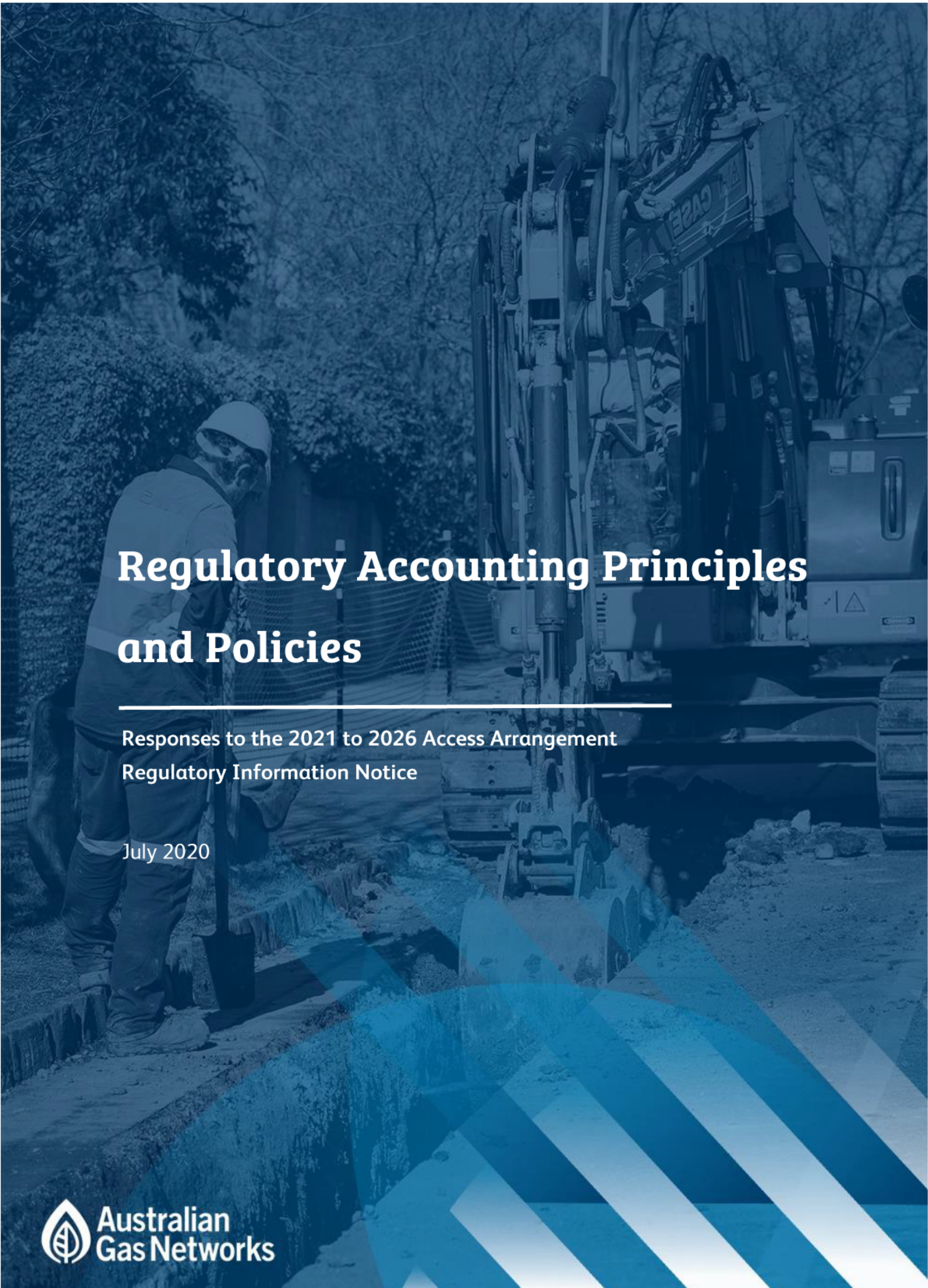

Regulatory Accounting Principles and Policies

Responses to the 2021 to 2026 Access Arrangement Regulatory Information Notice

July 2020

Australian Gas Networks

Enquiries concerning the currency of this policy should be addressed to:

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AMENDMENT RECORD

Version	Date	Author	Description of Changes
1.0	30 June 2020	Mark McAra	Final for AGN (SA) AA RIN

Contents

1. Introduction

Regulatory financial information reported by Australian Gas Networks Limited (AGN Limited) to the Australian Energy Regulatory (AER) is to be prepared in accordance with the accounting principles and policies that are applied in preparing the group's statutory financial statements, with the exception only of specific differences that are noted in this policy.

