expenditures attached to those segments and services.

SPIMS performance (incentive based) fees are costed to SP AusNet's businesses and reported within management and statutory accounts, however, these fees are not allocated to regulated business segments within the annual regulatory accounts (ie. are classified as non-regulated).

3.5 Overhead capitalisation approach

SP AusNet employs a systematic approach to calculate and capitalise reasonable overhead costs in the construction of new network assets. In accordance with internal accounting policy, the overhead capitalisation process references ABC survey results, forecast cost information and a 'true-up' mechanism to ensure that appropriate overhead

costs are reflected within reported capital expenditures at the end of each reporting period.

The rate which is applied to capital projects through the year is based on the following formula:

$$\frac{\text{Forecast Overhead Costs (for each network)}}{\text{Forecast Direct Capital Expenditure (for each network)}}$$

This unique rate is then applied to all direct capital expenditure for that network (ie. transmission, electricity or gas) automatically through the financial system at the end of each month.

Periodically, the overheads capitalised are reviewed and adjusted to take into account movements in the following:

- The actual direct capital expenditure (compared to forecast)
- The actual overhead costs (compared to forecast); and
- The result of the end of year ABC survey (compared to the previous year).

Prior to the end of the reporting period, adjusting entries are effected against all capital projects if the overhead review process identifies that an under or over capitalisation of overhead costs has occurred during the period (based on the application of 'actual' costs and surveys rather than 'forecast' costs and surveys).

4 Directors' statement

We, as directors of SPI PowerNet Pty Ltd, confirm that:

- In the directors' opinion the information contained in this cost allocation methodology version 1.0 dated 1 August 2008 is accurate; and
- It is the intention of the directors to comply with this cost allocation methodology, as approved by the AER.

Signed _____

Name: Mr Nino Ficca

Date: 1 August 2008

Director

Signed _____

Name: Mr Paul Adams

Date: 1 August 2008

Director

APPENDIX A - SP AusNet Global Cost Flow (March 2008)

