Attachment 5.10

Approved CAM

May 2014

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Sydney NSW 2000
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www.ausgrid.com.au

29 November 2013

Mr. Warwick Anderson
General Manager
Network Regulation North Branch
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

By email: NSWACTelectricity@aer.gov.au

Dear Mr Anderson

Re: Submission of Ausgrid's cost allocation method

I am writing to you to submit the cost allocation method (CAM) that will apply to Ausgrid for the regulatory control period commencing 1 July 2014.

Ausgrid's current CAM was prepared under Chapter 11 of the National Electricity Rules (Transitional Rules) and is applicable only for the current 2009-14 regulatory control period. For the regulatory control periods commencing on 1 July 2014, Ausgrid is subject to chapter 6 of the National Electricity Rules (Rules). The AER must therefore approve a CAM under the Rules. In turn, this CAM is required to comply with the AER's cost allocation guidelines published in June 2008.[1]

The AER considered Ausgrid's current CAM is inconsistent with the AER's cost allocation guidelines and indicated that it will request Ausgrid to submit a proposed CAM to commence on 1 July 2014 that complies with the requirements of the Rules.[2]

In light of the above, Ausgrid had amended its current CAM for the AER's review and approval in accordance with clause 6.15.4(f) of the Rules and clause 4.2 of the AER's cost allocation

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[1] AER, Electricity distribution network service providers, Cost allocation guidelines, June 2008, version 1, 26 June 2008.

[2] AER, *Preliminary positions, Framework and approach paper, Ausgrid, Endeavour Energy and Essential Energy, Regulatory control period commencing 1 July 2014, June 2012, p104.*

guidelines. A proposed CAM was formally submitted to the AER on 3 July 2012. We understand that this CAM was suitable for approval by the AER subject to minor changes and clarification.

Ausgrid, however, withdrew this CAM on 5 December 2012 upon a request from the AER. This is because the AER's officers considered that changes may be required to this CAM due to recent changes in the National Electricity Rules, the approach to the classification of services and industry changes.

Now that these matters are settled, Ausgrid had informally provided a draft CAM to AER's officer on 24 September 213 for comments and review at staff level. This CAM incorporated changes in response to the review conducted by the AER's consultant on the CAM submitted on 3 July 2012.

The AER had provided us with further review comments from its consultant, requiring only a few minor clarifications. We have made these clarifications in our proposed CAM[3]. This CAM is attached and is now submitted to the AER for formal approval.

I also would like to take this opportunity to thank the AER's staff for their collaboration and assistance during this process. From the feedback we have received thus far, I trust that Ausgrid's proposed CAM is now suitable for formal approval.

If you have any further queries on Ausgrid's proposed CAM please contact Mr Aaron Brown on 02 4951 0181 or abrown@ausgrid.com.au.

Yours Sincerely,

Joe Pizzinga
General Manager
Finance and Compliance

Attachment A – Ausgrid's Cost Allocation Method.

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[3] These clarifications are in section 5 (page 8), table 3 (insurance and internal audit) and section 6.7.1 (insertion of a footnote).

Cost Allocation Method

November 2013

Ausgrid

Contents

Enquiries concerning Ausgrid's Cost Allocation Method should be addressed to:
Mr. Aaron Brown, Ausgrid, GPO Box 487, Newcastle NSW 2300.
Phone: 02 4951 0181. Email: abrown@ausgrid.com.au

This CAM is version 1.3.

The date of issue is the date of approval. The date of commencement is 1 July 2014.

On approval, Ausgrid will post a copy of this Cost Allocation Method on Ausgrid's website (www.ausgrid.com.au) as required by clause 6.15.4(h) of the National Electricity Rules.

Version History

Version No.	Date of Revision	Details of Amendments
1.0	June 2012	Initial Draft
1.1	July 2012	Submitted CAM withdrawn at AER's request
1.2	June 2013	Draft revised CAM for submission to AER
1.3	November 2013	CAM amended to provide further details requested by the AER

1. Background

1.1 Company profile

Ausgrid[1] is a New South Wales ('NSW') State Owned Corporation ('SOC') established under the Energy Services Corporations Act 1995 and the State Owned Corporations Act 1989. Ausgrid's main activities are the safe ownership and management of its electricity network. Ausgrid's shareholding Ministers are the NSW Treasurer and the Minister for Finance.

