

V E N C o r p



Cost Allocation Methodology

July 2008

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1 Effective Date of Document

As the methodology that is set out in this document is consistent with VENCorp's current cost allocation processes it is proposed that this document becomes effective upon the approval of this document by the Australian Energy Regulator (AER).

Version	Date	Author(s)	Changes and Comments
Version 1	March 2008	J Fitcher and F Cavoli	Documentation of methodology
Version 1a	July 2008	J Fitcher and F Cavoli	Clarification of services provided by VENCorp and to whom they are provided.

2 Purpose of Document

In September 2007, the AER published its cost allocation guidelines in accordance with clause 6A.19.3 of the National Electricity Rules (NER). The NER not only required the AER to develop the guidelines based on cost allocation principles (see section 6A.19.2 of the NER), it also requires TNSPs to submit to the AER their cost allocation methodology in accordance with clause 6A.19.4(c) and (d) of NER by 28 March 2008.

Accordingly, VENCorp is required to submit a cost allocation methodology that accords with Part G of the NER and the cost allocation guidelines published by the AER by 28 March 2008.

This cost allocation methodology must be submitted to the AER for approval. The purpose of the methodology is to enable the AER to replicate the outcomes reported by the TNSP to the AER regarding the costs of its transmission services.

VENCorp intends to use this methodology as its basis for allocation of costs incurred in respect of its functions and duties pertaining to its role as electricity transmission network service provider and planner in the State of Victoria. To enable this, VENCorp will ensure that its internal processes incorporate, and are consistent with, the requirements of this methodology. Recording, treatment, reporting and auditing of costs are currently being carried out in accordance with this Methodology and will continue to be treated in the same manner. Any change to the processes will be consistent with any allowed amendment to this methodology.

3 Accountabilities for the Document

It is the responsibility of VENCorp's Manager, Finance & Risk to ensure that this document is updated and maintained and that the cost allocation methodology is applied.

4 VENCorp Background

VENCorp is a statutory authority established by the Gas Industry (Further Amendment) Act 1997. It is governed by a Board of 10 directors (including the Chairman) appointed by the Governor in Council. VENCorp's day-to-day operations are overseen by the Chief Executive Officer who reports to the VENCorp Board.

A copy of VENCorp's organisation structure as at 1 February 2008 has been included as Figure 1.

Along with being the Victorian electricity Transmission Network Service Provider (TNSP), VENCorp's functions also include:

- Independent system operator for the Victorian gas transmission network;
- Manager and developer of the Victorian wholesale gas market;

- Operation of the gas market Bulletin Board;
- Short term trading market;
- Facilitator of gas Full Retail Contestability (FRC) in Victoria and Queensland;
- Transmission infrastructure planner for the gas industry; and
- Primary responsibilities during major gas and electricity emergencies through NGERAC (National Gas Emergency Response Advisory Committee).

These functions and duties and treatment of costs are depicted in Figure 2.

VENCorp provides a subset of “prescribed transmission services” to “Transmission Network Users” as defined in the NER. Transmission Network Users include generators, distributors and directly connected customers etc.

Of the prescribed transmission services provided in the Victorian market, Entry Services and Exit Services are a subset of prescribed transmission services that are provided to transmission network users directly by asset owning Transmission Network Service Providers. Remaining prescribed transmission services (shared network services)¹ are provided to Transmission Network Users by VENCorp who procures those services from transmission asset owners². The split of prescribed transmission services and who provides them is diagrammatically represented Figure 3.

5 Categories of Transmission Services

Section 79(1) of the Electricity Industry Act 1996 (Vic) (EI Act) provides that VENCorp has the following functions:

- (a) to plan, and direct the augmentation of, the electricity transmission system;
- (b) to provide information and other services to facilitate decisions for investment and the use of resources in the electricity industry;
- (c) to carry out directions given to VENCorp under section 79AA, whether or not for purposes connected with functions under this Part or under a licence issued under Part 2;
- (d) any other functions conferred on VENCorp under this Part or under a licence issued under Part 2;
- (e) any other functions conferred on VENCorp in relation to the electricity industry under this Act or any other Act.

