Electricity Transmission Network Owners

AER Regulatory Accounting Methodologies

Response to Position Paper

October 2005

ElectraNet ♦ Powerlink ♦ SP AusNet ♦ Transend

1. INTRODUCTION

This submission is made on behalf of electricity transmission owners ElectraNet Pty Limited, Powerlink Queensland, SP AusNet and Transend Networks Pty Ltd (the "**TNOs**").

The TNOs welcome the opportunity that the AER has provided for submissions on an important regulatory principle. The TNOs have a significant interest in the issue of preparing regulatory accounts and regulatory applications on the basis of expenditure as-incurred or as-commissioned. There may be major impacts upon TNO business processes depending upon the approach chosen. These impacts are outlined in this paper.

Before considering the issues raised in the AER's Position Paper, it is important to understand that setting the capex accounting framework is only the first of four interrelated steps required to achieve a functional and simple regulatory modelling and reporting regime. These steps are:

- Decide on the preferred framework — as-incurred or as-commissioned capex accounting;
- Redesign the AER's Post Tax Revenue Model (PTRM) so it is fit for purpose for the chosen accounting approach for decision-making at the start of a regulatory period and for tracking performance over a regulatory period;
- Redesign information requirements to suit input into the PTRM; and
- Redesign and simplify regulatory accounts so they can be used to track progress using the PTRM during a regulatory period.

The TNOs believe that these interrelated matters must be addressed together and not in isolation. Therefore, the TNOs have addressed some of the above interrelated matters in this submission, where appropriate. As such, the body of the submission sets out issues under the four steps referred to above. TNO responses to the specific questions raised by the AER Position Paper are summarised in Section 6 of this submission.

2. TNO POSITION ON AS-INCURRED CAPEX FRAMEWORK

The TNOs could support the as-incurred framework **provided:**

- the PTRM, information requirements and regulatory accounts are implemented or amended to appropriately accommodate this approach and
- the approach does not apply until the TNO's next revenue cap decision.

The interaction of the AER's preferred as-incurred approach with the application of the PTRM and regulatory reporting is of primary concern. The PTRM is clearly designed for use with an as-commissioned approach to capex and has been utilised in Decisions (either the PTRM or its predecessors) for Powerlink, SP AusNet, Transend Networks, and ElectraNet, all of whose applications were based on an as-commissioned approach. Notwithstanding its problematic use in the 2005 TransGrid and Energy Australia Decisions on an as-incurred basis, various modifications, described in this paper, are required for it to be suitable for use with an as-incurred approach. If these modifications were appropriately made, TNO concerns could be satisfied.

The key change required for the approach to be practical is to allow the introduction of a Work in Progress (WIP) asset category, which would not be depreciated. In the absence of allowing such a modification, all TNOs using the as-commissioned approach are currently incapable of generating the information that would be required for regulatory reporting by the as-incurred approach.

In addition the TNOs disagree with many of the claims advanced in the AER's Position Paper. TNOs believe it is important to address these concerns, to clarify any misconceptions within the AER or by other stakeholders about the current as-commissioned approach so as not to place unrealistic expectations on the AER's favoured as-incurred approach. Put simply, the AER may favour the as-incurred approach for the wrong reasons.

3. TNO RESPONSE TO THE AER POSITION PAPER

The TNOs believe the as-incurred and as-commissioned capex methodologies are equivalent **if** modelled correctly. That is, they:

- provide the same incentive properties;
- place a similar administrative burden on the TNOs; and
- can be similarly assessed by the AER.

The four issues considered by the Position Paper are addressed in turn below.

The critical claims the AER has used to reach its conclusion in each section are also listed below along with a TNO response.

Issue 1: Will different accounting approaches result in different efficiency incentives?

The correct implementation of either approach should result in identical incentives. The examples and criticisms of the as-commissioned approach provided in the paper contain errors and misconceptions about how the current regime functions and the actual calculations required to implement either regime.

