

Attachment 9.5

BDO Review of proposed treatment for replaced HDPE pipelines

SA revised Final Plan July 2021 – June 2026
January 2021



Australian Gas Networks Limited

Review of proposed treatment for replaced HDPE pipelines (AGN SA)

13 January 2021

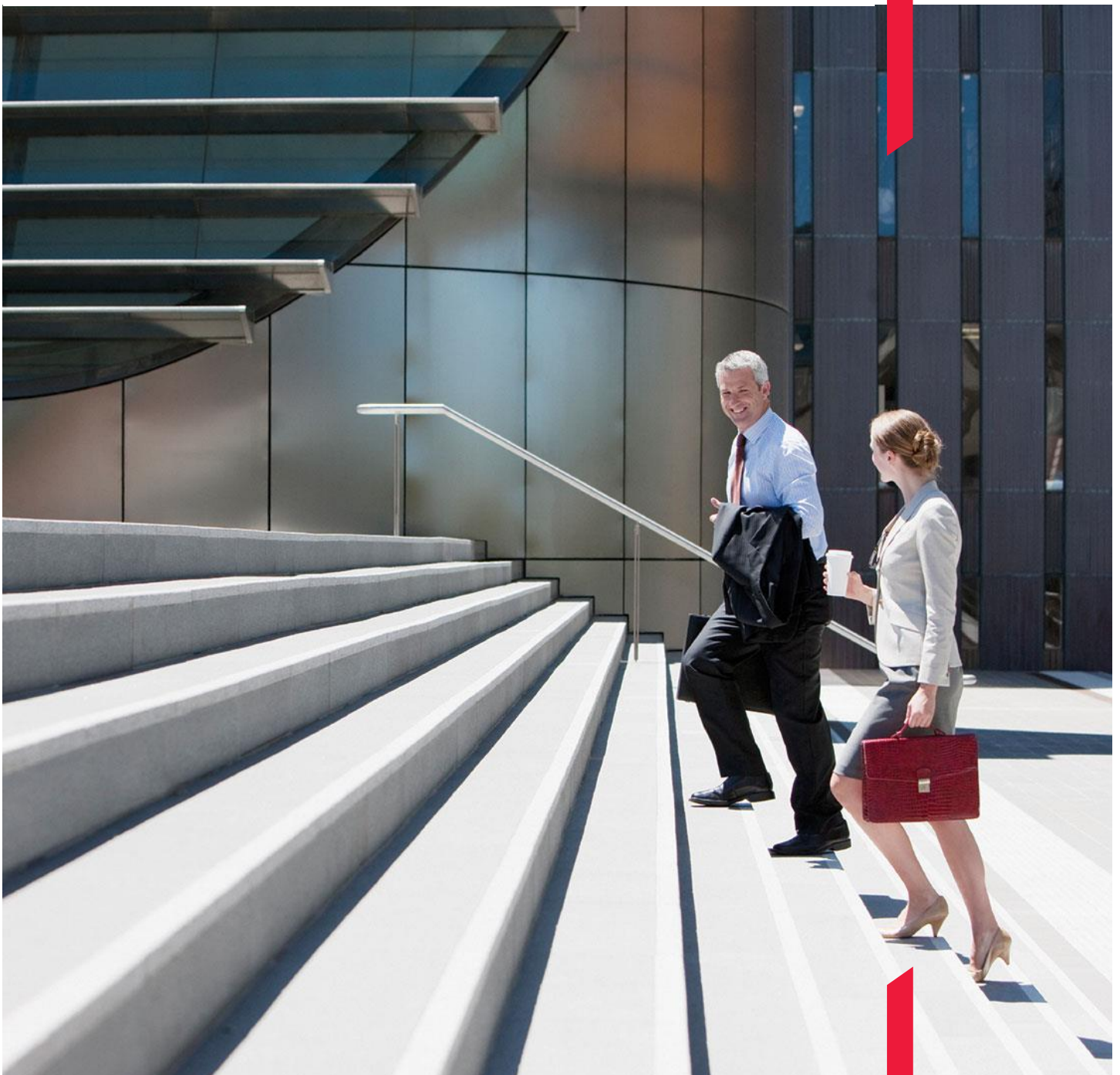


Table of Contents

Introduction..... 3
Approach 4
Summary of Key Findings..... 5
Appendix 1 - Regulatory precedents for revising the useful life of replaced assets 6
Appendix 2 - Detailed Findings 7