The functions as they currently stand only allow VENCorp to plan and direct the augmentation of the electricity transmission network. Accordingly, VENCorp does not own any electricity transmission assets. In addition to these functions, it has responsibilities to under the NER including, system planning, publication of Annual Planning Report, conduct of Regulatory Test, assessing connection applications among others. To the extent that it incurs costs in

¹ See definition in Rule 9.3.1 of the National Electricity Rules.

² With the exception of a couple of transformers within the Victorian system, these services are provided to VENCorp by SP AusNet

performing its functions and those costs can be classified as prescribed services, they will be allocated according to this Cost Allocation Methodology. Broadly, those services are:

- Transmission planning and augmentation (section 79(1)(a) EI Act);
- Provision of information (section 79(1)(b) EI Act)
- Any other function conferred on VENCorp by the Minister.

6 Principles and Policies for Allocating Costs

6.1 Basis of Preparation

The cost allocation methodology outlined below is consistent with the approach taken to prepare VENCorp's statutory financial statements.

The principles will be based on accrual basis of accounting and will be in accordance with applicable Australian Accounting Standards and other mandatory professional requirements. Australian Accounting Standards include Australian equivalents to International Financial Reporting Standards (A-IFRS).

In the application of A-IFRS, management is required to make judgements, estimates and assumptions about carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstance, the results of which form the basis of making judgements.

VENCorp differs from other Transmission Network Providers in the manner that it recovers electricity related costs. By virtue of the derogations contained in Chapter 9 of the National Electricity Rules, VENCorp is permitted to recover all "statutory electricity transmission-related costs" which relevantly is defined as "VENCorp's aggregate actual costs in operating and planning the Victorian Transmission Network". VENCorp's transmission related costs include (but is not limited to) prescribed services which are recovered through TUOS charges. Under the National Electricity Rules (NER) VENCorp is also able to provide negotiated and non-regulated transmission services. These charges are recovered directly from the service applicant (although we note that there have been no non-regulated services provided to date). It also charges applicants directly for costs incurred in processing connections to the shared transmission network. As its responsibilities relate to the shared transmission network it is not responsible for providing *connection services*³. It therefore cannot charge for ongoing entry and exit services (these charges are recovered by SP AusNet (formerly SPI PowerNet) or other transmission asset owners registered in Victoria. A diagram of the manner in which prescribed and negotiated services are charged (including allocation of corporate charges) appears on page 11 of this Cost Allocation Methodology.

³ Both shared network services and entry and exit services form part of "prescribed services" under the NER, however, Rule 9.8.4F(c)(3) of the NER determines who among VENCorp and registered transmission network owners (a "Regulated owner" as defined in the derogations to the NER) is able to charge for those services. Under that rule, *prescribed TUOS services* and *prescribed transmission common services* are recoverable through TUOS charges by VENCorp and *prescribed entry services* and *prescribed exit services* are recoverable by the Regulated owner through TUOS charges (italicised terms are defined in the NER). In essence, *prescribed TUOS services* and *prescribed transmission common services* are differentiated and non-differentiated *shared network services* while *prescribed entry services* and *prescribed exit services* are services provided at a connection point to a generator or generators and a distribution customer or distribution customers respectively that have been included in a TNSP's regulatory asset base.

Unless otherwise permitted or prohibited (as the case may be) by the AER, the *Electricity Industry Act 2000 (Vic)*, National Electricity Law, the NER and any derogation thereto (and any amendments to those instruments), in applying this Cost Allocation Methodology, VENCorp:

- will not, allocate costs to more than one category of transmission service nor re-allocate costs between categories of transmission services;
- will allocate costs according to its substance rather than its legal form; and
- will comply and be consistent with its Transmission Ring Fencing Guidelines.

6.2 *Goods and Services Tax (GST)*

Revenues, expenses and assets are recognised net of the amount of GST except:

- where the amount of GST incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or part of an item of expense; or
- for receivables and payables which are recognised inclusive of GST.

6.3 *Non Current Physical Assets*

Plant and equipment are brought to account at cost less, where applicable, any accumulated depreciation or amortisation. Plant and equipment purchases that have a value of less than \$2,000 are immediately expensed.

The carrying amount of plant and equipment is reviewed annually to ensure that it is not in excess of the recoverable amount from those assets.

6.4 *Intangible Assets*

Intangible assets represent identifiable non-monetary assets without physical substance.

