



APPENDIX B
Powerlink Cost Allocation Methodology
August 2008



POWERLINK COST ALLOCATION METHODOLOGY

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1 PURPOSE

The Australian Energy Regulator (AER) issued its *Electricity Transmission Network Service Providers Cost Allocation Guidelines* (Guidelines) in September 2007 in accordance with the *National Electricity Rules* (NER).

Each Transmission Network Service Provider (TNSP) is responsible for developing detailed principles and policies for attributing costs to, or allocating costs between or within, the categories of transmission services it provides. These detailed principles and policies must be included in the proposed cost allocation methodology that the TNSP submits to the AER for approval.

The purpose of the Powerlink Cost Allocation Methodology ("*Methodology*") is to establish Powerlink's methodology for attributing costs to, or allocating costs between or within prescribed, negotiated and other non-regulated transmission services.

2 SCOPE

The Methodology applies to the allocation of all Powerlink costs, and has been prepared in accordance with the requirements of the NER, the AER's Cost Allocation Guidelines and the Transmission Ring-Fencing Guidelines.

The Cost Allocation Methodology will be used by Powerlink for the preparation of capital and operating expenditure forecasts included in Revenue Proposals submitted to the AER, prices for negotiated transmission services, and certified annual statements (regulatory reporting) in accordance with the NER.

3 ACCOUNTABILITIES AND RESPONSIBILITIES

3.1 Accountabilities

Powerlink's Cost Allocation Methodology is, in the first instance, approved by the Powerlink Board, and then submitted to the AER for approval. Amendments to the Methodology must also be approved by the Board and AER.

3.2 Responsibilities

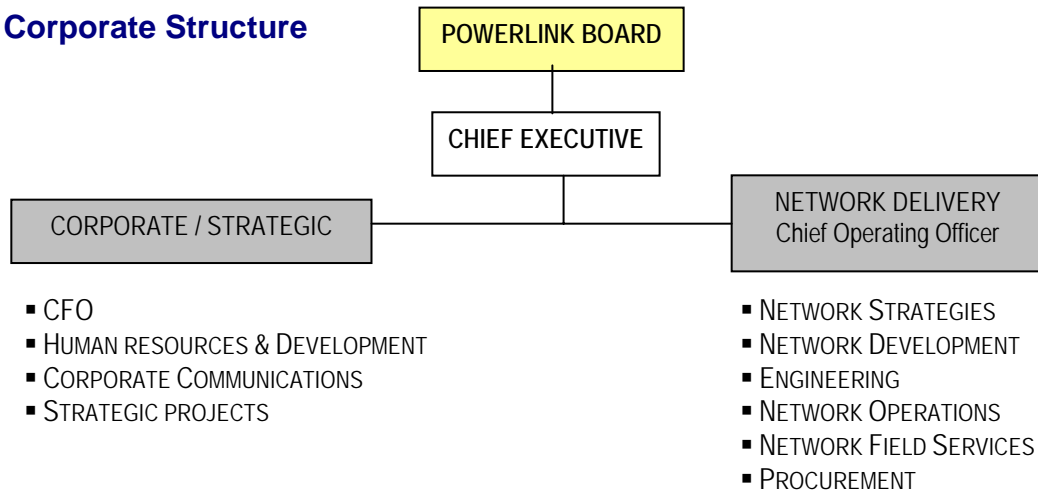
The Chief Financial Officer is delegated responsibility for the update, maintenance, application and monitoring of compliance with the Methodology across Powerlink. This includes reporting to the Board annually on its application as part of the regulatory reporting process.

The Chief Financial Officer is also delegated responsibility for ensuring that an independent audit of the regulatory financial statements is undertaken in accordance with the requirements of the AER's Information Guidelines.

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4 CORPORATE AND OPERATIONAL STRUCTURE

4.1 Corporate Structure



4.2 Powerlink Business Model (AO/AM/SP)

Powerlink operates an Asset Owner/Asset Manager/Service Provider (AO/AM/SP) business model to enable the effective and efficient management of assets involved in the provision of transmission services, including the management of operation and maintenance arrangements.

The model separates governance roles and functions, from the purchasers of goods and services, and from the providers of those services.

