

Historic Capitalisation of Regulatory Reset Costs

Accounting Treatment

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Introduction

Basslink seeks recovery of historic regulatory reset and conversion costs through the Initial Regulatory Asset Base (RAB), consistent with the National Electricity Rules. These costs were treated as capital expenditure (capex) in line with Australian Accounting Standards and expert advice.

The AER excluded these costs from the opening RAB, citing an accounting interpretation under SAC 4. This approach removes Basslink's ability to recover costs that were prudently and efficiently incurred to meet regulatory obligations.

Excluding these costs creates investment uncertainty and does not reflect the requirements of S6A.2.2, which obliges consideration of efficient expenditure to comply with the Rules. Basslink relied on independent accounting advice confirming capitalisation was appropriate under AASB 138, and APA has consistently applied this treatment.

Inclusion of the regulatory reset and conversion costs is appropriate because:

- The costs meet the definition of an intangible asset under AASB 138.
- They provide a legal right to charge regulated revenue from 1 July 2026.
- Expenditure was prudent, efficient, and subject to APA governance processes.
- They can be reliably measured and are clearly linked to Basslink's conversion and revenue determination.

Including these costs in the Initial RAB supports recovery of efficient expenditure, regulatory certainty, and aligns with sound business practice.

AER's draft decision

The AER's draft decision is set out below.

In the 'Other' asset category, Basslink included capex for the conversion application (\$1.7 million in 2022–23, \$1.6 million in 2023–24, \$1.4 million in 2024–25 (\$nominal)). Basslink described this as the costs incurred to prepare the conversion application and the revenue proposal. It proposed the capex be included on the basis that it is directly linked to future revenue and therefore capex as per Australian Statement of Accounting Concepts 4 (SAC 4). We assess that the conversion application and revenue proposal capex do not meet the SAC 4 requirements of an asset.

Definitionally, it does not meet the requirements of an asset:

- "Future economic benefits", that is, neither the conversion application capex or the revenue proposal capex provide a future service potential. (Paragraph 18)
- "Control by a particular entity", that is, there is no notion of control, or exclusion based on rights, associated with conversion application or revenue proposal expenditure. (Paragraphs 24, 25)

- “Occurrence of past transaction or other past event”, that is, the transaction or other event giving the entity control over the future economic benefits must have occurred. There has been no exchange creating future economic benefits. “Specification of a temporal characteristic has the effect of distinguishing between the future economic benefits of present and future assets of the entity. Future economic benefits that are not controlled at the present time would not qualify as assets.” (Paragraphs 29,30)

It does not meet the recognition requirements of an asset:

- it is not probable that future economic benefits are embodied in the asset, nor is it probable that they will eventuate
- the asset or economic benefit allegedly embedded in the conversion application and revenue proposal do not possess a cost or other value that can be measured reliably.

We do not consider that these amounts meet the definition of capex and have not included them in the RAB opening value.

Revised proposal

Basslink has included the Regulatory Reset and Conversion costs in its Initial RAB for the revised proposal on the basis that:

- the costs have been appropriately recorded as capital expenditure in accordance with the requirement of the Australian Accounting Standards, and
- Basslink should have the opportunity to recover these costs.

Definition and recognition criteria

Basslink applies the *Conceptual Framework for Financial Reporting*, which is effective from reporting periods beginning 1 July 2021, and the Australian Accounting Standards. Under the current Conceptual Framework, an asset is defined as:

*“A present economic resource controlled by the entity as a result of past events,”
where an economic resource is “a right that has the potential to produce economic benefits.”*

The Conceptual Framework definition of an asset focuses on three aspects – “right”, “potential to produce economic benefits” and “control”, which aligns with AASB 138 *Intangible Assets*, the operative standard for the accounting for intangible assets under the Australian Accounting Standards. Intangible assets differ from tangible assets.

AASB 138 defines an intangible asset as:

An identifiable non-monetary asset without physical substance that is:

- controlled by the entity as a result of past events, and
- expected to generate future economic benefits.

Under AASB 138, an intangible asset shall be recognised if:

- It is probable that future economic benefits will flow to the entity.
- The cost can be measured reliably.

Accounting assessment

APA engaged an independent accounting advisor (PwC) in 2019 to assess whether, in general, regulatory reset costs incurred to obtain a revenue determination are eligible for capitalisation. The advisor concluded that capitalisation was appropriate under AASB 138.

The definition and recognition criteria under AASB 138 have not changed. From an accounting perspective, APA has been capitalising revenue determination costs as intangible assets.

The costs associated with applying for regulatory determinations are eligible for capitalisation under AASB 138 as they are directly attributable costs to obtaining a legal right to charge approved revenue. These costs are amortised over the regulatory control period.