Ausgrid's electricity network covers 22,275 square kilometres from Waterfall in Sydney's south, to Auburn in western Sydney and the upper Hunter Valley in the north. Ausgrid supplies electricity to more than 1.6 million customers in Sydney, the Central Coast and the Hunter Region in NSW.

Ausgrid is an integrated business providing both regulated services and unregulated services. Whilst Ausgrid's electricity network comprises mainly distribution assets, a small portion of this network comprises high voltage transmission assets that operate in parallel and provide support to the higher voltage transmission network. Ausgrid's electricity network includes:

- A sub-transmission system of 33kV, 66kV and 132kV assets.
- A high-voltage distribution system of 5kV, 11kV and 22kV assets.
- A low-voltage distribution system of 240V and 415V assets.

The assets specified above are referred to throughout this document as the 'network'. Ausgrid's network customers are therefore customers who are connected to this network of assets. Ausgrid's customers include large and small businesses, as well as major industry including mining, shipping, tourism, manufacturing and agriculture. The network is made up of more than 200 large electricity substations, 500,000 power poles, 30,000 small distribution substations and almost 50,000km of below and above ground electricity cables.

In relation to the network, Ausgrid's key regulated services include:

- Construction of distribution and sub-transmission system assets to extend and upgrade Ausgrid's network.
- Ensuring the safety and reliability of the network through regular maintenance and vegetation management activities.
- Constructing and maintaining the public lighting system in Ausgrid's jurisdiction.
- Connecting new customers to Ausgrid's network.
- Controlling the operation of the network to ensure the network capacity needs of all customers are met.
- Collecting and providing meter data to retailers.

Ausgrid is also involved in the provision of unregulated services, including:

- Constructing, maintaining and managing assets on behalf of third parties.
- The provision of other energy services in the hot water, lighting and solar industries.
- The provision of retail business services to EnergyAustralia (formerly TRUenergy) under the Transition Services Agreement ('TSA').

1.2 Amendments to Ausgrid's Cost Allocation Method

This Cost Allocation Method ('CAM') may only be amended in accordance with clause 4.2 of the Electricity Distribution Network Service Providers Cost Allocation Guidelines, April 2008 ('CAG') and clause 6.15.4(f) of the National Electricity Rules ('NER'). This CAM supersedes the CAM approved by the Australian Energy Regulator ('AER') in April 2009[2] ('Previous CAM'), which has been amended for the following reasons:

- Ausgrid's previous CAM was prepared in accordance with clause 11.15 of the NER (the 'Transitional Rules') to apply to the regulatory control period 2009-2014. Specifically, Ausgrid's previous CAM:
  - Gave effect to, and was consistent with, the Accounting Separation Code for Electricity Distributors in NSW prepared by the Independent Pricing and Regulatory Tribunal ('IPART'). This Accounting Separation Code was deemed by the Transitional Rules to be the

The CAM outlines the basis we use to allocate costs between the different services we provide.

[1] Prior to the sale of Ausgrid's retail business to TRUenergy (now EnergyAustralia) on 1 March 2011, Ausgrid was known as EnergyAustralia.

[2] EnergyAustralia's proposed cost allocation method (22 January 2009).

Cost Allocation Guidelines made by the AER for the 2009-2014 regulatory control period.
  - Was prepared using the same cost allocation method last used in preparing Ausgrid's Regulatory Accounts for submission to IPART, being the 2006-2007 Regulatory Accounts.
- For regulatory control periods following the 2009-2014 period, Ausgrid is required to apply the AER's CAG in accordance with chapter 6 of the NER.
- On 1 March 2011 Ausgrid's retail business was sold to TRUenergy (now EnergyAustralia) as part of the NSW Government's re-structuring of the industry. This transaction constituted a material change in Ausgrid's circumstances and resulted in significant changes to Ausgrid's organisational structure, with Ausgrid to provide retail business services to EnergyAustralia for up to three years under a TSA.
- On 18 March 2012 the NSW government announced a major restructure of the NSW electricity distribution businesses to merge key elements of the three NSW Distribution Network Service Providers[3] ('DNSPs') under a common operating model. Accordingly, from 1 July 2012 the 3 NSW electricity distribution businesses began to progressively implement the arrangements as announced by the Government to include a common Chairman, Board and CEO for all three companies and subsequent common senior management team also appointed to all three companies, and commonly referred to as Networks NSW.

