Submission to the Australian Energy Regulator

Re: Issues Paper Electricity Distribution Network Service Providers

Annual Information reporting requirements

UNITED ENERGY
Distribution

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1 Introduction

The Australian Energy Regulator (AER) proposes to introduce a number of detailed reporting requirements on the basis that it requires the information to carry out its regulatory functions. We understand that the intention is to use that information to assist in the assessment of future regulatory proposals.

United Energy Distribution (UED) has no major objection with this broad intention. UED is supportive of a regime whereby the regulator has information that it requires to perform its functions under the relevant laws and rules.

UED, however, believes that the issues paper as currently drafted, has a number of significant problems. The paper seeks a large volume of information that in many cases is not relevant to the regulatory price setting process, yet will require a complex and often artificial or arbitrary derivation process.

Some of the specific issue that UED identifies are:

- There needs to be a clearly and specifically stated purpose for the collection of the information, and where different sets of information relate to different purposes these separate purposes also needs to be identified.

  It must be recognised data collection and creation processes of this nature require significant interpretation, judgement and often somewhat arbitrary allocations on the behalf of the businesses. Different purposes will generate different landings on these interpretations, judgements and allocations.

- The level of detail and categorisation proposed appears to inconsistent with the regulatory pricing process as well as being inconsistent with how the businesses are managed, the fundamental cost drivers business, and/or how data is collected.

  These inconsistencies give rise to the need to create the data for the purpose of reporting to the AER, with this created data having no other useful purpose. An example of this problem is the allocation of costs to high voltage feeders. UED (and I expect most other distributors) do not manage their costs by feeders. A significant data mining process to gather that information which relates to specific feeders is likely to address only a very small percentage of costs, leaving the remaining (say) 90% of costs to be allocated via an arbitrary allocation process.

  Such a process is not effective and creates an artificial accuracy to the final data reported.

- The cost categories nominated appear to be a legacy of the Victorian ESC reporting regime where similar templates have been completed on an annual basis. To the best of UED's knowledge these have never been used for the purposes of establishing revenue requirements. Rather it is information aggregated at a higher level has been used in establishing revenue requirements.

UED questions why the AER requires this level of detail and whether it is necessary in order to assess future regulatory proposals.

The level of detail proposed by the AER will require significant and costly changes to internal business processes and systems in order to provide the information being sought. This will add compliance costs to the business and will also involve an allocation of costs to categories far removed from the actual cost driver. In most of the financial templates, each number is required to be considered in five different ways, most not related to the actual cost driver.

UED believes that the AER has not been able to demonstrate how it would use this level of information in setting future revenue allowances. UED recommends that the AER establish a working group/s 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 these principles. This could be for both financial and technical requirements. It is difficult looking at the detail of the issues paper to reconcile the data that UED actually needs and uses to manage the business with the scope of information that the AER proposes to gather to regulate the business.

2 Proposed information requirements

2.1 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 capital expenditure templates have a consistent format which appears to be sourced from the Victorian guideline No.3 issue 6. Specifically they seek to categorise expenditure by:

- expenditure type (i.e. load management, network extensions);
- geographic nature (i.e. CBD, urban rural);
- voltage type (i.e. sub transmission, distribution HV, distribution LV);
- asset class (i.e. 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 (i.e. overhead or underground) although GL3 presently does not require assets to be reported by these categories.

UED has recording systems in place to automatically capture data for only two of these five headings (expenditure type and asset class). UED 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.

It is problematic establishing systems that require the same dollar spent to be categorised under five different headings for the sake of reporting. It is unclear why the AER requires expenditure to be categorised under these five headings when UED requires only two to operate and manage the business. The AER should rely on accepted accounting standards and management reporting standards to establish relevant headings rather than create headings that are not utilised by businesses for day–to–day management.

2.1.1 Expenditure type

UED has no issues in reporting expenditure at this level. Systems are in place to capture costs based on these headings. The headings represent real cost drivers and have been recognised internally for over ten years.

2.1.2 Geographic nature and voltage type

Whether expenditure is spent in the urban or short rural is of no management use to UED. Likewise whether expenditure is HV, LV or sub transmission is not relevant to UED in managing its operations - expenditure is not managed at this level of detail. These headings may be relevant to the management of the network however they have no use in managing expenditure. They are technical in nature and do not represent cost drivers of the business. For example the business does not manage budgets or order materials based on whether expenditure is required in the short rural area or urban areas of its network. UED 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 and are therefore accepted as a relevant heading to report expenditure. No system changes are required by UED.

2.1.4 Definitions

UED has not completed a thorough analysis of the definitions however it appears that some definitions have been transferred from jurisdictions without a 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 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?