This regulatory accounting policy requires that in all other respects, AGN Limited's regulatory financial information will be prepared in a manner that ensures:

a It is based on a recognisable and rational economic basis;

b The resultant financial information satisfies the concepts of relevance and reliability;

c The substance of the underlying transactions and events is reported in the regulatory templates;

d The regulatory templates can be understood;

e Consistency is applied allowing for comparisons to be made over time; and that

f It conforms to the recognition and measurement criteria of Australian Accounting Standards and applicable International Financial Reporting Standards (unless specifically noted otherwise in this policy).

2. General Accounting Policies - AGN Limited Statutory

The principal accounting policies adopted in the preparation of the consolidated financial statements, with relevance to the Access Arrangement (AA) Regulatory Information Notice (RIN), are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. The financial statements are for the consolidated entity consisting of AGN Limited and its subsidiaries (referred to hereafter as "the Group"). The financial statements are presented in Australian dollars.

a Basis of preparation

The financial statements are prepared in accordance with Australian Accounting Standards - Reduced Disclosure Requirements and Interpretations issued by the Australian Accounting Standards Board ('AASB') and the Corporations Act 2001, as appropriate for for-profit oriented entities.

Historical cost convention

The financial statements are prepared under the historical cost convention, except for, where applicable, the revaluation of financial assets and liabilities at fair value through profit or loss, financial assets at fair value through other comprehensive income and derivative financial instruments.

Critical accounting estimates

The preparation of financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies.

New and amended standards adopted by the Group

The impact of any changes in accounting policy or from implementing new and amended accounting standards are to be set out. These impacts are to be shown in accordance with any guidance issued by the Australian Accounting Standards Board (AASB).

b Principles of consolidation

Subsidiaries are all those entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The consolidated financial statements incorporate the activities and affairs of AGN Limited and its controlled entities (the "Group"):

Australian Gas Networks (SA Holdings 1) Limited ACN 008 181 066
Australian Gas Networks (SA) Limited ACN 008 139 204
Australian Gas Networks (QLD) Limited ACN 009 760 883
Australian Gas Networks (Vic Holdings 1) Pty Ltd ACN 085 882 337
Australian Gas Networks (Vic Holdings 2) Limited ACN 085 882 364
Australian Gas Networks (Vic 3) Pty Ltd ACN 085 882 373
Australian Gas Networks (Vic) Pty Ltd ACN 085 899 001
Australian Gas Networks (Albury) Pty Ltd ACN 000 001 249
Australian Gas Networks (NSW Holdings 1) Pty Ltd ACN 108 315 957
Australian Gas Networks (NSW Holdings 2) Pty Ltd ACN 108 316 249
Australian Gas Networks (NSW Holdings 3) Pty Ltd ACN 108 316 007
Australian Gas Networks (NSW) Pty Ltd ACN 083 199 839
AGN (Darling Downs) Pty Ltd ACN 618 798 262

The effects of transactions between the entities within the AGN Limited Group are eliminated on consolidation.

c Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to costs to be incurred on particular projects of an operating nature are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate.

Government grants relating to depreciable assets are recognised by reducing the carrying amount of the asset.

d Goods and Services Tax ('GST')

Revenues, expenses and assets are recognised net of the amount of associated GST, unless the GST incurred is not recoverable from the tax authority. In this case it is recognised as part of the cost of the acquisition of the asset or as part of the expense.

e Rounding amounts

The Company is of a kind referred to in ASIC Legislative Instrument 2016/191, issued by the Australian Securities and Investments Commission, relating to the "rounding off" of amounts in the Directors' report and financial statements. Amounts in the financial statements have been rounded off in accordance with that Class Order to the nearest million dollars, unless specifically stated otherwise.

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3. APA Asset Management

The operation and management of AGN's distribution network, including the delivery of the capital program, is contracted to APA Asset Management (APA) under a long-term agreement. This agreement (the 'OMA') commenced on 2 July 2007 and has continued since that time, including through Envestra's change of ownership which led to its re-branding as "Australian Gas Networks" in October 2014.

