

Better Regulation: Draft expenditure forecast assessment guideline

9 August 2013

The Australian Energy Regulator (AER) commenced the Better Regulation program in December 2012. Today we released our draft expenditure forecast assessment guideline. This describes the process, techniques and associated data requirements for our approach to setting efficient expenditure allowances for network businesses.

What is the Better Regulation program?

The AER initiated the Better Regulation program following changes to the electricity and gas rules in late 2012. The program brings together improvements to our regulatory approach with other important reforms announced by the Prime Minister in December 2012.

The Better Regulation program delivers an improved regulatory framework focused on the long term interests of electricity consumers.

The Better Regulation program involves:

- extensive consultation on seven new guidelines that outline our revised approach to determining electricity network revenues and prices
- establishing a consumer reference group for our guideline development work
- forming an ongoing Consumer Challenge Panel
- improving our internal technical expertise and systems.

What is expenditure forecast assessment?

Network businesses plan the expenditure they will need to provide a safe and reliable supply of electricity for consumers over the next five year period. Businesses then put these expenditure proposals to us for assessment during a regulatory determination. We publish a final determination setting out the total expenditure the business is allowed for the next period.

What is the draft expenditure forecast assessment guideline?

The draft assessment guideline sets out our enhanced expenditure assessment approach. It outlines the types of assessments we'll do to determine efficient expenditure allowances, and the information we require from businesses to do so.

Our forecasting approaches will be rigorous, transparent and cost effective. Businesses need to invest in electricity networks, but we'll focus on the efficiency of that expenditure so consumers pay no more than necessary.

The assessment guideline is based on a nationally consistent reporting framework allowing us to compare the relative efficiencies of network businesses, and decide upon efficient expenditure allowances. Our guideline and explanatory statement outline the:

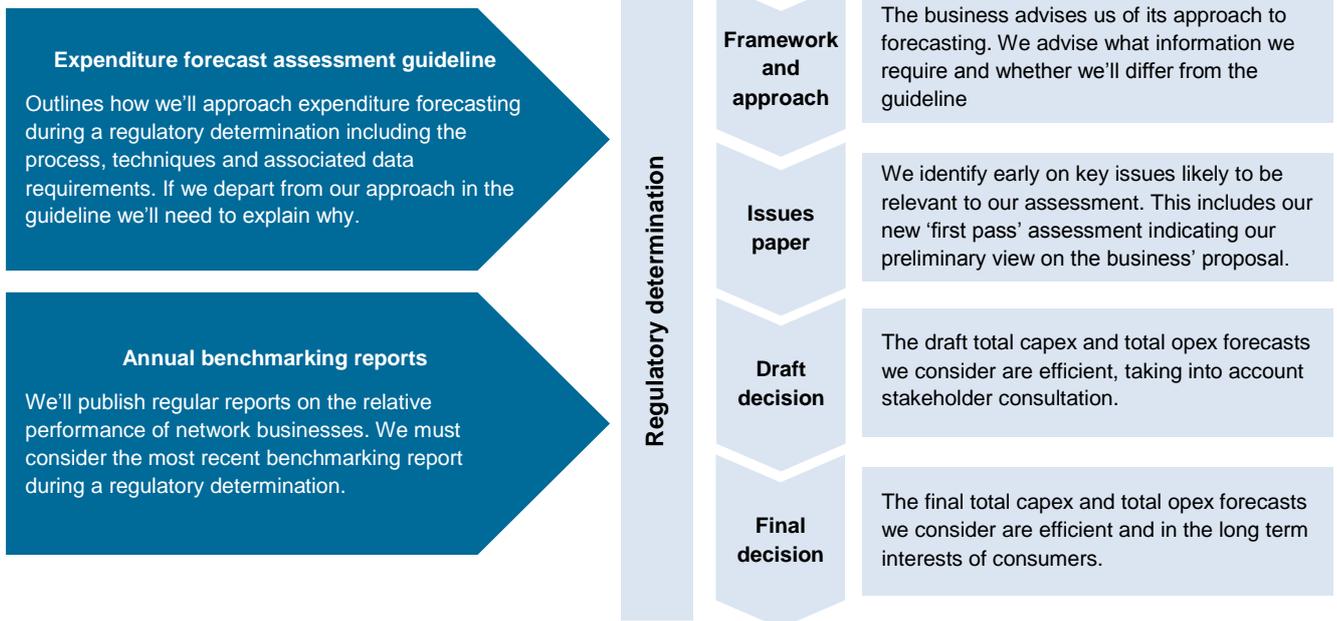
- new assessment techniques—we're expanding our regulatory toolkit to make greater use of benchmarking
- refined techniques—we're refining some of our techniques to ensure the expenditure allowances we approve are efficient
- assessment principles—the basic principles we'll typically consider when assessing expenditure proposals and determining what assessment techniques are most appropriate to use
- more detailed information requirements—part of improving our assessment approach is collecting consistent data from all businesses. We explain what data we need and why, when we intend to collect it, and how we will collect it.