Each role has the following accountabilities:

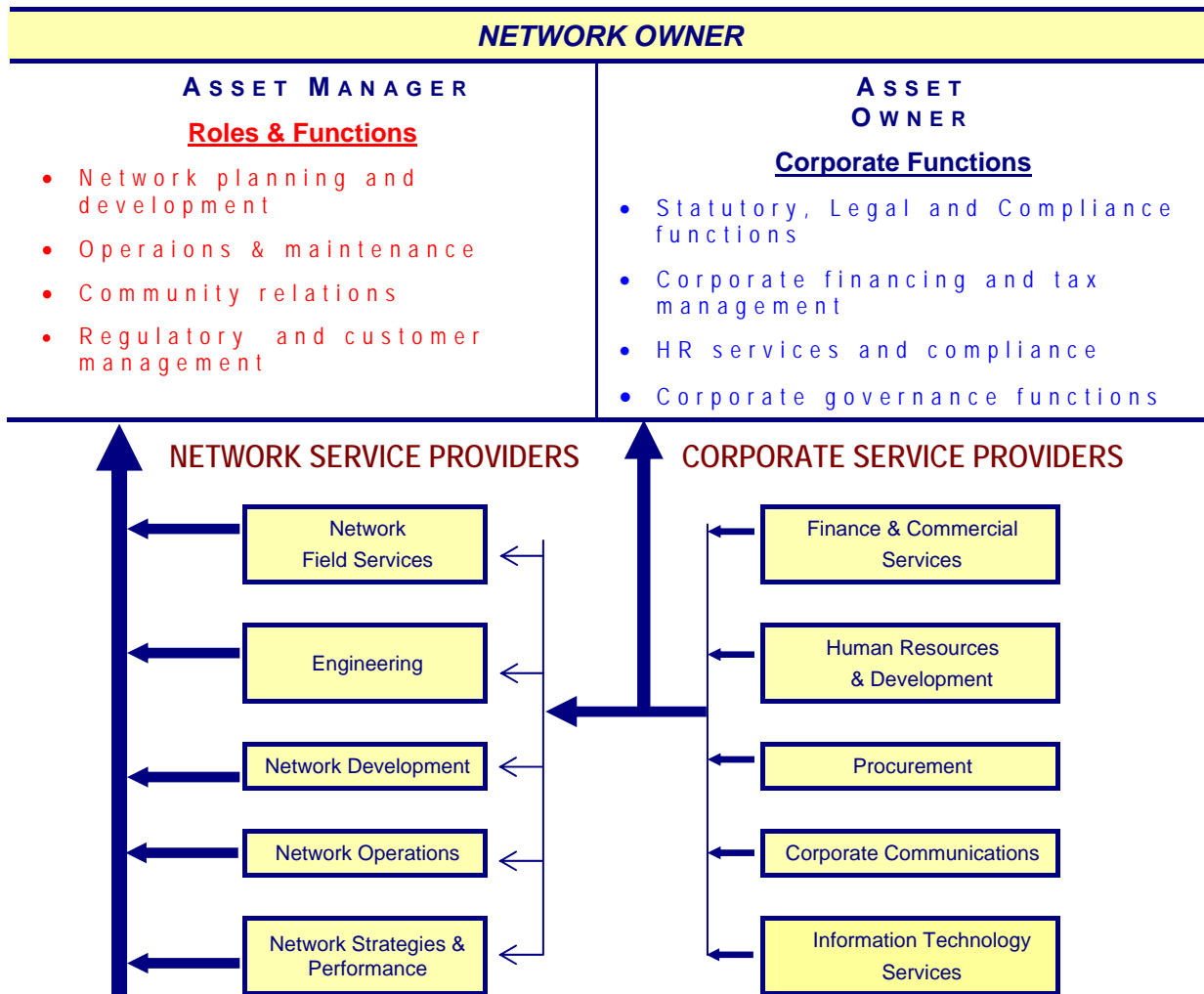
- *Asset Owner (AO)* – provides ownership functions (eg. corporate governance, financing, etc.).
- *Asset Manager (AM)* – meets mandated reliability and regulatory obligations by ensuring that there is effective long term asset investment, utilisation and management.
- *Service Provider (SP)* – comprising network service providers which deliver services such as planning, operation and maintenance to achieve the asset manager's requirements, and corporate service providers such as finance, procurement and human resources management. These comprise both internal and external service providers.