Introduction

BDO were engaged by Australian Gas Networks Limited (AGN) to undertake a review of its proposal in the South Australian access arrangement to reduce the useful life of certain high-pressure gas pipeline assets (classification HDPE 575) used in mains and services, which is being replaced through a method known as ‘mains insertion’. This pipeline has been subject to a replacement program during the current five-year access arrangement period for SA (having commenced in July 2016) and will continue to be replaced during the next five-year access arrangement period (commencing July 2021). This report documents the scope, agreed approach and our findings.

Scope and Scope Limitations

The assignment is a consulting engagement as outlined in the ‘Framework for Assurance Engagements’, issued by the Auditing and Assurances Standards Board, Section 10. Consulting engagements employ an assurance practitioner’s technical skills, education, observations, experiences and knowledge of the consulting process. The consulting process is an analytical process that typically involves some combination of activities relating to: objective-setting, fact-finding, definition of problems or opportunities, evaluation of alternatives, development of recommendations including actions, communication of results, and sometimes implementation and follow-up.

The nature and scope of work has been determined by agreement between BDO and AGN and was to review AGN’s proposal in the context of regulatory practice in Australia, including previous decisions by the AER and other regulators. This consulting engagement does not meet the definition of an assurance engagement, as such; we are not proposing an audit in accordance with generally accepted auditing standards.

Except as otherwise noted in this report, we have not performed any testing on the information provided to confirm its completeness and accuracy.

Our report is prepared solely for the use of AGN and its response to the draft decision by the Australian Energy Regulator (AER) on its regulatory proposal for the next South Australian access arrangement. No responsibility to any third party shall be accepted, as our report has not been prepared, and is not intended, for any other purpose.

This report is based on the latest information made available to us as at the date of this report and we accept no responsibility to update it for events that take place after the date of its issue.

The following items have been excluded from the scope of this review:

1. Except as otherwise noted, we will not perform any testing on the information provided to confirm its completeness and accuracy.
2. In performing our procedures, we will rely upon certain representations made by AGN and their representatives. We will not perform procedures to verify the accuracy or completeness of such representations.

Approach

To address the objectives of this assignment, the following procedures were determined, agreed and undertaken:



Phase 1: Business Understanding

In this phase, BDO engaged with AGN to understand the nature of the current and planned pipeline replacement program under review.

We also participated in a teleconference with AGN's engineering consultant GHD Pty Ltd (GHD) and obtained a copy of GHD's report¹ on the ongoing role of replaced high-density polyethylene (HDPE) pipelines.

Phase 2: Business Information Analysis

In this phase, we conducted a review of the information obtained as part of phase 1.

Work completed:

- ▶ Reviewed and considered the activities associated with the HDPE pipeline replacement program.
- ▶ Reviewed and considered the report written by GHD on the ongoing role of replaced HDPE pipelines.
- ▶ Reviewed publicly available information relating to the treatment of replaced assets and related decisions by regulators with respect to revising the useful life of assets.
- ▶ Considered the reasonableness of reducing the useful life of HDPE pipeline assets associated with the pipeline replacement programs considering regulatory practice in Australia (further information in relation to relevant precedents found in previous decisions by the AER and other regulators, is provided in Appendix 1).

Phase 3: Report Findings

This report documents a summary of our findings ('Key Findings') and a detailed explanation of our findings (provided in Appendix 2).