Position Paper Claim 1

"To ensure that the ex-ante approach can be implemented with an "as-commissioned" approach, it will be necessary to alter the calculation of the amount to be added to the regulatory asset base for each project when it is commissioned. This is necessary to ensure that the present value of the stream of depreciation and return on asset payments once the asset has been commissioned will be the same under the "as-commissioned" approach as under the "as-incurred" approach." (p. 6)

<u>TNO Response</u>

This is a very simple adjustment, which is performed now in current Decisions. The average length of a capex project in the ex-post forecast is calculated and then the average Finance During Construction (FDC) for a capex project calculated. This average FDC is used to provide the FDC capitalisation adjustment for all projects, obviating the need for specific project-by-project adjustments. Most importantly, the FDC adjustment is just the return on the forecast WIP capitalised into the project. Therefore, in effect, the same calculations have to be performed (and checked by the AER) for either approach.

Position Paper Claim 2 (The Example)

The as-incurred example assumes the AER approves $180 million for the project and the TNO completes the project for $136 million thus earning the return and depreciation benefits on the $44 million difference.

However, for the as-commissioned example the AER apparently approves only $136 million. That is, the return is on actual expenditure. (pp. 7-9)

<u>TNO Response</u>

This example makes an incorrect assumption that the AER approves different amounts under the two approaches for a project. Given that the AER is approving the same project with the same information, it seems right to assume the AER would approve the same amount under either approach. In fact, given FDC must be included in the as-commissioned approach, the AER would approve a higher amount for the as-commissioned example. Once this mistake is corrected, the NPV of the benefits under either regime are the same. Hence it is the TNOs view that, across the entire capex program and over time this produces materially the same incentives as an as-incurred approach with WIP balances calculated.

Forecasting issues will exist under both the as-incurred and as-commissioned approaches; i.e. outlying expenditure and capitalisations are both more susceptible to forecasting error than close in expenditure and capitalisations.

Position Paper Claim 3

"The "as-incurred" approach uses information on the actual expenditure by asset category to calculate the closing regulatory asset base. The "as-commissioned" approach requires a project-specific examination." (p. 8)

TNO Response

The as-commissioned approach no more needs a project-by-project analysis than the as-incurred approach. The as-commissioned approach uses the identical information on actual expenditure by asset category to calculate the closing regulatory asset base.

More importantly, the asset categories at commissioning are known and TNOs appropriately allocate general project expenditure (e.g. site establishment, project management and compliance costs associated with a project) across these asset categories at project completion.

Under the as-incurred approach, without a WIP asset class, actual expenditure by asset category is not necessarily known at the time the expenditure is incurred, as the final assets and an appropriate basis for allocation of general expenditure are not explicitly identifiable. Some form of estimating or forecasting per project would be necessary, with all the associated administrative burden of periodically correcting previous estimation and forecasting errors.

Depreciating such expenditure is **totally** inconsistent with Australian Accounting Standards. While application forecasts can be assessed on this basis, for actual expenditure it would require TNOs to instigate new business processes and systems to generate the information required. Auditors would also need to become familiar with the new systems and processes to be able to express an opinion on the regulatory accounts. Correction of estimation/forecasting errors between regulatory periods further complicates matters.

As-commissioned expenditure is simply a different view of as-incurred expenditure information. Incorporating a WIP asset class to the as-incurred approach mirrors the as-commissioned approach by deferring the allocation of actual expenditure to serviceable assets once those assets are known. This process is very closely aligned with existing financial accounting processes. A roll-forward of the RAB under this approach is far more certain.

Position Paper Claim 4

"The "as-incurred" approach is not concerned with whether the project is commissioned. The "as-commissioned" approach would require that adjustment is only made to projects that have been commissioned (and hence are eligible for inclusion in the regulatory asset base)." (p. 8)

TNO Response

TNOs make an adjustment now with no difficulty or extra "burden" – see response to Claim 1.