The OMA is an arms-length arrangement, which provides for APA to recover its direct and indirect costs in delivering the services to AGN Limited, and for the payment of a Network Management Fee (NMF) which represents APA's margin. The NMF is calculated using a formula that is based upon a percentage of AGN Limited's revenue in each regulated and unregulated business zone.

4. Capex

4.1. Property, Plant and Equipment

Property, plant and equipment is stated at historical cost less accumulated depreciation and impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the items and is in accordance with *AASB 116 Property, Plant and Equipment*.

4.2. Regulatory Accounting Adjustments

In respect of the categories of expenditure shown in the AA RIN templates (e.g. Direct Internal Labour, Direct Contractor Expenditure, Other Direct Expenditure, Overhead Expenditure and Related Party Margin Expenditure), given the contracting arrangements with APA for the delivery of AGN Limited's capital program, capital expenditure reported by AGN Limited is almost exclusively Direct Contractor Expenditure and Overhead Expenditure.

AGN Limited also receives Capital Contributions (see section 4.2.6) which for regulatory accounting purposes are deducted from the gross expenditure, resulting in the net capital expenditure being recorded in the Regulatory Asset Base (RAB).

The following sections detail the differences in the treatment of Capex for regulatory reporting purposes relative to statutory accounting. Other than for the items set out below, Capex reported in the AA RIN templates are consistent with AGN Limited's statutory accounts.

4.2.1. Heat shrinking sleeves

In the AER's draft decision for the 2016/17-2020/21 SA AA, expenditure relating to 'transmission pressure pipeline corrosion under heat shrink sleeves (SA21a)', was determined to be an operating item (see Attachment 7 – Operating expenditure, section 7.4.3.6 - Capex projects reclassified as Opex, page 29). Therefore, since 1 July 2016, AGN Limited classifies this expenditure as operating expenditure (repairs and maintenance) in its regulatory reporting to the AER.

For statutory accounting purposes, this expenditure is treated as Capex in accordance with AGN Limited's interpretation of relevant Australian Accounting Standards (e.g. *AASB 116 Property, Plant and Equipment*) and the Accounting Standard Board's *Framework for the Preparation and Presentation of Financial Statements ("the Framework")*.

4.2.2. Piecemeal mains replacement

Consistent with its treatment during prior regulatory access arrangement periods, piecemeal mains replacement (relating to small sections of mains replacement) is reported as operating expenditure (repairs and maintenance) for regulatory purposes.

For statutory accounting purposes, AGN Limited treats this expenditure as Capex in accordance with its interpretation of relevant Australian Accounting Standards (e.g. *AASB 116 Property, Plant and Equipment*) and the Accounting Standard Board's *Framework*.

4.2.3. Capitalised interest

In accordance with its accounting policies related to Finance Expenses, AGN Limited may capitalise certain interest costs for statutory accounting purposes.

For regulatory accounting purposes, AGN Limited removes capitalised interest from regulatory capital expenditure, as these costs are calculated as part of the AER's post tax revenue model (PTRM) and are deemed to be operating in nature.

4.2.4. Capitalised overheads

A proportion of APA's overhead costs are capitalised in accordance with the AGN Limited Cost Allocation Methodology and Capitalisation Policy. Overheads charged by APA includes their Network Management Fee (NMF) which represents APA's margin under the OMA.

In accordance with interpretation of relevant accounting standards (i.e. *AASB 116 Property, Plant and Equipment*) and the Accounting Standard Board's *Framework,* AGN Limited capitalises a proportion of these overheads for statutory accounting purposes, including the NMF. Currently 65% of the total NMF paid to APA is capitalised for statutory accounting purposes.

For regulatory reporting purposes all NMF is treated as operating expenditure, consistent with the Access Arrangement Information (amended by order of the Australian Competition Tribunal) issued by the AER on 10 February 2012.

In accordance with AGN Limited's Capitalisation Policy, AGN Limited does not capitalise any of its internal overhead costs, which are all treated as operating expenditure both for statutory and regulatory accounting purposes.

4.2.5. Marketing Rebates

AGN Limited provides marketing rebates to certain customers in the form of a cash payment, as an incentive to have gas connected and to take up gas appliances (i.e. gas hot water, gas central heating etc.).