As outlined in the independent advice, the key driver for the capitalisation of such costs is that it gives Basslink a legal right from which it will generate future economic benefit (i.e. access to the approved revenue) and meets the definition and recognition criteria of an intangible asset under AASB 138:

- **Identifiability:** The conversion and revenue determination confer a legal right to charge regulated revenue and therefore meets the identifiability criteria for recognition as an intangible asset.
- **Probable future economic benefits:** The regulatory conversion has been accepted by the AER, and Basslink is actively engaged in the revenue determination process. It is probable that Basslink will be converted to a regulated asset. The revenue determination, once finalised, provides a legally enforceable right to charge regulated revenue from 1 July 2026, resulting in future economic benefits (enforceable stream of cash inflows) to APA over the regulatory period.
- **Control:** Upon conversion, Basslink obtains a legal right to recover regulated revenue over the regulatory control period. Basslink controls this right as it can benefit from the regulated revenue and restricts others access to this right.
- **Reliable measurement:** The costs are measured reliably and recorded in Basslink's accounting system. They are directly attributable to the conversion application of Basslink, obtaining the regulatory determination, and thereby the associated legal right to charge regulated revenue.

The key additional consideration for Basslink is that the costs incurred also include the preparation and submission of Basslink's application for regulatory conversion of the asset, prior to the initial regulatory determination. Management has considered and concluded that such costs are appropriately similar in nature such that the treatment of regulatory conversion costs should be consistent with those incurred for the initial and ongoing regulatory determination. The costs are necessarily incurred for Basslink to obtain the right to a regulatory determination and the associated revenues. That is, in the absence of regulatory conversion, Basslink would not be entitled to obtain a revenue determination which underpins future cash inflows.

Therefore, Basslink has treated these Regulatory Reset and Conversion costs as an asset in both its statutory accounts and Initial RAB.

Impact of the AER's draft decision

The ex-post rejection of capital expenditure based on a preferred accounting treatment for these costs is inconsistent with the National Electricity Rules.

The AER's draft decision set the initial capital base using the Depreciated Actual Cost Method, which is based on past capital expenditure. When determining Basslink's RAB, the AER is required to have regard to the prudent and efficient value of the assets used by the relevant Transmission Network Service Provider.¹

By excluding these amounts from the Initial RAB, the AER has removed the opportunity for Basslink to recover these costs. The AER has not provided for recovery through other components of the allowed revenue to offset their removal from the Initial RAB. This means these costs are unrecoverable.

This approach results in an ex-post decision that preventing recovery of the costs incurred prior to Basslink becoming a regulated asset. Good regulatory practice requires the AER to demonstrate that it was unreasonable for Basslink to have treated the expenditure as capital expenditure. The AER has not demonstrated that this higher threshold has been met in its draft decision.

Furthermore, even if the AER maintains that the burden of proof should be whether capitalisation is appropriate under the Australian Accounting Standards, Basslink has met that requirement.

Basslink relied on the advice of a qualified expert (see attachment 6.1) and the rationale set out above which directly contradicts the position taken in the AER's draft decision.

¹ Rule 11.6.20(g)(1)

Prudent and Efficient Capital Expenditure and S6A2.2

As a result of the draft decision concluding that the regulatory costs must be treated as operating expenditure, the AER did not address whether the capital expenditure incurred prior to the initial regulatory control period should be added to the Initial RAB.

When determining whether capital expenditure is prudent and efficient to be included in the Initial RAB, the AER is required to consider those matters that are set out in S6A.2.2 of the National Electricity Rules. In particular, the AER's decision must give weight to relevant parts of S6A.2.2 in relation to providing Basslink with an opportunity to recover the efficient costs associated with complying with all applicable regulatory obligations or requirements².

In this case, it is the regulatory obligations and requirements associated with undertaking a conversion application and revenue reset required by the National Electricity Rules to establish a prescribed Transmission Service and create a regulated revenue stream.

The expenditure is prudent and efficient as stakeholder engagement, document publication, legal advice, engineering advice and the internal resources to support them are all efficient expenditure to meet the obligations outlined in the National Electricity Rules for Basslink's conversion application and first revenue determination. Basslink has applied APA's procurement policies and expenditure governance process to ensure efficiency.

In addition, the AER must give weight to the need to minimise investment uncertainty for Basslink. The decision to reclassify this expenditure was made after the expenditure had been incurred, creating uncertainty for future capital expenditure.

The AER must also consider whether its decision would create incentives to avoid undertaking inefficient capital expenditure or would promote economic efficiency to counterbalance those factors outlined above. Consistent with the AER's draft decision, Basslink has included future regulatory costs in its forecast operating expenditure, so there will be no impact on incentives for incurring future regulatory capital expenditure from retaining these costs in the Initial RAB.

Treating this expenditure as capital expenditure, consistent with expert accounting advice and the requirements of S6A2.2, means that the expenditure should be retained in the Initial RAB.

² Rule S6A.2.2(1)