Position Paper Claim 5

"The "as-incurred" approach does not require special adjustment according to whether or not the project was included in the determination of the target expenditure. The "as-commissioned" approach will require an ex-post determination of the expenditure target for all projects that are commissioned but which were not included in the regulatory target." (pp. 8-9)

TNO Response

In setting the target capital expenditure under either approach the regulator must assess the value of future projects, their component asset categories, and the timing of expenditure over the life of the projects. This may be done using a probabilistic approach that does not make allowance for particular projects *per se*.

Under an ex-ante as-commissioned approach, the TNO will commission projects (and split these into their component asset categories) through the period.

- If the TNO commissions aggregate projects of higher value than the ex-ante capex allowance over the period, the same financial penalty applies as per the SRP.
- If the TNO commissions aggregate projects (and splits these into their component asset categories) of lesser value than the cap, the same reward applies as per the SRP.

This is no different to the comparison being performed for an as-incurred approach. Both methods provide an assessment of forecast capital additions by asset categories, which are reconciled against actual capital additions by asset categories. Whether the AER chooses to do a more detailed project-by-project assessment is not driven by the choice of approach as both provide a target number to be compared with an actual outcome.

Position Paper Claim 6

"The "as-incurred" approach only requires the calculation of the closing regulatory asset base once, at the end of the regulatory period. The "as-commissioned" approach will require the regulatory asset base to be re-adjusted throughout the revenue control period for projects whose expenditure started in the previous regulatory control but which are commissioned in the current regulatory control." (p. 9)

TNO Response

The ex-ante capex allowance is established on the basis of all projects (or an expected outcome of scenarios of likely projects) that are forecast to be commissioned during the regulatory period, including those where construction started in the previous period, as is done for current Decisions. A comparison is made once at the end of the regulatory period and the actual commissioned projects (in their component asset categories) used to form the opening RAB for the next period. This is no different to the as-incurred approach and there is no more need to continually adjust the RAB.

The inclusion of a WIP asset class would bring projects under construction into the RAB and allow for revenue to be earned on this expenditure (instead of being capitalised into the asset base using an average FDC as currently occurs).

By aligning regulatory accounting procedures with the PTRM, the closing regulatory asset base could be effortlessly calculated every year, not just at the end of each regulatory period.

Conclusion: There is no material difference in the incentive properties of the two regimes.

Issue 2: Will the administration of an as-commissioned regulatory approach be onerous?

The administration of either approach should be practically identical, as the same information needs to be addressed.

For the as-commissioned approach, the TNO must calculate the commissioning profile for capex and the movements in and ongoing balance for WIP to calculate the required FDC (in effect the as-incurred profile). For the as-incurred approach, the TNO must calculate the as-incurred profile of capex including WIP and the as-commissioned profile to calculate transfers out of WIP into commissioned asset classes (as is done for statutory accounts).

The critical claims the AER has used to reach its conclusion with regard to administration considerations are listed below with a TNO response.

Position Paper Claim 7

"Different approaches to the categorisation of expenditure may cause uncertainty. For example is the easement for a particular transmission line. Is this is a commissioned asset in its own right or is it part of a transmission line that will be commissioned in various stages? If the easement is defined as a commissioned asset in its own right, it would be included in the regulatory asset base calculation for this regulatory period. But, if the easement is categorised as part of the expenditure on the transmission line project to be commissioned during the next regulatory period, then it should be included in the regulatory asset base in the next regulatory period." (p. 10)

<u>TNO Response</u>

There should be no confusion. A TNO must calculate its as-commissioned capex profile even under an as-incurred approach as it must calculate transfers out of WIP and in to commissioned asset classes. It also must ensure that forecast future system requirements are met by the TNO commissioning the right assets at the right time. As-incurred capex is then determined to meet those dates.

The easement example is misleading. An easement title or right of way is purchased and becomes a non-depreciable asset independent of the commissioning of a line over that easement. In any case, should there be any confusion about when to incorporate assets in the asset base under the as-commissioned approach, the accounting standards provide guidance and must be complied with in relation to this matter.