How will we set efficient expenditure allowances?

We examine a business' expenditure proposal and other relevant information to either accept the proposal, or not accept it and replace it with an alternative estimate.

Businesses must provide economic analysis to justify the efficiency and prudence of their expenditure proposals. In the absence of economic justification we are unlikely to accept their forecast expenditure.

Our expenditure assessment framework



We will complement our existing assessment techniques with two new benchmarking techniques—economic benchmarking and category analysis—to assist us to form a view about efficient expenditure levels.

Economic benchmarking techniques will enable us to measure a business' efficiency overall, while category analysis will enable us to analyse expenditure drivers and the costs of conducting similar activities across businesses.

We have also developed a new tool to better forecast the expenditure needed to build, upgrade or replace network assets to address changes in demand (augmentation capex, or augex). This complements our existing tool that examines the expenditure needed to replace aging assets (replacement capex, or repex).

We will integrate our new and refined techniques into our assessment approach, but they will not displace our existing techniques. Rather, we will use them in combination with existing techniques to form a view about forecast expenditure. However, we anticipate placing increasing reliance on benchmarking techniques as more data becomes available.

What's the role of benchmarking?

In addition to applying our new benchmarking techniques to assist us to form a view about efficient expenditure levels, we will also publish annual benchmarking reports from September 2014. These will provide regular information on the relative efficiency of network businesses. Public scrutiny of network businesses' performance in our benchmarking reports will encourage businesses to improve, and identify areas we're likely to target at the time of price reviews.

Benchmarking lets us compare electricity network businesses against each other and determine how efficient they are by comparison. Inefficient networks will face cuts to their proposed expenditure.

How does forecasting work with incentives?

We have a strong preference for incentive-based regulation, which rewards businesses for efficient performance. Where incentives are effective we prefer to use a business' past spending as an efficient starting point to set its future expenditure allowance. Where we're not satisfied incentives are effective we will now be able to draw on our own benchmarking and other assessment techniques to form a view on efficient costs.

Our assessment guideline operates as a package with our expenditure incentives—the capital expenditure incentives guideline and efficiency benefit sharing scheme.

How can I provide a submission or comments?

We invite interested parties to make submissions or comments on our draft assessment guideline. If you would like to have your say on the guideline prior to us publishing the final version, you have until close of business **20 September 2013** to get your submission or comments to us.

We are currently consulting with stakeholders on economic benchmarking data requirements under a different timeframe to the guideline. We are requesting submissions on this by **16 August 2013**, with a view to proceeding to draft regulatory information notices in September.

For details on how to provide submissions please visit our expenditure assessments web page www.aer.gov.au/node/18864 or email us at [expenditure@aer.gov.au](mailto:expenditure@ aer.gov.au) if you have questions.

For more information

For more information or to get involved in the consultation processes for the Better Regulation program, please visit our website www.aer.gov.au/better-regulation-reform-program or email us at betterregulation@aer.gov.au.