

Expenditure Forecast Assessment Guidelines Working Group meeting No. 19

Summary of meeting – 2 September 2013

Held via video link between AER's Melbourne and Sydney offices

Following the release of the draft Expenditure Forecast Assessment Guidelines (the Guidelines), AER staff hosted a working group meeting with external stakeholders on 2 September 2013.

A full attendee list can be found at Attachment A. The presentation given by AER staff at the meeting is available on the AER's website alongside this summary.¹

This summary outlines the key topics and themes of the meeting, including views expressed at the meeting, without ascribing particular comments to any one individual or organisation.

1 *Introductions*

AER staff explained that the purpose of this meeting was to obtain initial feedback on the draft Guidelines and explanatory statement, and to consider the scope of details to be discussed in future workshops or meetings.

AER staff noted the key milestones between now and the release of the final Guidelines, which included the release of draft RINs, consultation on category analysis and the deadline for submissions on the draft Guidelines.

AER staff provided a recap of the draft Guidelines and related material, including positions arrived at by the AER:

- by design, the draft Guidelines are written in plain language, and in a manner that ensures the role of expenditure assessment techniques is not constrained for future assessments.
- the AER will issue regulatory information notices (RINs) to collect data specified in the Guidelines.
- the assessment approach is broadly similar to the current approach to both opex and capex.

¹ <http://www.aer.gov.au/node/21625>

2. Content of the Guidelines and Explanatory Statement

One stakeholder commented that the development of expenditure forecast assessment techniques and their application in determination processes appears to be an evolutionary process. The Guidelines provide little clarity on how the AER will introduce new assessment techniques and how they will be specifically applied to expenditure proposals. The AER should also provide stakeholders with certainty over the application and limitations of specific techniques.

Stakeholders asked about the relationship between the Guidelines and explanatory statement, particularly in relation to the assessment principles set out in the explanatory statement. They noted that the Guidelines are non-binding, and information in the explanatory statement may be seen to be less important. The AER is required to explain any variations from the assessment process set out in the Guidelines. Because the principles are included in the explanatory statement, however, the AER will not have to explain any departures from these principles. Stakeholders considered this creates a lack of accountability that may lead the AER to use techniques that are unreliable or unsuitable. The AER should generally consider transferring key sections from the explanatory statement into the Guidelines to provide stakeholders with additional certainty. These sections included the assessment principles, “economic analysis” (which was loosely defined in the guidelines), assessment of step changes, and methods of forecasting opex aside from base-step-trend. AER staff took this feedback on board.

Another stakeholder added that the Guidelines and explanatory statement should lead to consistency in the AER’s assessment approach. Assessment principles provide context on how the AER arrives at its decisions. It allows NSPs to propose forecasts with more confidence in the knowledge that they may arrive at alternative figures to the AER’s assessment.

AER staff commented that, in their view, the principles outlined in the explanatory statement generally reflect provisions in the National Electricity Rules (NER). They noted that those principles are common-sense, and there is no complete list of principles for them to include in the Guidelines. Stakeholders elaborated that the purpose of including principles in the Guideline is to allow NSPs to see a decision from a different perspective. Where there is disagreement, they can see how the AER has interpreted the rules. If the Guidelines do not include the principles, there is a risk that the AER may not be fully bound to explain its approach. Stakeholders suggested generally that there was value in the Guidelines specifying those matters the AER inferred from or took for granted in terms of interpreting NER provisions.

Stakeholders commented that the Guidelines should not present a bias against or force particular forecasting approaches used by NSPs, for example, using “base-step-trend” in opex forecasts. AER staff noted that NSPs are free to choose their forecast techniques, however the AER has been clear on its approach to assessing and setting opex allowances through a base-step-trend approach. In particular, the approach is inextricably linked to, and supports, the opex incentive design. This approach has been employed in all the AER’s recent network determinations and stakeholders were referred to the recent draft decision for SP AusNet for the AER’s thinking on this matter. It was noted that some NSPs would be unable to obtain director’s sign-off on the base step trend method for all opex items. If NSPs are free to choose their own forecasting techniques, some of the language used in the Guidelines may need softening. With respect to opex forecasts in particular, the Guidelines should explain the consequences of NSPs submitting forecasts developed without use of the base-step-trend approach.

Stakeholders commented that it was not clear how the AER will determine if techniques are fit for purpose and noted that the application of the AER's principles would be inherently subjective. They suggested the AER needs to provide further clarity of the application of its principles to particular techniques, for example, the use of confidence intervals in where econometric methods are employed, or more generally how data would be considered for their accuracy.

It was suggested that the principle of "parsimony" proposed by the AER was not reflective of NER requirements, and was arguably picked up under other principles. AER staff considered that, all else being equal, simple and transparent assessment methods would be preferable. Stakeholders questioned whether there would be benefit in having a further workshop on the guidelines' principles. AER staff considered that, in the context of other priorities and time constraints, it may be sufficient to consider views on this matter in written submissions.