As noted previously, more confusion and uncertainty is likely to occur on an as-incurred approach (as implemented in the PTRM used for the 2005 TransGrid Decision) as all WIP expenditure must be categorised into an asset class, even general project expenditure (such as site establishment, project management and compliance costs) that is not attributable to any asset class at the time it is incurred. TNO accounting systems cannot do this at the moment, and should not need to if the TNOs' suggested WIP asset category is implemented in the PTRM.

Position Paper Claim 8 "There will be uncertainty on the commissioning date for projects, particularly towards the end of the regulatory period." (p. 10)

TNO Response

There is identical uncertainty towards the end of the period under either approach. Therefore, the identified problem is not related to the framework choice.

The as-incurred approach requires more administrative effort by the TNO and the regulator at the application and assessment stages. Under an as-commissioned approach the TNO need only forecast the possible projects that will be commissioned in a regulatory period. Under an as-incurred approach the TNO must forecast all the projects that are likely to commence in a regulatory period, including their final cost, probability of commencing in that period, asset categorisation, and timing of cash flows. Therefore, under an as-incurred approach, the regulator must assess the reasonableness and prudency of the assessments made for a larger range of projects.

With the exception of this up-front work, the two regimes effectively use the same information, so there should be no material effect on administration. Projects are identified with target commissioning dates to meet identified needs. Cash flows are then forecast to meet the target commissioning date for each project.

Position Paper Claim 9 "The AER is not aware of any other regulated utility in Australia or elsewhere that has adopted this approach." (p. 3)

TNO Response

The TNOs understand that:

- In Queensland, the Queensland Competition Authority uses an as-commissioned approach for regulated gas, water and electricity entities in Queensland.
- In NSW, IPART uses as-incurred for regulatory applications and as-commissioned for regulatory accounts.
- In Victoria, ESC incorporate changes in WIP into both regulatory applications and regulatory accounts, resulting in a combination of as-incurred and as-commissioned approaches similar to that being proposed here by the TNOs.

The TNOs are not aware of any regulated gas, water, or electricity entities in Australia who prepare their regulated accounts on an as-incurred basis in a way that mirrors the PTRM approach taken in the 2005 TransGrid Decision.

Position Paper Claim 10 The AER's preliminary view is that the "as commissioned" approach would involve additional administrative complexity. (p. 11)

TNO Response

As noted above, if the AER allows the TNO suggested treatment of WIP in the PTRM with the inclusion of a WIP asset class, identical calculations that mirror current accounting processes will have to be made by the TNOs under either framework. Essentially identical information will have to be assessed by the AER. The key difference is that the forecasting timeframe is longer under the as-incurred approach.

Under the as-incurred approach, with a WIP asset class, the TNOs have to calculate their WIP each year and the transfers from WIP into asset classes as projects are completed each year (that is, the as-commissioned profile). This is assessed by the AER.

Under the as-commissioned approach, the TNOs will need to calculate their as-commissioned profile and make an adjustment for capitalised FDC. The FDC is equivalent to the return on the WIP profile. Again all these aspects are assessed by the AER.

However, <u>without</u> allowing a WIP asset class in the PTRM, a <u>significant</u> volume of additional information, estimating and processing would need to be managed to depreciate expenditure as-incurred.

Position Paper Claim 11

"The AER recognises that TNSPs may incur one-off costs in the transition from one approach to another and that TNSPs should be compensated for any additional costs." (p. 12)

TNO Response

Internal investigations suggest there will not be significant transition costs **if** a WIP asset class is utilised and the PTRM is redesigned appropriately, allowing existing systems to generate the information required.

However, other significant transition issues do exist, primarily:

- *When moving to an as-incurred approach, how does a TNSP recover revenue for FDC incurred, but not capitalised, during the current as-commissioned regulatory period that remain in WIP at the end of this period?*

  The Position Paper is silent on this issue but it is one that would have to be resolved before the TNOs could agree to changes. The TNOs would suggest rolling outstanding FDC from the current period into the WIP used for the future period.