See comments above

Furthermore, opex is not split by underground and overhead nor is maintenance split by condition based, emergency and routine maintenance categories in the financial records of UED so this will require allocators to be developed. Also the template requires the revenue cap allowance to be disclosed with explanations of variances with actual expenditure. This may not be feasible due to the aggregated nature of revenue cap allowance data provided from regulatory determinations.

2.2.1 Materials 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 per cent 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 a relatively disaggregated level, 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 requirements are in the NGR:

- 6.5.7 Forecast capital expenditure. Clause 6.5.7(e) lists the ten 'capital expenditure factors' which 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'.

Given that forecast capex is stringently assessed and then locked into the building blocks for the forthcoming regulatory period and actual capex is subsequently rolled into the RAB, UED queries why AER requires annual capex information on a project basis. The AER would be monitoring something for which there is no compliance requirement.

In making price submissions UED has previously provided asset management plans that provides forecast expenditure against asset categories and expenditure types. 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 the proposal put forward in the previous section, UED contends that the threshold has been set at an arbitrary level and is too low for reporting requirements and will inadvertently include programs of work. For example a project to install $5 million dollars of equipment such as 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. Distributor B is required to report on this project whereas distributor A is not 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 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 in this requirement.

2.3 Disaggregation statements

2.3.1 Income statement

UED makes no comment at this stage on the income statement or the disaggregated information.

2.3.2 Balance sheet

The AER does not require a detailed or disaggregated balance sheet in order to assess pricing proposals. The only relevant component for establishing revenue benchmarks is 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. Rather it establishes a burden on business to report in a consistent manner that cannot be practically applied for the assessing pricing proposals and increases the cost of preparing and auditing the regulatory accounting statements. These costs will need to be recovered via higher network tariffs.

The AER needs to establish how it will practically apply a detailed balance sheet in its pricing determinations rather than relying a general catch all statement that the information is actually required..

2.3.3 Cash flow statement

UED's position on the cash flow statement is the same as our views expressed in relation to the Balance Sheet. As the cash flow statement represents the aggregation of cash flows of entities that form the distribution business including corporate areas and related parties, the cash flow cannot be automatically produced from existing costing systems. It will be an exacting, onerous and expensive task to produce and audit the statement for no obvious regulatory benefit.

Furthermore, UED 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. UED is strongly of the view that a regulatory cash flow statement is unnecessary as the external auditors provide assurances regarding the statutory financial data that is used in preparing the regulatory accounts, and their opinions regarding the viability of the business are supported by signed Directors assurances.

Should the AER for a special reason, require specific additional information leading into a price review period, that information should be 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.

UED contends that this is not the role of the AER, rather it is the role of the board and the auditors to perform this task.

UED 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. UED proposes that this approach be adopted by the AER.

UED 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

UED 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 Distribution Business in managing asset utilisation. Presumably written down values are being sought which would require the associated depreciation to be tracked as well.

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

2.3.6 Relationships with other entities

It is not clear from the issues paper and attached templates the exact nature of information required by the AER. UED will contact the AER directly in order to inform any future response on this issue.

2.3.7 Service performance requirements

UED, together with the ENA have recognised that it would be of benefit 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 a set, or toolbox, of 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. The production of this work has involved input from all DNSPs in the NEM.

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 must 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?

UED generally supports a process whereby there has been genuine consultation with the business agreeing to high level reporting principles and the detail data required to support those principles. UED 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. It is difficult looking at the detail of the issues paper to reconcile the data that UED actually needs and uses to manage the business with the scope of information that the AER proposes to gather to regulate the business.

UED does not object to starting the annual requirements in 2011 (this being the first year in the new regulatory period), however does object to providing the information within four months. Based on the information requirements contained in the issues paper UED envisages 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. UED recommends that businesses be allowed six months to submit reports for the first two years so that it can establish the necessary process to produce a quality 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 what appears in the existing draft and therefore in excess of what presently is being prepared and provided 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. These accounts need to be audited, the regulatory accounts to be prepared, these accounts to be audited and for Directors review and sign off. In the past, the ESC's Guideline 3 allowed 4 months, however the draft AER paper has significantly more 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?

UED believes the back casting templates are not appropriate. Forcing historical data into templates will become an exercise of allocation rather than representing the actual cost driver. UED does not want to be held accountable in the future for allocations made in back casting templates.

UED 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 headings 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?

UED makes no comment on the benefits however can state that the business will incur additional costs on order to establish the systems and comply annually with the proposed requirements. UED has not calculated the cost however will provide them 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 required to audit annual regulatory reports, however these costs will be significantly higher if another 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 in the issue paper whether an audit is required for the non-financial information. Audit companies 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.