Intangible assets are recognised at cost. Costs incurred subsequent to initial acquisition are capitalised when it is expected that additional future economic benefits will flow to the organisation.

Intangible assets with finite useful lives are amortised on a straight-line basis over the asset's useful life. Amortisation begins when the asset is available for use, that is, when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. The carrying amount of intangible assets is reviewed annually to ensure that they are not in excess of the recoverable amount from those assets.

6.5 *Leased Assets*

All VENCorp leases are operating leases under which the lessor effectively retains substantially all such risks and benefits and which are not capitalised. All lease payments are charged against the Operating Statement in the period in which they are incurred.

6.6 *Depreciation and Amortisation of Assets*

Depreciation or Amortisation is charged on each relevant non-current asset and is calculated in order to write the cost of the asset off over the estimated useful life to the organisation using the straight line method. Estimates of the remaining useful lives for all assets are reviewed at least annually. Where assets have separately identifiable components that are subject to

regular replacement, those components are assigned useful lives distinct from the asset to which they relate.

The cost of improvements to leasehold property are amortised over the unexpired period of the lease or estimated useful life of the improvement to the corporation, whichever is the shorter.

6.7 Impairment of Assets

Assets are tested annually for indications of impairment (i.e. as to whether their carrying value exceeds their recoverable amount).

If there is an indication of impairment, the assets concerned are tested as to whether their carrying value exceeds their recoverable amount. Where an asset's carrying value exceeds its recoverable amount, the difference is written off by a change to the operating statement except to the extent that the write-down can be debited to an asset revaluation reserve amount applicable to that class of asset.

6.8 Receivables & Revenue Recognition

Receivables and revenue are recognised on an accrual basis.

6.9 Payables

Payables are recognised when the organisation becomes obliged to make future payments resulting from the purchase of goods and services.

6.10 Prepaid Expenses

Operating expenditure that is greater than \$10,000 (GST exclusive) and which the invoiced period covers more than 3 months is classified as a prepayment and expensed over the appropriate periods.

6.11 Provisions

Provisions are recognised when the organisation has a present obligation, the future sacrifice of economic benefits is probable, and the amount of the provision can be measured reliably.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cashflows.

When some or all of the economic benefits required to settle a provision are expected to be recognised from a third party, the receivable is recognised as an asset if it is virtually certain that recovery will be received and the amount of the receivable can be measured reliably.

6.12 Interest Bearing Liabilities

Loans are carried at historical cost. Interest is accrued over the period it becomes due and is recorded as part of other creditors.

6.13 Borrowing Costs

Borrowing costs are recognised as expenses in the period in which they are incurred. Borrowing costs include interest on bank overdrafts and short-term and long-term borrowings.

6.14 *Employee Entitlements*

All annual leave and unconditional vested long service leave representing 7+ years of continuous service is:

- (a) disclosed in accordance with AASB 101, as a current liability even where VENCorp does not expect to settle the liability within 12 months as it will not have the unconditional right to defer the settlement of the entitlement should an employee take leave within 12 months; and is
- (b) measured at:
 - nominal value under AASB 119 where a component of this current liability is expected to fall due within 12 months after the end of the period; and
 - present value under AASB 119 where the entity does not expect to settle a component of this current liability within 12 months.

Long service leave representing less than 7 years of continuous service is:

- (a) disclosed in accordance with AASB 101 as a non-current liability; and is
- (b) measured at present value under AASB 119 as the entity does not expect to settle this non-current liability within 12 months.

6.15 *Superannuation*

Defined contribution plans

Contributions to defined contribution superannuation plans are expensed when incurred.

Defined benefit plans

The amount charged to the operating statement in respect of defined benefit superannuation represents the contributions made by the organisation in respect to the current services of current staff. Superannuation contributions are made to the plans based on the relevant rules of each plan.

The defined benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, with any gains or losses being immediately recognised in the operating statement.

6.16 *Surpluses and Deficits*

VENCorp is funded by industry and, under legislation and regulation, applies any accumulated surplus / (deficiency) to the future pricing of its services. Therefore any accumulated surplus/deficit is not transferred to contributed capital.

7 Direct Costs

Where practicable costs will be attributed directly to the business segment in which they were incurred.

7.1 *Network Charges*

Electricity network charges represent payments to asset owners for the provision of the shared transmission network. These costs include regulated and excluded network charges. Both do however relate to prescribed transmission network services.