Powerlink's AO/AM/SP model is an essential element in managing the complex environment in which it operates. The model delivers an integrated and responsive management structure, capable of reconciling complex issues through well-defined responsibilities coupled with collaboration to ensure that all relevant information is available.

This model ensures that strategic asset management decisions are integrated to allow a whole of life approach to assets.

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4.3 Operational Structure



5 CATEGORIES OF TRANSMISSION SERVICES

Under the NER, Powerlink provides three categories of transmission service:

- Prescribed transmission services – These services are regulated by the AER and are associated with the use of the shared transmission network, connections services to distribution networks, and grandfathered connection services provided to generators and high voltage customers.
- Negotiated transmission services – These are connection services provided to a generator or transmission customer, or a group of generators or transmission customers, and shared transmission services provided to customers where the service exceeds standard network performance requirements. These services although not regulated by the AER, are subject to the NER on the basis they can only be provided by Powerlink.
- Other non-regulated transmission services – These services are contestable as they can be provided by a range of suppliers. Commercial terms and conditions are negotiated between the parties.

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6 COST ALLOCATION PRINCIPLES & POLICIES

6.1 Powerlink Costing Model Principles

The Powerlink Costing Model embodies the following principles.

6.1.1 Categorisation of Transmission Service Activities

The following principles are adopted in categorising activities:

- Each asset and activity is assigned to a category of transmission service (as per Section 5). Where an activity is directly associated with an asset, the relevant category of transmission services for that asset is automatically applied to that activity. This ensures costs are correctly attributed to the relevant transmission service.
- Activities are classified as either opex or capex in compliance with Australian Accounting Standards.

In this way, costs are automatically separated and allocated at the source to the appropriate transmission service category.

6.1.2 Classification of Operating Activities

Operating expenditure comprises the following classifications:

- *Network Maintenance* – all operational transmission network maintenance, including corrective, routine, condition-based, and refurbishment work.
- *Network Monitoring & Control* – includes all activities in operating and monitoring the transmission network.
- *Asset Manager Support* – operational activities to support strategic development and ongoing asset management of the network.
- *Corporate Support* – support activities required to ensure adequate and effective corporate governance and business administration.
- *Insurance* – costs associated with insurance premiums and self insurance allowances for uninsurable items and non cost effective insurance elements.
- *Network (Grid) Support* – costs associated with the provision of non-network solutions.
- *Debt Raising* – debt raising related costs not included in finance charges.

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6.2 Cost Capture and Financial Management Systems

Powerlink's fully integrated SAP system is used to capture all costs – both operating and capital. Each year, millions of transactions are automatically processed by SAP. Powerlink's chart of accounts and costing systems have been established such that costs (both operating and capital) can be separately accounted for and reported in accordance with the Cost Allocation Methodology and regulatory reporting requirements.

The chart of account structure enables costs to be automatically costed directly to, or automatically allocates costs between the categories of transmission services:

- Prescribed transmission services
- Negotiated transmission services
- Other Non-regulated services

6.3 Cost Allocation Policies

Powerlink's SAP business system provides an integrated approach to tracking costs (and activities) *from their original source* to their ultimate allocation, regardless of whether these costs are incurred within or external to Powerlink. The original source may be labour timesheets, purchase orders, requisitions, invoices, etc.

Costs charged to activities are on a full cost recovery basis and do not incorporate internal profits.

6.3.1 Cost Allocation Approach

In accordance with the Guidelines:

- Powerlink will not allocate the same cost more than once.
- A direct cost will only be attributed to one category of transmission service.
- The same cost will not be treated as both a direct and a shared cost.
- A shared cost will only be allocated once.
- Powerlink will recover the same cost only once through the charges that it levies for its transmission services.

Wherever possible, Powerlink will directly attribute or allocate costs to the relevant activity, which ensures costs are automatically allocated to the appropriate transmission service category. The majority of Powerlink costs are directly allocated in this way.

If direct attribution is not possible, a causal basis of allocation is undertaken. Powerlink utilises Direct Labour as the cost allocator for most business support costs to transmission service categories, and procurement oncost as the cost allocator for procurement costs to transmission service categories.

Powerlink has adopted this approach since inception.