For regulatory accounting purposes, this expenditure is accounted for as operating expenditure, which is consistent with SAIPAR’s 2002 Access Arrangement final decision (page 99). This treatment for regulatory accounting purposes has not been changed since.

Until the reporting period ended 31 December 2015, AGN Limited also treated all of these marketing rebates as operating expenditure in its statutory financial statements.

From 1 January 2016, AGN Limited changed its policy to capitalise the expenditure on rebates specifically relating to new customers with existing homes that have previously been all electric, to the service asset category (Inlets).

4.2.6. Capital Contributions

Capital works

AGN Limited performs alteration and construction works on its distribution network at the request of customers. These works are funded by the customer. Where the contract only allows for capital works there is one performance obligation and revenue is recognised when the service is provided. The customer receives the benefit of the service as the work is performed therefore the performance obligation is satisfied "over time". As the contribution to the capital works is received from the customer it is recognised as a contract liability on balance sheet and taken to revenue over time using an output method, either percentage of completion or milestones reached as specified in the contract.

Some contracts will include more than one deliverable, being the capital works and the subsequent provision of haulage services and/or maintenance services:

- Where the performance obligations are determined to be distinct, the contract price is allocated to each performance obligation using estimated or actual construction costs, an estimation of maintenance costs if applicable and commercial tariffs for haulage revenue. Revenue is then recognised as each performance obligation is satisfied; or
- Where the performance obligations are determined to not be distinct, the total contract price is recognised over the life of the contract.

<u>Statutory Accounting Practice</u>

Customer contributions are made in relation to various capital projects. These contributions are recognised as revenue under AASB 15 Revenue since 1 January 2018 and Interpretation 18 Transfers of Assets from Customers and AASB 118 Revenue until 31 December 2017. There has been no change in accounting treatment resulting from the adoption of the new standard AASB 15 in respect of customer contributions.

<u>Regulatory Accounting Practice</u>

For regulatory accounting purposes, the revenue is removed and the value of customer contributions received is deducted from the cost, to ensure that only that part of Capex which was funded by the business (total Capex less customer contribution) is included in the RAB.

Within the RIN templates Capex for regulatory accounting purposes is reported both on a gross basis and net of any customer contributions received in relation to capital projects. The value of customer contributions is also reported separately in the RIN templates.

4.2.6.1. Other Capital Contributions (Government grants)

Statutory and Regulatory Accounting Practice

The accounting for amounts received in the form of government grants for operating projects is to recognise the grants as revenue in the period the expenses to which they relate are incurred.

Government grants relating to depreciable assets are recognised by reducing the carrying amount of the asset.

5. Operating Expenditure

Opex is classified into the following Annual RIN categories:

5.1. Repairs and Maintenance

Repairs and maintenance costs are works performed directly on the physical asset. Work is predominantly on the Gas Distribution Business however there is a component of Ancillary Reference Services (ARS) and Ancillary Non-Reference Services (NRS). The total repairs and maintenance cost is driven by the charge from APA Asset Management (APA), in accordance with the Operations and Management Agreement (OMA). This category includes expenditure on heat shrinking sleeves and piecemeal mains replacement.

5.2. Marketing and Retail Incentives

AGN Limited undertakes various marketing activities to retain and increase customer numbers. This program incorporates advertising (for example), on platforms such as television, radio, digital and press.

AGN Limited provides marketing rebates to certain customers in the form of a cash payment, as an incentive to have gas connected and take up gas appliances (i.e. gas hot water, gas central heating etc.) in place of their equivalent electric appliances.

For regulatory accounting purposes, this expenditure is accounted for as operating expenditure, which is consistent with SAIPAR's 2002 Access Arrangement final decision (page 99) and subsequent regulatory reviews since that time

5.3. Debt Raising

Expenditure reported for debt raising costs comprise the following fees and charges paid in relation to raising debt financing for AGN Limited:

- Agents fees
- Registrar Fees
- Arrangement fees
- Rating Agent fees
- Establishment/extension fees
- Legal fees
- Roadshow and associated travelling costs

Debt raising costs are excluded for the purposes of the Efficiency Carryover Mechanism (ECM) calculation in workbook 3 of the AA RIN.