- *If moving to an "as-incurred" approach does result in significant price shocks for a particular TNO, how will this affect the regulator's assessment of the revenue cap application?*

  TNOs seek assurance that any price shocks resulting from a move to the "as commissioned" approach would not prejudice consideration of each of the building block components on its merits.

Conclusion: With the exception of additional effort at the application stage (which is greater for as-incurred forecasting), if a WIP asset class is introduced there is no material difference in the administrative burden of the two regimes.

Issue 3: Will different accounting approaches impede consistent comparison of TNSP expenditure?

The TNOs acknowledge that there are advantages to consistency between regulatory accounting approaches across TNOs.

However, it should be noted that differences caused by the as-incurred versus the as-commissioned approach are small when compared with other factors causing differences between TNOs' regulatory financial reporting.

Therefore, aligning the regulatory accounting approach, with all TNOs reporting on an as-incurred basis, will not address the majority of the performance comparison differences the AER has with regulatory accounts used in its TNSP comparison report.

Conclusion: While there may be some benefits from aligning the TNO regulatory accounting approach, it is not the panacea to the comparison problems suggested in the paper.

Issue 4: Will the choice of accounting approach deliver price shocks?

All things being equal the shift from an as-commissioned to an as-incurred regulatory accounting approach for capex will bring forward cashflow. This could cause an upward price shock. However, given that many other variables can change during a revenue review, this may not be a significant factor.

It is interesting to note that using the AER's proposed as-incurred approach in conjunction with the PTRM, there will be two elements to the pricing step increase:

- the revenue from "return on" capital as expenditure incurred is rolled into the RAB; and

- the revenue from "return of" capital as the WIP is depreciated.

The TNOs' proposal to create a WIP asset class with no depreciation defers the "return of" capital component to align with the physical life of the assets and thus reduces any price shock.

Conclusion: There will be a price shock from a transition from an as-commissioned approach to an as-incurred approach, however, this may not be a significant factor.

4. IMPROVEMENTS NEEDED TO AER PTRM MODEL

In addition to the changes to implementation of the PTRM needed to make it suitable for use under an as-incurred approach, the following examples of errors and inconsistencies also cause problems and risks for the TNOs as they are uncertain how to treat these issues.

These and other identified problems should be dealt with in detail during the second stage of the process suggested by the TNOs, once the decision on an as-incurred or as-commissioned approach is made.

Decision versus Actual CPI Adjustments

The current PTRM does not adjust for actual CPI outcomes as they occur throughout the period. This makes it difficult for a business to track actual versus Decision capex, depreciation and RAB roll-forward.

In effect this means the AER has no official RAB roll-forward model. Each TNO constructs its own RAB roll-forward model to track its progress against its Decision. These models do not have any official standing with the AER.

CPI Definitions

The AER has not indicated which form of CPI indexation to use in a roll-forward model. Currently, some TNOs use the lagged CPI that is used for revenue indexation purposes while others use the un-lagged CPI.

For example, a Company could use a March 2004 to March 2005 or June 2004 to June 2005 indexation for the July 2004 to June 2005 Roll-forward.

Depreciation and Indexation

The PTRM does not provide transparent depreciation or indexation outputs when generating its economic depreciation output. This makes it difficult for a TNO to track Actual versus Decision Depreciation and again requires an additional model to be built by the TNO and assessed by the regulator.

The TNOs consider that the AER should:

- change the architecture of the model to produce these outputs in a transparent manner; and

- modify its regulatory accounting requirements to model economic depreciation, rather than straight-line depreciation that is presently required. Again, this inconsistent reporting of depreciation compromises the accuracy of the regulatory report.

Also, the regulatory reports prepared by the regulator to date have not adjusted for actual inflation, reducing the accuracy of the analysis of forecast versus actual expenditure.

Transparency of Efficiency Carry Forward Payments

The PTRM does not provide a separate line for efficiency carry forward payments from the previous period that are being glide-pathed over the current period. Instead the efficiency carry forward payments are included in the opex line. This adjusted number then causes significant confusion when attempting to compare actual opex with forecasts assumed in the Decision during the regulatory period. Often it is incorrectly inferred that large opex underspending is taking place when the differences are due to comparisons with an opex line that includes the efficiency carry forward payment.