One stakeholder questioned when the AER would release models for economic benchmarking. AER staff noted that the AER has already provided economic benchmarking models at its 6 June workshop, and that the AER's application of these models would be published, along with sensitivity analysis, in 2014.

Stakeholders questioned the process whereby NSPs in NSW would have an opportunity to view and comment on the AER's benchmarking data and analysis. AER staff noted the situation of NSPs submitting proposals before the AER obtains and releases benchmarking data. Without binding the AER's future actions, it was expected that the analysis contained in the AER's first benchmarking report and draft decisions in mid to late 2014 would be based on a process of collaboration and questioning of data with all NSPs. Stakeholders suggested this should be reflected in the Guidelines, and also recognise the role of user representatives in this process.

Stakeholders queried AER staff on providing more information on the assessment techniques they intend to use (including TFP, DEA and econometric analysis). Stakeholders noted that while an example spreadsheet had been posted with the June 6 workshop, something like an explanatory statement to help users understand this model would be very useful. This could appear on the main expenditure assessment guideline webpage. AER staff took this feedback on board.

3. Discussion on data auditing requirements and backcasting data

NSP representatives expressed a general concern at the auditing requirements on historic data set out with the draft guidelines. They noted the position in the explanatory statement requiring director sign-off of data. They raised particular concerns on providing assurances to the AER where they do not have the requested data, leading them to use assumptions or providing caveats. AER staff commented that they would need to consider a NSP's ability to provide backcast information on a case-by-case basis, and they would need to consider data provision issues in greater substance before changes to the provision process are made. These issues will be raised in further consultation with individual NSPs to determine which information they cannot provide and the reasons for this. AER staff expressed concern at the sentiment that all NSPs and all historic data would be of poor quality. Some historical data may be problematic but there will also be data of suitable quality.

Stakeholders suggested that the AER's understanding of auditing standards may be different to that of the auditors themselves. They also cautioned against the AER conflating assurances over the reliability of data (e.g. a "process" audit, where assumptions or allocation rules were not questioned) with assurances on the accuracy of that data (where assumptions were tested or not required in the first place).

A stakeholder noted that relying on backcast data may result in misleading calculations, and considered rather than rely on backcast data the AER set out an ideal data disaggregation for NSPs to follow at present. AER staff replied that they would like a discussion on data constraints, but they do not accept that there is simply no historical data for expenditure assessment purposes.

Stakeholders noted that some pockets of data require estimating, with no guarantee of complete accuracy. One stakeholder highlighted an example of an inability to provide historic information on assets under the AER's proposed definitions due to changes in methods of depreciation and asset categorisation over time. While they can provide assurance of the estimation process and assumptions used to obtain the AER's requested data, they cannot provide assurance of the accuracy of these data.

One stakeholder commented that it may not be possible to obtain auditing assurance on particular technical documentation. They noted the example of verifying historic engineering datasets, particularly if the AER requests this type of data from several years ago. Other problems with historic data may include turnover of key staff and datasets becoming corrupt.

One stakeholder noted the data requested by the AER must be of consistent quality across NSPs for the purpose of benchmarking. The desire for high quality information, when combined with impending timelines and auditing assurances creates pressure on NSPs. It was asked whether the AER had therefore considered a transitional period that limits the use of/ collection of some data in the short term, encouraging NSPs to collaborate with the AER. AER staff noted the pressure felt by some NSPs, however this was a positive reflection on the importance of obtaining and using quality information for expenditure assessments. It was noted that introducing benchmarking would significantly improve the AER's expenditure assessment process and this was of paramount importance to consumers.

AER staff noted their intention to discuss specific areas of backcast data that NSPs can feasibly provide. A stakeholder replied that if the AER says what assessment techniques it will use, NSPs can prioritise their resources to comply with the AER's data requirements. AER staff responded that they want NSPs to genuinely attempt to provide the requested data, but recognise there will be teething issues. One stakeholder commented that the Guidelines and explanatory statement don't adequately acknowledge those teething issues; the documents say what the AER will do but not how they will do it, noting for example, the text on partial productivity indicators.

4. *Other comments on the Guidelines*

One stakeholder noted that discussion of a Guidelines sunset clause was raised in previous workshops. AER staff replied that the Guidelines are not structured in a way that would bind the AER to use of specific assessment techniques, negating the need for a sunset clause. The AER will gain experience with techniques over time and will likely modify their application accordingly. AER staff noted that they would not know how reliable or robust the techniques are until they are applied in practice.

One stakeholder queried the visibility of the data quality the AER uses to set expenditure allowances. They consider it is important that the AER understands how much estimation or assumptions have gone into the data provided. AER staff replied that where NSPs provide data with caveats and assumptions, these would need to be articulated in a manner that would be clear, including to other NSPs or stakeholders viewing the data. AER staff reaffirmed that data submitted would be made available to other NSPs, subject to confidentiality claims.