As a result, amendments to Ausgrid's previous CAM are required for the business to effectively promote the AER's CAG, to account for material changes in Ausgrid's circumstances and to reflect the nature of costs incurred by the business and the way in which Ausgrid manages its expenditure.

Ausgrid has undertaken a detailed analysis and assessment of its shared cost allocators to identify the most appropriate cost drivers for each shared cost category. This includes the application of appropriate non-causal allocators for shared costs which are not material or where a causal based method of allocation cannot be established without undue cost and effort. Furthermore, due to the material changes in Ausgrid's circumstances (as outlined above), Ausgrid believes the review of shared cost allocators is required and appropriate for regulatory control periods following the 2009-2014 period.

Ausgrid also undertakes to approach and inform the AER in the event of any material changes that occur during the period in which the approved CAM applies. A change in circumstances will be considered material if its omission, misstatement or non-disclosure has the potential to prejudice the understanding of the financial position of Ausgrid, as gained by an assessment of the financial information relating to Ausgrid.

2. Nature, Scope and Purpose

The purpose of this document is to set out the CAM adopted by Ausgrid for the purposes of complying with its regulatory obligations. This is pursuant to clause 6.15.4 of the NER, which requires that:

a) Each DNSP must submit to the AER for its approval, a document setting out its proposed CAM (clause 6.15.4(a) of the NER).

b) The CAM proposed by a DNSP must give effect to, and be consistent with, the CAG (clause 6.15.4(b) of the NER).

As required by clause 2.1 of the CAG, each DNSP is responsible for developing the detailed principles and policies for attributing costs to, or allocating costs between, the categories of distribution services that it provides. These detailed principles and policies must be included in the proposed CAM that Ausgrid submits to the AER for approval. This document contains detailed principles and policies for attributing costs to, or allocating costs between, the categories of distribution services Ausgrid provides.

Ausgrid's CAM has been prepared in accordance with the Cost Allocation Principles contained in section 6.15.2 of the NER. Specifically:

- The principles and policies used by Ausgrid to allocate costs between the different categories of distribution services are contained in this document, and are described in sufficient detail to enable the AER to replicate the reported outcomes through the application of the principles and policies (clause 6.15.2(1) of the NER).
- The allocation of costs has been determined according to the substance of a transaction or event rather than its legal form (clause 6.15.2(2) of the NER).
- Costs allocated to a particular category of distribution services are either:
  - Costs which are directly attributable to the provision of those services (clause 6.15.2(3)(i) of the NER).
  - Costs which are not directly attributable to the provision of those services but which are incurred in providing those services and which are allocated using an appropriate allocator (clause 6.15.2(3)(ii) of the NER).
- The reasons for using the method of the chosen allocator, and the numeric quantity (if any) of the chosen allocator, is clearly described in this document (clause 6.15.2(4) of the NER).
- The same costs are not allocated more than once (clause 6.15.2(5) of the NER).
- The principles, policies and approach used to allocate costs are consistent with the Distribution Ring-Fencing Guidelines (clause 6.15.2(6) of the NER).

[3] The three NSW DNSPs include Ausgrid, Endeavour Energy and Essential Energy.

- Costs which have been allocated to a particular service will not be reallocated to another service during the course of a regulatory control period (clause 6.15.2(7) of the NER).

In accordance with clause 6.15.1 of the NER, Ausgrid has a duty to comply with the CAM that has been approved by the AER.

Pursuant to clause 5.1(b) of the CAG, Ausgrid will apply its CAM in preparing:

- Forecast operating expenditure to be submitted to the AER in accordance with clause 6.5.6 of the NER.
- Forecast capital expenditure to be submitted to the AER in accordance with clause 6.5.7 of the NER.
- Prices for a negotiated distribution services determined in accordance with clause 6.7.1 of the NER.
- Annual statements in accordance with a future regulatory information instrument.
- Actual or estimated capital expenditure for the purposes of increasing the value of its regulatory asset base under NER schedule 6.2.1(f).

The records associated with Ausgrid's attribution or allocation of costs can be audited or verified by a third party as required by clause 3.2(a)(7) of the CAG.

3. Responsibility for the Cost Allocation Method

Ausgrid considers that the CAM complies with the requirements of the NER and the CAG and all regulatory financial information and reporting is prepared in a manner that is consistent with it. Ausgrid is committed to implementing this CAM in full following approval from the AER.