TNOs believe that the AER should change the architecture of the model to separate out the efficiency carry forward from the opex in a transparent manner.

Inflation assumption for indexation of TNO data into the PTRM Model

The current PTRM seeks real inputs denoted in dollars of the last year of the previous regulatory period but applies the expected average annual inflation calculated for the future five-year regulatory period to escalate these numbers to the first year of the future period (eg. the inflation expectations for 2005 to 2009 are used to escalate from 2004 to 2005 dollars). There is no correlation between inflation for the last year of the current period (eg. over 2004) and expected annual inflation for the future period (eg. 2005 to 2009).

TNOs believe that the AER should use the expected inflation over the final year of the current period to inflate the TNO data for use in the PTRM.

Depreciation of Capex

When capex is rolled into the RAB at the end of a regulatory year it is assumed to have been placed into service on average halfway though the year. The capex is correctly adjusted to capitalise the return on those 6 months before it is included in the asset base for the following year. This adjustment is required irrespective of whether an as-commissioned or as-incurred approach to capex is adopted.

4.1 TNO Generic Model

The TNOs have constructed a generic roll-forward model that they believe addresses many of the problems with the current PTRM without compromising any of the AER's objectives.

Compared to the PTRM, the architecture of the Generic Model is simpler and more transparent with the added advantage that CPI adjusted nominal forecasts are produced for comparison with the nominal actual outturns that are produced by the businesses on a day-to-day basis. It easily incorporates actual CPI as it occurs through the period.

The TNOs would be pleased to share and discuss their model in person with the AER once the issue of an as-incurred or as-commissioned approach is resolved.

5. INFORMATION REQUIREMENTS AND REGULATORY ACCOUNTS

TNOs consider that the current information requirements and regulatory accounts guidelines are ambiguous, overly complicated and do not align with the reporting required to monitor performance against a revenue cap. In addition, auditors that sign-off on regulated accounts in different jurisdictions interpret the present guidelines in multiple ways. This leads to differences in the information collected and reported by each TNO, as each uses its best endeavours to comply with the guidelines. The regulatory guidelines also require large amounts of data to be collected, much of which is not relevant to the regulatory position of the businesses.

TNOs believe the present guidelines require a lot of effort to be expended in generating 'regulatory' statements that are at best indicative, and at worst completely misleading, with respect to the company's regulatory position.

Furthermore, there is no alignment of the SRP information requirements, historical regulatory information requirements and adjustments incorporated in individual revenue cap decisions, the PTRM and the regulatory accounting guidelines.

This results in TNOs potentially having to maintain up to four sets of financial information just for regulatory purposes:

- the statutory account information from which the other forms of information are generated;
- the regulatory accounts prepared under the AER Guidelines but which do not reflect the actual regulatory position of the business;
- regulatory information that is actually consistent with the internal roll-forward models and do reflect the actual regulatory positions of the businesses; and
- regulatory information suitable for input into the AER PTRM at the TNO's next Decision.

If the regulator seeks to rely on the audited statutory financial statements, as is presently the case, regulatory accounts must be derived from the relevant statements prepared for the entire TNO organisation (incorporating both revenue-capped and non-capped activities) according to statutory accounting guidelines.

Compliance costs for a company are clearly reduced to the extent that the same accounting principles and standards are used for both regulatory and statutory accounting purposes.

However, if the regulator wishes to establish regulatory accounting requirements that do not align with statutory accounting requirements, then:

- the benefit of any such regulatory treatment must first be carefully considered against the compliance costs
- the required regulatory accounting treatment must be explicitly documented by the regulator and clearly conveyed to all stakeholders
- the regulatory accounting guidelines should not be based on the full organisation's audited statutory statements, but should only require audited regulatory information for line items required by the PTRM.

Whichever approach is adopted, the regulatory accounts should be able to be used as input information into the PTRM for use in the Decision for the next regulatory period and used to roll-forward the RAB over the current period.