¹ GHD (January 2021) - Ongoing role of replaced HDPE pipelines - Australian Gas Networks (SA)

Summary of Key Findings

Based on the information provided, we consider AGN's proposal to reduce the useful life of the high-pressure mains and services gas pipeline (classified as HDPE 575) which is being replaced during the current and next South Australian access arrangement periods through to June 2026, is reasonable with the relevant key points being as follows:

- ▶ AGN has received independent advice from experienced engineers (GHD) which concluded the replaced pipeline plays no role in the ongoing delivery of gas haulage services and does not provide any additional asset management support to the new pipeline². As such, GHD does not consider mains insertion is a modification to the existing main but is in fact a replacement. This assessment by GHD is consistent with AGN's approach, as outlined in its final plan to the AER for the next South Australian access arrangement period.
- ▶ From BDO's review of recent and historical decisions by the AER and other regulators (see further details in Appendix 1), it would be consistent with Australian regulatory practice to fully depreciate the current carrying value of the assets as they are replaced.
- ▶ BDO notes the proposed impact of reducing the useful life of these assets includes an element of additional depreciation for assets being replaced in the current access arrangement period (2016/17 to 2020/21). These assets currently being replaced therefore have a useful life of one year or less.

However, AGN proposes to average the impact of all assets being replaced (i.e. both in the current and next access arrangement periods) over the next access arrangement period (2021/22 to 2025/26), by applying a life of five years for all replaced assets, instead of one for assets replaced in the current period. From our review of comparative cases, BDO notes this proposed treatment is consistent with previous decisions by the AER.

- ▶ AGN's proposed approach to revise the useful life of the HDPE 575 pipeline assets being replaced and to recalculate depreciation, which results in increasing depreciation as compared with current depreciation charges (in this case to be reflected over the next access arrangement period for regulatory purposes), is consistent with the relevant provisions of the Australian Accounting Standards and prior decisions made by the AER.

² GHD (January 2021) - Ongoing role of replaced HDPE pipelines - Australian Gas Networks (SA)

Appendix 1 - Regulatory precedents for revising the useful life of replaced assets

From a review of other regulatory determinations, BDO understands the AER has previously approved revising the useful life of pipeline identified for replacement, including mains and services pipeline replaced through the insertion method, which results in accelerated depreciation³. Examples of such precedents specifically related to gas pipeline decisions by the AER, are as follows:

▶ SPI Networks (Gas) Pty Ltd

In its final determination, the AER allowed SPI's adjustments to the depreciation schedule reflecting changes in the expected economic life of low-pressure mains that was to be replaced during the 2013-17 access arrangement period (AER, March 2013).

▶ AGN Victoria and Albury

In its final determination, the AER allowed AGNs proposed accelerated depreciation of mains and services pipeline to be replaced through its replacement program over the 2018-22 access arrangement period (AER, November 2017).

A further example related to gas pipelines, is the following decision by the Essential Services Commission in Victoria:

▶ Multinet

In its final determination, the Essential Services Commission allowed Multinet's proposed accelerated depreciation associated with its low-pressure pipe replacement program (Essential Services Commission, March 2008).

BDO also notes the following, relevant precedents of decisions by the AER in the electricity industry:

▶ AusNet Services

In its preliminary decision and endorsed in the final determination, the AER allowed accelerated depreciation in respect of AusNet Services' early replacement of assets in bushfire prone areas during the 2016 to 2020 access arrangement (AER, May 2016).

▶ United Energy

In its final decision, the AER allowed accelerated depreciation for assets being replaced by United Energy during the 2011 to 2015 access arrangement period, in advance of previously assumed remaining lives (AER, October 2010).

References:

AER. (March 2013). *Access arrangement final decision - SPI Networks (Gas) Pty Ltd 2013-17 - Part 2: Attachments.*

AER. (November 2017). *Final Decision - Australian Gas Networks Victoria and Albury gas access arrangement 2018 to 2022 - Attachment 5 - Regulatory depreciation.*

Essential Services Commission. (March 2008). *Gas Access Arrangement Review 2008-2012 - Final Decision - Public Version.*

AER. (May 2016). *Final decision - AusNet distribution determination - Attachment 5 - Regulatory depreciation.*

AER. (October 2010). *Victorian distribution determination - final decision 2011-2015.*

³ BDO notes the term 'accelerated depreciation' is commonly used in the context of regulatory proposals and access arrangements, and that it results from reducing the useful life of regulated assets, as compared with previously assumed useful lives in approved access arrangement decisions.

Appendix 2 - Detailed Findings

Detailed below are our findings and observations from the procedures that we performed.