Regulated electricity network charges are determined in accordance with Chapter 6A of the NER, as varied by the Victorian network pricing derogation set out in clause 9.8; and the Network Services Agreement between VENCorp and SPI PowerNet, dated 3 November 1994.

Excluded and contestable network charges are defined in contracted arrangements between VENCorp and the asset owner.

7.2 Labour

Employee costs including salary & wages, superannuation, annual leave, long service leave, sick leave, maternity & paternity leave, bonus payments, payroll tax and workcover.

7.3 Contracted Services

Costs associated with the provision of operational goods and services through a contracting company. The main distinction between a contracted service and a contractor is that a contracted service would not specify who does the work where a contractor is usually specified in the agreement.

7.4 Insurance

Costs associated with providing an appropriate level of insurance cover for the organisation.

7.5 Computing

Costs associated with the provision of the organisation's IT requirements including hardware, software and support and maintenance.

7.6 Telecommunications

Costs associated with VENCorp's mobile phones, landlines and faxes.

7.7 Consultancies

Costs associated with receiving expert analysis and advice. These costs usually are associated with a specific one-off task or set of tasks. The work involves skills or perspective of which would not normally be expected to reside in VENCorp.

7.8 Contractors

Costs associated with the provision of services that would normally be provided by an employee of VENCorp.

7.9 Vehicles & Travel

Costs associated with the maintenance and running of VENCorp's vehicles including fuel, repairs, registration and parking. Also includes costs associated with any intrastate, interstate and overseas travel.

7.10 Occupancy

Costs associated with the provision of office accommodation, including rent, cleaning, power and security.

7.11 Administration

Includes costs associated with printing & stationery, repairs & maintenance, staff amenities, postage and records management & storage.

7.12 Depreciation & Amortisation

Costs associated with the write-down of the value of the organisation's assets.

7.13 Finance Charges

Costs associated with obtaining funding, including interest charges and bank fees.

8 Allocation of Shared Costs

Where it is not practicable to allocate costs directly to a business segment the costs will be allocated to the Corporate segment. Costs that are allocated to the Corporate segment are then fully apportioned to the other segments of the business based on approved and documented allocation methods.

8.1 Allocation Methods

Following an initial review of monthly Corporate costs, these costs are allocated on the following basis:

- (i) Full Time Equivalents (FTEs) per segment as a percentage of total organisational FTEs.

Corporate costs associated with Computing, Depreciation, Insurance and Occupancy are allocated on the basis of this method. The rationale for this treatment is that these costs don't fluctuate in line with the number of hours worked.

- (ii) The number of hours worked in a segment as a percentage of total organisational hours.

With respect to FTE's per segment (electricity or gas), Corporate costs associated with Computing, Depreciation, Insurance and Occupancy are allocated on the basis of FTEs and are included in the costs of those specific line items. The rationale for this treatment is that these costs do not fluctuate in line with the number of hours worked.

Following the completion of the allocations based on FTEs, the remaining corporate costs are allocated based on the number of hours worked in a segment as a percentage of total hours worked in the organisation. The rationale for this treatment is that the number of hours worked by a particular segment of the business will require a proportionate amount of service delivery from the Corporate segment. Therefore, the more hours of work in a segment, the more time and resources the Corporate segment assigns to this segment and vice versa. This is set out in the flow chart in Figure 4.

Information on hours worked is extracted from VENCorp's time recording system. All VENCorp employees have access to the TimeControl system and are required to complete timesheets on a weekly basis. In relation to the allocation of costs, direct labour costs are allocated to the business segments via the use of timesheets. The timesheet process is robust and provides suitable cost categories for the regulated electricity business segment. All employees are required to allocate their time worked to the different functions of the business.

Data is extracted from the TimeControl system at month end to determine the percentage of time worked in each function of the business. These percentages are then used to allocate Corporate Department costs to the other segments of the business.

Following the completion of the allocations based on FTEs, the remaining corporate costs are allocated based on the number of hours worked in a segment as a percentage of total hours

worked in the organisation. The rationale for this treatment is that the number of hours worked by a particular segment of the business will require a proportionate amount of service delivery from the Corporate segment. Therefore, the more hours of work in a segment, the more time and resources the Corporate segment assigns to this segment and vice versa.