One stakeholder disagreed with the explanatory statement's suggestion that early consultation on data requirements with the NSW/ACT NSPs would be to their benefit, given they would still be submitting proposals without visibility of the AER's benchmarking datasets or analysis.

5. Discussion on category analysis

AER staff summarised the key elements of the AER's proposed approach, indicating possible points for discussion, before seeking stakeholder comments.

In terms of further meetings or workshops, it was suggested that TNSPs be engaged separately.

One stakeholder considered that the AER's approach on category analysis was the least clear aspect of the AER's Guidelines. In particular, it was not clear whether the data templates required backcast or forecast data. AER staff commented that the data templates released with the guideline were intended to be generic, accommodating both historic and forecast data. Forecast data would only be requested of NSPs at the time of submitting their individual revenue proposals. All NSPs would be required to provide historic category data in RINs to be issued in late 2013/ early 2014.

It was asked whether the AER intended to implement a new roll-forward model given the change in capex data categories. AER staff responded that, as per current practice, the categories used for capex assessment would need to be reconciled to those used for depreciation purposes. Clarity on any linkages with expenditure assessment categories and the AER's financial models should be provided to aid NSPs in arranging their resources.

Stakeholders commented that it was not clear what instrument the AER would use to request data from NSPs, particularly those not approaching their determination process. AER staff answered that all NSPs will be asked to provide annual backcast data in annual RINs. One stakeholder queried why AER staff had chosen not to issue a RIO. AER staff responded that it is to allow for tailored requests for each NSP, and that RIOs will be issued in the future once annual data reporting process becomes clearer. It was noted that RIOs would be preferable as they would be stable across businesses, and that the early issue RIOs for annual reporting beyond 2014 would be advantageous to NSPs in preparing their internal reporting arrangements.

Stakeholders noted their uncertainty on the arbitrary allocation of assets, particularly how much time they would require to address definitional issues, for example, the proposed splitting of costs into CBD/urban/rural and high/low voltage. AER staff noted they are aware of these issues, in particular the lax approach to allocating costs between rural, urban etc taken by Victorian DNSPs, which has not been scrutinised by the AER (or the ESCV before it).

AER staff confirmed that the auditing requirements contemplated for economic benchmarking data would be the same for category information.

One NSP mentioned they expect to take three to four months to provide category analysis data, so issuing a data request in February with a response due in May (as outlined in the explanatory statement) does not provide sufficient time. It was suggested that there may be value in issuing the data request earlier even if it was not a formal request. It was also noted that the time taken to prepare the information would be affected by the degree of auditing assurance and the number of years of backcast information requested.

Another stakeholder commented that the AER should make clear its definition of audited data, citing a potential difference in interpretation of that classifies data as being audited. AER staff noted this point has been made. It was also suggested that requiring all NSPs to audit information under the same timeframes may create a resourcing issue for auditors typically used for this work.

Stakeholders noted the importance of interactions between the expenditure assessment approach and incentive schemes, and questioned whether there would be further workshops on these matters. AER staff took this on notice and suggested that this may be driven by consultation on incentive guidelines.

AER staff said during a discussion on the opex model that the model will explicitly estimate the productivity component of a firm's factor growth.

One stakeholder questioned when the AER would release its cost benefit assessment as foreshadowed in the explanatory statement. AER staff responded that now NSPs had full visibility of the data likely to be requested of them, they should provide an estimate of the compliance costs in their submissions on the guidelines.

When asked about the focus on further consultation on category analysis issues, stakeholders generally noted that discussions on data definitions and templates may be more beneficial than conceptual issues (including because previous concerns expressed are still relevant).

Attachment A: Attendee list

Melbourne office

Name	Organisation
Andrew Kingsmill	TransGrid
Anton Murashev	Jemena Electricity Networks
Blair Alexander	ActewAGL
David Dawson	Arup
Eric Lindner	SA Power Networks
Jeff Balchin	Incenta Economic Consulting
Jess Hunt	AEMO
Katie Yates	SP AusNet
Malcolm Tadgell	KPMG
Mark Henley	Uniting Care Australia
Megan Willcox	Powercor Australia
Robert McMillan	Jemena Gas Networks
Stephanie McDougall	United Energy and Multinet Gas
Bill Jackson	ElectraNet
Lawrence Irlam	AER
Mark McLeish	AER
Esmond Smith	AER
Paul Dunn	AER
Toby Holder	AER
Anthony Hynes	AER
Jess Manahan	AER
Cameron Smith	AER
Israel del Mundo	AER

Sydney office

Name	Organisation
Alexandra Curran	APA Group
Jason Cooke	Essential Energy
Jim Bain	Energy Networks Association
Matt Cooper	Ausgrid
Nicola Roscoe	Energex
Patrick Duffy	Endeavour Energy
Zubin Meher-Homji	Networks NSW
Yili Zhu	AER
Matt Le Cornu	AER