Within Ausgrid, overall responsibility for the governance and sign-off of the CAM is with the General Manager Finance & Compliance. The General Manager Finance & Compliance is a senior member of Ausgrid's executive leadership team and Chief Financial Officer ('CFO') of Ausgrid.

The Financial Controller is responsible for ensuring the CAM is updated, maintained and applied, including the internal monitoring and reporting of its application. The Financial Controller is responsible for the preparation of the annual Regulatory Accounts together with periodic internal regulatory reporting. The Financial Controller works in close collaboration with other groups within Ausgrid to communicate the requirements of the CAM and monitor Ausgrid's compliance with the CAM.

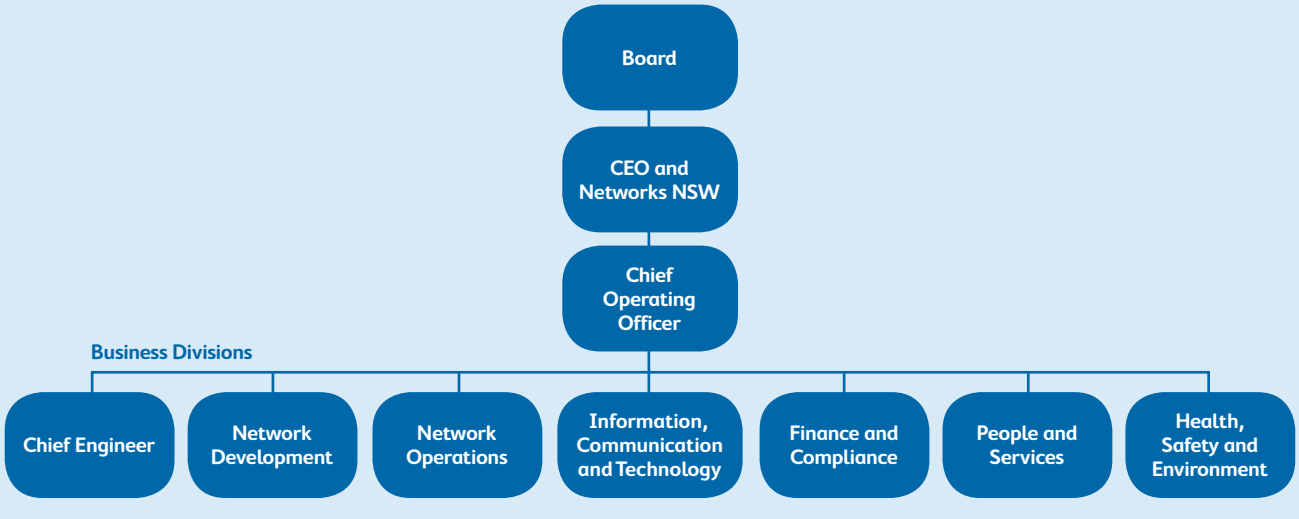
4. Corporate and Organisational Structure

Ausgrid's corporate and organisational structure has been developed to align with key business strategies. These strategies aim to meet the requirements of Ausgrid's customers and reflect the commitment to engaging with stakeholders on key issues to help achieve best outcomes.

Ausgrid delivers its business activities through seven business divisions, the Office of the Chief Operating Officer and Networks NSW which includes the Chief Executive Officer, Corporate Secretary and a common Group Executive Leadership team. Business divisions are split along the lines of those providing network services and those providing services to support the operational divisions. The corporate and organisational structure is illustrated in Figure 1 below.

Ausgrid has undertaken a detailed analysis of its shared cost allocators to identify the most appropriate cost drivers for each shared cost category.

Figure 1: Ausgrid's organisational structure as at 1 July 2013



The key responsibilities of each area of the business are as follows:

- ***Chief Engineer*** – responsible for overseeing the strategic management of the network within the regulatory framework. The division plans and develops the network, sets engineering policies and standards and monitors compliance.

- ***Network Development*** – responsible for the program management, development and delivery Ausgrid's system capital and system maintenance programs including life cycle program management and delivery of efficient and effective network asset management services.

- ***Network Operations*** – responsible for the delivery of the network capital and maintenance programs and has day-to-day responsibility for managing the network. Network Operations also has responsibility for managing customer connections and the interface with Accredited Service Providers (ASPs).