Any costs referable to activities relating to VENCorp's gas system operation and planning activities and any cost able to be apportioned to these activities will be excluded from VENCorp's electricity costs allocations.

In May 2007 VENCorp engaged PricewaterhouseCoopers to undertake a review of VENCorp's corporate cost allocation methodology. PricewaterhouseCoopers' reported that "Based on our review of VENCorp's ring fence costing process, the Corporate cost allocation and methodology appears reasonable".⁴

9 Maintenance and Audit of Records

9.1 Maintenance of Records

VENCorp's current finance system structure and processes are consistent with the requirements of the Cost Allocation Methodology and will provide the level of detail necessary for VENCorp to provide the supporting work paper referred to by and required under clause 5.2 of AER's Cost Allocation Guidelines.

VENCorp will ensure that this Methodology is considered when making changes to any relevant internal processes to ensure continued consistency with this Methodology and an amendment to the Methodology will be sought whenever a change to a relevant process is considered.

VENCorp currently reports to its Executive and Board of Directors in a manner that is consistent with clause 5.2 of the AER's Cost Allocation Guidelines. This consistency of reporting will ensure that VENCorp can efficiently re-produce information as required.

9.2 Audit Provisions

Where the AER requests an audit of the application of this methodology VENCorp will:

- (a) employ an auditor. This will most likely be VENCorp's Internal Auditor at the time of the request; and
- (b) ensure that the AER receives the auditor's assurance that the information can be relied upon for regulatory purposes.

9.3 Internal Financial Controls

VENCorp has strict Delegations of Authority that require all purchases to be approved by either a member of the Executive team or the Chief Executive Officer. The Delegations of Authority are approved by the Board on an annual basis.

VENCorp have a thorough financial audit process in place. The financial policies and procedures are reviewed annually by the organisation's internal auditors, who are appointed by the VENCorp Board via a tender process.

⁴ PricewaterhouseCoopers – VENCorp Ring Fencing Review May 2007

VENCorp's financial statements are audited annually by the Victorian Auditor General. The costs allocation methodology outlined in this approach is consistent with the approach taken to prepare VENCorp's statutory financial statements.

10 VENCorp's Statement of Accuracy and Intention

We believe that the contents of the methodology listed above are accurate and that VENCorp intends to comply with this methodology.



