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17 October 2005

Mr Sebastian Roberts
General Manager Transition Group
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

By email to AERInquiry@aer.gov.au

Re: Regulatory Accounting Methodologies Position Paper

Dear Mr Roberts

AGL welcomes the opportunity to respond to the Australian Energy Regulator's (AER) consultation on the Regulatory Accounting Methodologies Position Paper (the Position Paper). The AGL group is a leading energy wholesaler and retailer throughout Australia. AGL also has extensive interests in energy infrastructure both as an owner and operator. Accordingly, AGL is able to comment on this issue from all viewpoints. In addition, given the AER's role as energy regulator, AGL has an interest which stems from the possibility that issues resolved for electricity transmission will be transferred to the electricity distribution and gas regulatory framework.

AGL supports the AER in resolving outstanding issues associated with regulatory accounts for the Statement of Regulatory Principles (SRP). AGL believes this consultation contributes to the finalisation of a transparent, consistent and national approach to regulation benefiting both market participants and consumers by streamlining and simplifying regulation. While not supporting all of its contents, AGL believes the SRP provides a transparent and consistent approach to regulation and finalising unresolved issues will help to promote investment by providing greater certainty to asset owners.

The AER has arrived at the preliminary position that the 'as-incurred' approach is preferable to the 'as-commissioned' approach for rolling electricity transmission assets into the asset base. Rather than having a preference for either of the accounting methods described in the Position Paper, AGL considers that what is important is an internally consistent application of an accounting method, as this will maintain the incentive properties of the *ex ante* approach adopted in the SRP. AGL does not support the adoption of this approach as precedent for other sectors. Deatiled comments on these and other issues follow.

Maintaining incentive properties of *ex ante* approach

Unless a consistent application of accounting methodologies is used, incentive properties of the *ex ante* approach described in the SRP will be lost. That is, the same method needs to be used to determine revenue requirements at the commencement of a regulatory period as is used when rolling forward the asset base at the end of the regulatory period in order to preserve the incentive properties. For purposes of determining TNSPs' revenue requirements, the SRP has established that an 'as-incurred' approach will be applied to capital expenditure. That is, revenues will include allowances for depreciation of and return on capital as it is spent. Consistent with the analysis in the Position Paper, if the desired incentive properties of the SRP approach are to be realised, then capital accounting in regulatory accounts must also be on an 'as-incurred' basis. More generally, the incentive properties of the regulatory approach will be realised only if the regulatory accounting treatment of capital expenditure is the same as its treatment in setting revenues.

Other accounting approaches

The AER identifies two accounting methods used by Australian TNSPs; the 'as-incurred' and 'as-commissioned' accounting approach. For the 'as-commissioned' approach, actual expenditure is appreciated at WACC until the asset is commissioned at which point the total amount is brought into the capital base. However, a third approach has been adopted by IPART and the ESCV for setting electricity and gas distribution revenues. Under this third approach, a return on forecast capital expenditure is allowed in revenue from the time it is expended as per the 'as-incurred' approach described in the Position Paper, but depreciation does not occur until the asset is commissioned, as per the 'as-commissioned' approach. The amount taken into the capital base is then the actual capital cost of the asset. This approach of recognising expenditure when it is incurred, but commencing depreciation when it is commissioned is consistent with Australian and international accounting standards.

Alignment with accounting standards

While the AER has settled on the 'as-incurred' approach, aligning the *ex ante* 'as-incurred' and 'as-commissioned' accounting methods with accounting standards may be an onerous task for asset owners. A result of using different approaches for regulatory accounts to those required by accounting standards may be that service providers have to maintain separate accounts for regulatory, statutory and taxation accounting purposes. AGL suggests that consideration is required as to whether regulatory accounting should depart from statutory accounting, and should be part of this or a later review. The additional and ongoing costs involved in operating separate accounts needs to be considered and justified before being mandated.

Application beyond electricity transmission

AGL has concerns that if an 'as-incurred' accounting approach is finalised for TNSPs, the AER may see this as a precedent which may be translated to electricity distribution and the gas industry for purposes of national and market alignment. AGL submits that the AER's preferred approach for electricity transmission cannot be translated to other sectors without potential for disruption, particularly for service providers who do not maintain separate regulatory accounts.

AGL supports the internally consistent adoption of a regulatory accounting method for TNSPs as it will promote consistency in treatment for revenue setting and for rolling forward the asset base at the end of the regulatory period. This will maintain the incentive properties of the *ex ante* approach adopted in the SRP. AGL also supports the AER's proposal to compensate asset owners for transition from one approach to another. However, AGL does not support the application of this approach as precedent for electricity distribution, gas transmission and gas distribution.

If you have any queries in relation to this submission please contact Chris Harvey, Manager Regulatory Development, on (02) 9921 2601 or by e-mail to charvey@agl.com.au.

Yours sincerely

Dr Robert Wiles

General Manager, Regulation and Policy