5.4. Equity Raising

AGN Limited does not currently incur equity raising costs under its existing ownership structure and has not incurred equity raising costs for the period covered by the AA RIN templates.

5.5. Unaccounted for Gas

Expenditure incurred by AGN Limited in relation to the difference between the quantity of gas metered as having been injected into the gas distribution network and the quantity of gas metered as having been delivered to customers is reported as the cost of Unaccounted for Gas (UAFG).

UAFG costs are excluded for the purposes of the ECM calculation in workbook 3 of the AA RIN.

5.6. Jurisdictional Charges

Expenditure reported for jurisdictional charges comprises license fees paid to current and former regulatory bodies.

5.7. GSL Payments

AGN Limited has not incurred any expenditure in relation to GSL payments for the period covered by the Annual RIN templates.

5.8. Other Opex

These are the other direct costs associated with the business and include items such as employee costs, consulting expenses, IT costs and direct overhead costs.

5.8.1. Rent expense

Since adopting AASB 116 Leases in 2019, for statutory accounting purposes, AGN Limited's straight-line operating lease expense (or rent) recognition is replaced with a depreciation charge for the right-of-use assets (i.e. leased premises) and an interest expense on the recognised lease liabilities (included in finance costs).

The payment of rent expense on leased business premises occupied by AGN Limited, is recognised as operating expenditure for regulatory accounting purposes. This is consistent with historical accounting practice for both regulatory and statutory purposes until the adoption of the new Australian Accounting Standard *AASB 16 Leases*, from 1 January 2019.

5.8.2. Movements in provisions

In accordance with AGN Limited's Cost Allocation Methodology, for regulatory accounting purposes, the amount of any changes in provisions that are recognised in the statutory accounts (e.g. employee related provisions), are allocated on a direct basis to relevant regulated pipelines, including the South Australian AA.

This is to be done with reference to the underlying driver for the movement in provisions and by identifying the regulated proportion of that driver. For example with site remediation related provisions, by determining if the site is a regulated or unregulated asset for the purpose of the RAB.

These costs are excluded for the purposes of the ECM calculation in workbook 3 of the AA RIN.

6. Overheads Expenditure

As set out in section 4.2.4 above, AGN Limited capitalises a proportion of the overheads charged APA Asset Management.

There are differences between the statutory and regulatory accounting treatment of capitalised overheads, which is also set out above.

Overheads are allocated to Reference Services and Non-Reference Services in accordance with the AGN Limited Cost Allocation Methodology document.

In accordance with the Capitalisation Policy, AGN Limited does not capitalise any of its internal overhead expenditure, which is all reported as operating expenditure for both statutory and regulatory accounting purposes.

7. Related Parties

Policy

Disclosures in the notes to the financial statements of entities preparing general purpose financial statements are required in respect of transactions between the reporting entity (being Australian Gas Networks Ltd) and its related parties.

7.1. APA Asset Management

Until the current owner of AGN Limited acquired the Envestra business on 29 August 2014, through the purchase of all the issued shares in Envestra Limited, the APA Group was a significant shareholder in Envestra, owning 33% of the company. This meant that until this date, APA Asset Management which is an entity within the APA Group, satisfied the definition of a related party.

There is no Related Party Margin Expenditure in respect of AGN Limited's capital expenditure reported in the AA RIN template as 100% of the NMF paid to APA is reported as operating expenditure in accordance with the regulatory accounting policy set out in section 4.2.4 above. This is consistent with the Access Arrangement Information (amended by order of the Australian Competition Tribunal) issued by the AER on 10 February 2012.

8. Application and effective date

This regulatory accounting principles and policies document:

a. Applies to the preparation of historical regulatory financial information to be provided to the AER by AGN Limited in respect of the Access Arrangement Regulatory Information Notice issued on 28 February 2020 and is current at the date of approval;
b. Is applicable to all AGN Limited personnel involved in the preparation of regulatory financial reporting to the AER;
c. Incorporates all applicable regulatory accounting principles and policies for the relevant reporting periods included in the AER's AA Regulatory Information Notice dated 28 February 2020 (i.e. 2014-15 to 2018-19); and
d. Remains effective for future regulatory reporting periods, subject to amendment.

Approved by:

[redacted]

Paul May

Chief Financial Officer

[redacted]

Peter Bucki

Head of Regulation

Date: 30 June 2020