.....
Director

18.08.08



.....
Director

18.08.08

Figure 1

VENCorp's 2008 Organisation Structure

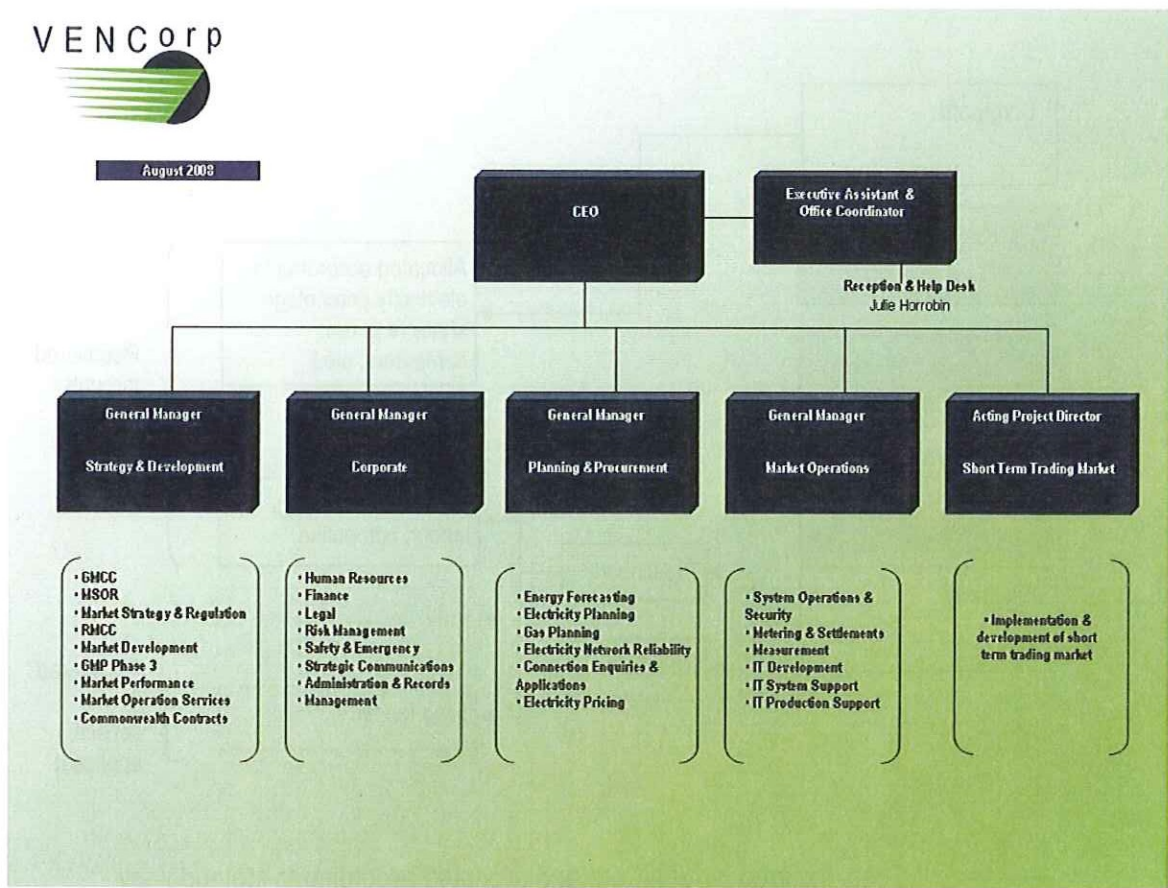


Figure 2

VENCorp Costs by functions and duties

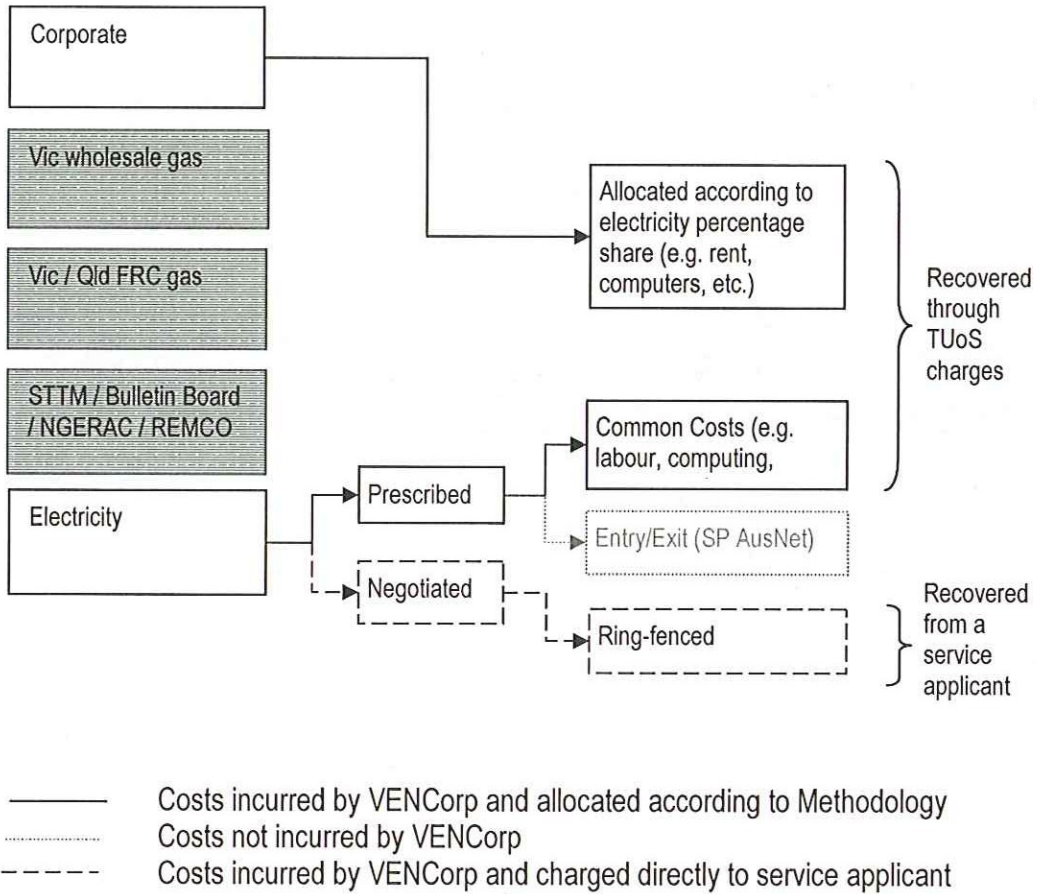


Figure 3

Elements of Transmission Services

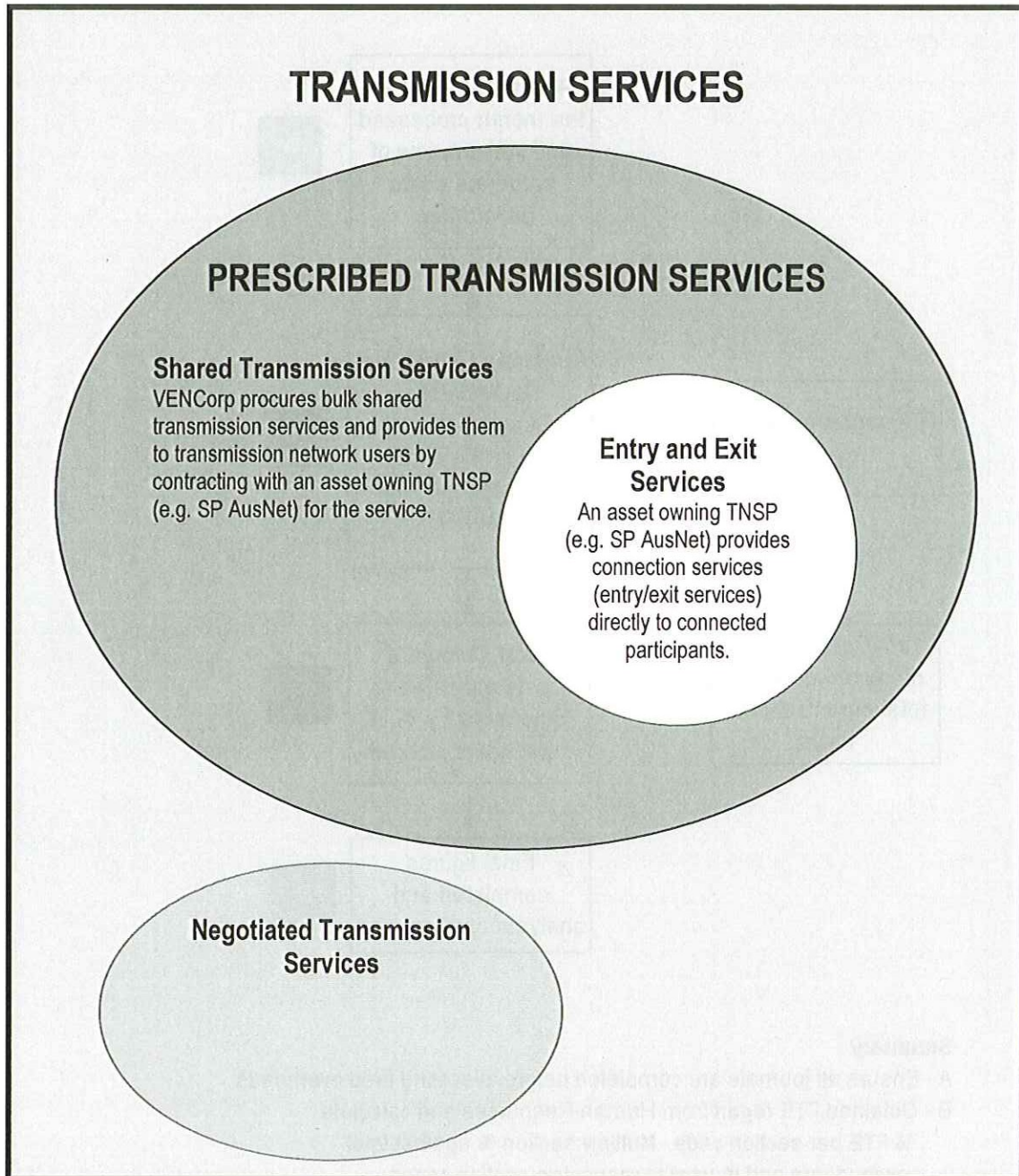