The simplest way to achieve these outcomes is to amend the PTRM to handle actual outcomes from the regulatory accounting framework. This would allow the

AER to have one set of information requirements for both the review process and monitoring actual performance over the period.

6. SPECIFIC QUESTIONS RAISED IN AER POSITION PAPER

The AER Position Paper invites responses to the following questions. A summary response is provided under each question drawing on the more detailed discussion earlier in this submission.

Has the AER identified the appropriate issues? Are there other relevant matters that the AER should consider?

The AER has not provided analysis of other interrelated regulatory requirements. Consideration of the capex framework should be part of the TNO proposed four step process:

- Decide on the preferred framework — as-incurred or as-commissioned capex accounting;
- Redesign the PTRM so it is fit for purpose for the chosen accounting approach and for both decision-making at the start of a regulatory period and tracking over a regulatory period;
- Redesign information requirements to suit input into the PTRM; and
- Redesign and simplify regulatory accounts so they can be used to track progress in the PTRM during a regulatory period.

(Refer: Introduction)

Is the "as-commissioned" approach consistent with the ex-ante incentive regime established by the AER's SRP? How could the "as-commissioned" approach be applied to be consistent with the ex-ante incentive framework in the SRP?

Using an averaged FDC, the as-commissioned approach has the same incentives and risks as the as-incurred approach and is, therefore, completely consistent with the ex-ante framework.

Assets commissioned for lower than target cost provide a reward that is retained until the next regulatory period under both approaches.

Forecasting for the latter years of a regulatory period has more uncertainty than the earlier years under both approaches.

(Refer Issue 1)

Given the issues raised in the second point, would the implementation of an "as-commissioned" approach be more administratively complex than the "as-incurred" approach? If so how material is the additional administrative complexity?

With the exception of additional effort at the application stage (which is greater for as-incurred forecasting), and providing that a non-depreciable WIP asset class is introduced, there is no difference in the administrative burden of the two approaches.

However, if WIP is depreciated then there will be far more complexity and administration under an as-incurred approach.

The as-incurred approach will incur additional costs that are likely to be material for the TNO to prepare additional forecasting information that the approach requires.

(Refer: Issue 2)

Some TNSPs currently apply the "as-incurred" approach and some the "as-commissioned" approach. Are there costs in moving from one approach to the other? How material are they?

Apart from the additional forecasting costs (noted above), transition costs are not expected to be significant **provided** a WIP asset class is utilised and the PTRM is redesigned appropriately by allowing existing systems to generate the information required.

However, other significant transition issues exist, primarily:

- When moving to an as-incurred approach, how does a TNSP recover revenue for FDC incurred, but not capitalised, during the current as-commissioned regulatory period that remain in WIP at the end of this period?

- If moving to an as-incurred approach does result in significant price shocks for a particular TNO, how will this affect the regulator's assessment of the revenue cap application?

(Refer: Issue 2)

If a TNSP changes its approach it may need to modify its regulatory accounts. Does this raise any accounting standards, auditing or other accounting issues?

Compliance costs for a company are clearly reduced to the extent that the same accounting principles and standards are used for both regulatory and statutory accounting purposes.

The present approach to regulatory accounts raises a number of issues including that it does not provide a true regulatory position.

TNOs believe that simpler regulatory accounting requirements would provide a better outcome for the company, auditors, the regulator and external stakeholders seeking to interpret the reported data.

(Refer: Issue 3)

Has the AER appropriately weighed up the relevant issues in reaching its preliminary position?

Setting the capex accounting framework is only the first of the four interrelated steps listed above that are required to achieve a functional and simple regulatory modelling and reporting regime. In relation to the Position Paper, insufficient consideration has been given to

- the additional forecasting effort required under an as-incurred approach
- the additional costs in implementing systems and processes if WIP is depreciated
- the additional administrative effort required to maintain the systems and processes implemented.

Adopting the TNOs' proposal to allow a non-depreciable WIP asset class eliminates the latter two issues.