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6.3.2 Direct Costing Approach

Service Provider Costs

As noted in section 6.3.1, costs shall be accounted for and allocated only once. Service provider charges are costed on a full cost recovery basis, as follows:

- Where the provision of services is for labour, a fully costed standard labour rate, inclusive of all relevant business overheads, is adopted.
- An internal procurement oncost is applied to all external purchase costs. Purchases are costed directly to the appropriate activity.

The methods by which service provider costs are charged to activities include:

- *Fee for Service* – where the service user is charged at an agreed standard rate per unit of service.
- *Fixed Charge* – where the service user is charged a fixed charge for provision of an agreed service. The total cost of the service attributed or allocated to each user is apportioned on the basis of an appropriate cost driver (ie. a causal basis).

Standard Labour Rates

Standard labour rates are determined by “pooling” employee salaries and wages costs into common groupings that reflect their levels of skill and experience. The standard labour rate incorporates:

- Salaries and wages costs, plus
- Labour related oncosts, plus
- Overhead costs (eg. including other service provider charges).

6.3.3 Shared Cost Allocation

In accordance with the Guidelines, shared cost must be allocated on a causal basis unless the shared costs are immaterial or a causal relationship cannot be established without undue cost and effort.

Powerlink’s approach identifies all material costs that Network and Corporate Service Providers (refer Sections 4.2 and 4.3) incur in providing their services. Principal users of a service (asset owner, asset manager and other service providers) are allocated their share of the cost of the service on the basis of the appropriate cost driver (ie. causal basis). Minor users of a service are then allocated any remaining material costs.

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6.3.4 Cost Allocation Consistency

The cost allocation approach will be applied consistently each year throughout the regulatory period.

As the nature of costs may change from time to time, Powerlink will periodically review cost allocations in regards to:

- consistency with prior accounting/regulatory periods; and
- the basis of cost allocation to ensure the substance is always considered over legal form.

7 COMPLIANCE AND DOCUMENTATION

7.1 Audit Trails and Documentation

Powerlink will maintain financial source documentation and records consistent with the accounting standards and statutory requirements to demonstrate compliance with its Methodology.

Powerlink will prepare and maintain appropriate documentation and information that support the preparation of regulatory financial reports for submission to the AER.

The Powerlink Cost Allocation Methodology is intended to remain consistent over time so that actual and forecast costs can be compared. This is verified through the certified annual financial statements and additional financial information that is prepared in accordance with relevant accounting standards and regulatory requirements.

Costing is recorded through Powerlink's fully integrated SAP computer system. Through this integrated system, Powerlink maintains records of attribution or allocation of costs to, or between, categories of transmission services. This approach forms the basis for the independent sign-off of the annual regulatory accounts, and is available to be verified if requested by the AER.

When preparing reports for submission to the AER, Powerlink will have available work papers and/or documentation with sufficient detail to demonstrate that Powerlink has complied with the requirements of its Cost Allocation Methodology.

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7.2 Regulatory Compliance

The Chief Financial Officer is delegated responsibility for monitoring and ensuring compliance with the Methodology across Powerlink.

The annual statutory financial statements and SAP system processes are reviewed by external audit.

In addition, on an annual basis, Powerlink undertakes an independent audit of its regulatory financial statements to ensure it is compliant with regulatory reporting requirements, including the Cost Allocation Methodology.

7.3 Publication of Methodology

In accordance with the Guidelines, a current copy of Powerlink's approved Methodology will be maintained on the Powerlink website.

8 REFERENCES AND DEFINITIONS

National Electricity Rules

Electricity Transmission Network Service Providers Cost Allocation Guidelines

Electricity Transmission Network Service Providers Information Guidelines

Transmission Ring-Fencing Guidelines

9 OPERATIONAL DATE

This Methodology is current as at the date of publication and will apply immediately. The Methodology will remain in force until such time as a new or amended Methodology is approved by the Board and AER.



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10 DIRECTORS' SIGN-OFF

Clause 3.2 (10) of the AER's Cost Allocation Guidelines requires not less than two directors to state whether in their opinion, the information contained in the TNSP's Cost Allocation Methodology is accurate, and to confirm the TNSP's intention to comply with the Methodology as approved by the AER.

The Powerlink Board resolved that:

- in their opinion, the information contained in Powerlink's Cost Allocation Methodology (ie. this Policy document) is accurate; and
- Powerlink intends to comply with the Powerlink Cost Allocation Methodology.

Signed off by Directors.....
Powerlink Queensland

15 August 2008
Date