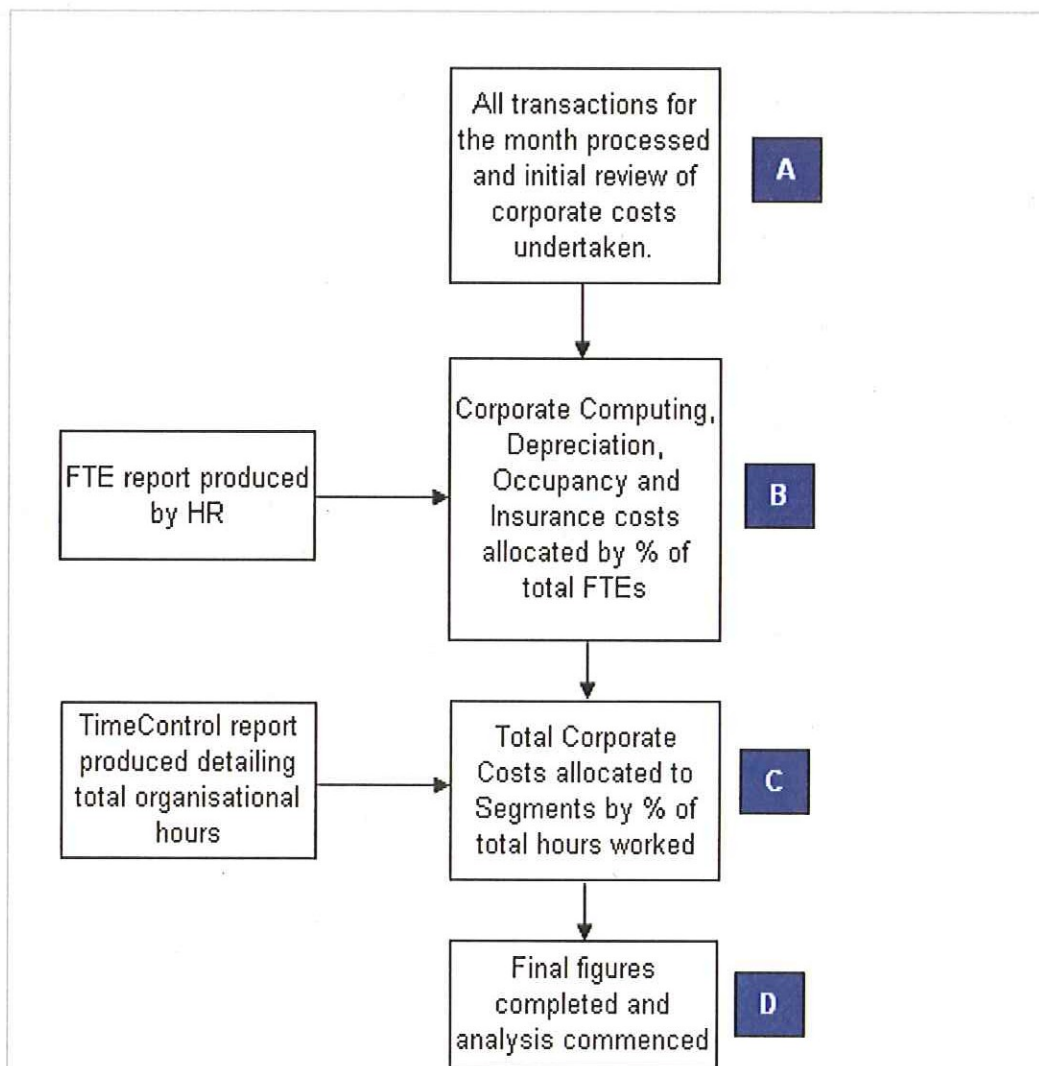


Figure 4

Flow Chart – Allocation of FTE and other Corporate Costs



Summary

- A - Ensure all journals are completed before allocating fixed overheads
- B - Obtained FTE report from Human Resources and calculate % FTE per section code. Multiply section % against total expenditure and journal to respective section codes.
- C - Ensure that Step B has been completed before moving on to this step. Obtain timecontrol report of total organisational hours by Segment and calculate % hours per segment. Multiply the balance of corporate expenditure by % per Segment
- D - Check final figures for reasonableness and commence analysis.