Is mains insertion a modification or a replacement of the pipeline?	
<p>Description of activities:</p> <p>Mains insertion involves inserting a new high-density polyethylene (HDPE) pipe through the existing pipes, in the process cutting out sections of existing pipe at various intervals to enable the insertion of the new pipe to occur. During this process the service connection points, or inlets are also replaced.</p> <p>BDO understands this method is typically used due to being lower cost, more efficient and less intrusive than alternative methods of pipeline replacement, such as direct burial via trenching.</p> <p>In its draft decision for the next SA access arrangement period, the AER has questioned whether the insertion of new HDPE pipe was a modification, as opposed to a replacement of the pipeline, and whether AGN’s proposed reduction of the useful life of the old pipeline was appropriate, (as explained further below).</p>	<p>Findings:</p> <p>AGN engaged GHD to provide a technical specialist explanation of the process of mains replacement through insertion and to make an assessment as to whether the old pipeline that remains following replacement, plays a role in the ongoing delivery of gas haulage services, including any asset management benefit for the new mains and services pipeline.</p> <p>In its report to AGN on the ongoing role of replaced HDPE pipelines, GHD noted “the replaced [pipeline] plays no role in the ongoing delivery of gas haulage services and does not provide any additional asset management support to the new [pipeline]. As such, GHD does not consider mains replacement is a modification to the existing main but is in fact a replacement.” GHD provides justification for this assessment within the Executive Summary of their report.</p> <p>This assessment by GHD is consistent with AGN’s final plan for the next SA access arrangement period, where AGN noted that the HDPE pipeline identified to be replaced (HDPE 575 DN40) and already replaced (HDPE 575 DN40 and DN50 which has previously failed) will serve no ongoing purpose and provide no benefit to the gas network after the new HDPE pipe has been inserted.</p>
BDO review of AGN’s proposed treatment of replaced HDPE pipeline assets.	
<p>AGN’s proposed treatment:</p> <p>AGN’s proposed treatment of replaced HDPE pipeline assets, is based on its position that there is no benefit to the gas network from replaced HDPE pipes, as set out in its final plan for the next SA access arrangement period.</p> <p>AGN proposed to revise the useful life of existing HDPE pipeline to reflect this, which would result in the quantity of pipeline already replaced and the pipeline to be replaced during the next SA access arrangement period, being fully depreciated by June 2026.</p> <p>As noted above, the AER has questioned whether the insertion of new HDPE pipe was a modification, as opposed to a replacement and whether AGN’s proposed reduction of the useful life of the old pipeline (with its ‘accelerated depreciation’) was appropriate.</p>	<p>Findings:</p> <p>Having reviewed the activities proposed under the current and proposed asset replacement program and the specialist advice of GHD (as noted above), BDO considers that it is reasonable for the identified HDPE pipeline assets to be fully depreciated over the next access arrangement period, in line with the asset replacement program.</p> <p>BDO notes the regulatory precedents for revising the useful life of replaced assets, as set out in Appendix 1, and considers therefore that AGN’s proposed treatment of these assets, is consistent with Australian regulatory practice.</p> <p>AGN’s proposed approach to revise the useful life of the HDPE 575 pipeline assets being replaced and to recalculate depreciation, which results in increasing depreciation as compared with current depreciation charges (in this case to be reflected over the next access arrangement period for regulatory purposes), is consistent with the relevant provisions of the Australian Accounting Standards and prior decisions made by the AER.</p>

1300 138 991
www.bdo.com.au

Distinctively different – it's how we see you
AUDIT • TAX • ADVISORY

ADELAIDE
BRISBANE
CAIRNS
DARWIN
HOBART
MELBOURNE
PERTH
SYDNEY

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact the BDO member firms in Australia to discuss these matters in the context of your particular circumstances. BDO Australia Ltd and each BDO member firm in Australia, their partners and/or directors, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

BDO Advisory (SA) Pty Ltd ACN 161 378 892 and BDO Holdings (SA) Pty Ltd ACN 161 232 373 are members of a national association of independent entities which are all members of BDO Australia Ltd ABN 77 050 110 275, an Australian company limited by guarantee. BDO Holdings (SA) Pty Ltd and BDO Australia Ltd are members of BDO International Ltd, a UK company limited by guarantee, and form part of the international BDO network of independent member firms.

BDO is the brand name for the BDO network and for each of the BDO member firms.