- ***Information, Communication & Technology*** – responsible for the ongoing management of Ausgrid's information technology and telecommunication systems and provision of this support to the wider organisation.

- ***Finance and Compliance*** – responsible for Ausgrid's financial operations, network regulation, compliance management and corporate governance functions, in addition to the delivery of TSA services to EnergyAustralia.

- ***People & Services*** – responsible for delivering performance through people, with a focus on supporting Ausgrid in delivering safe and reliable services to our customers, in addition to managing the organisations property, fleet, procurement & logistics functions.

- ***Health, Safety & Environment*** – responsible for supporting safe people, safe places and safe processes with the ultimate aim of achieving a workplace with zero harm, in addition to overseeing Ausgrid's environmental obligations.

- ***Office of the Chief Operating Officer*** – is responsible for leading Ausgrid's operations.

- ***CEO / Networks NSW*** – responsible for assisting the Board and CEO in undertaking reform of the industry consistent with the objectives of the NSW Government policy and in line with the Umbrella Cooperation Agreement (UCA).

Ausgrid is an integrated business providing both regulated services and unregulated services. These services are provided by each area of the business and are detailed in the remainder of this document.

On 1 July 2012, the Networks NSW (NNSW) operating model commenced with Endeavour Energy, Ausgrid and Essential Energy (DNSPs) having separate Boards with common Directors, a common Chairman and common Chief Executive Officer (CEO). A Group Management structure is being implemented to assist the Board and the CEO in undertaking reform of the industry consistent with the objectives of NSW Government policy and in line with the Umbrella Cooperation Agreement (UCA).

NNSW is not a legal entity and the personnel and associated costs of the NNSW group management have been captured by the individual DNSPs and equitably shared between the three DNSPs. The Umbrella Cooperation Agreement facilitates the management and cooperation of NNSW and each of the DNSPs. It enables the DNSPs to identify and implement reform measures and realise and share the initiatives through acting collectively and co-operatively.

Subsequent to 30 June 2013 the Energy Services Corporations Amendment (Distributor Efficiency) Legislation was passed. The amendment legislation provides for the appointment of a single board of directors that is to be the board of each of the energy distributors (Ausgrid, Endeavour Energy and Essential Energy) to act in the best interests of energy distributors as if they formed part of a combined operation. The legislation was proclaimed on 27 August 2013.

Although Ausgrid's organisational structure has changed as a result of this reform, Ausgrid will continue to apply the principles and policies as outlined in this document for attributing costs directly to, or allocating costs between, the relevant categories of services provided.

5. Distribution Services

Under clause 6.2.1(a) of the NER, the AER may classify distribution services provided by DNSPs as either:

- A direct control service.
- A negotiated distribution service.

Broadly, distribution services are the core services provided in ultimately delivering energy to a customer's premises. They include planning, constructing, maintaining and operating the electricity distribution network. Ausgrid also provides some non-distribution services, including retail business services to EnergyAustralia (previously TRUenergy) under the TSA and various other external business services. These services are not subject to regulation under the National Electricity Law or the NER.

The AER may choose to classify some services as negotiated distribution services having regard to the form of regulation factors and the classification of services applied in previous determinations or in other jurisdictions.

There are also a number of distribution services that the AER may not classify as direct control services or negotiated distribution services. These services are characterised by a high level of market contestability. For the purpose of the CAM, these unclassified distribution services are grouped with non-distribution services in the general category of 'Unregulated Services'.

Direct control services are further divided into two subclasses for classification purposes:

- Standard control services.
- Alternative control services.

Standard control services comprises of distribution services that are integral to electricity supply and are relied upon by the majority of our customers. Alternative control services are customer specific or customer requested services. These services are provided to a specific group of customers (e.g. local councils) or to customers who request the service[4].

Standard control services are further disaggregated into distribution standard control services and transmission standard control services. This is because Ausgrid's network includes high voltage transmission assets that operate in parallel and provide support to the higher voltage transmission network, and these assets are deemed to be Dual Function Assets for the purpose of economic regulation under the NER. The pricing for the services provided by Dual Function Assets may be decided by the AER to be subject to Part J of chapter 6A[5] of the NER. Such pricing arrangements necessitate the allocation of costs of providing standard control services between distribution standard control services and transmission standard control services. This allocation is discussed in section 6.7 below.

6. Cost Allocation Policies and Procedures

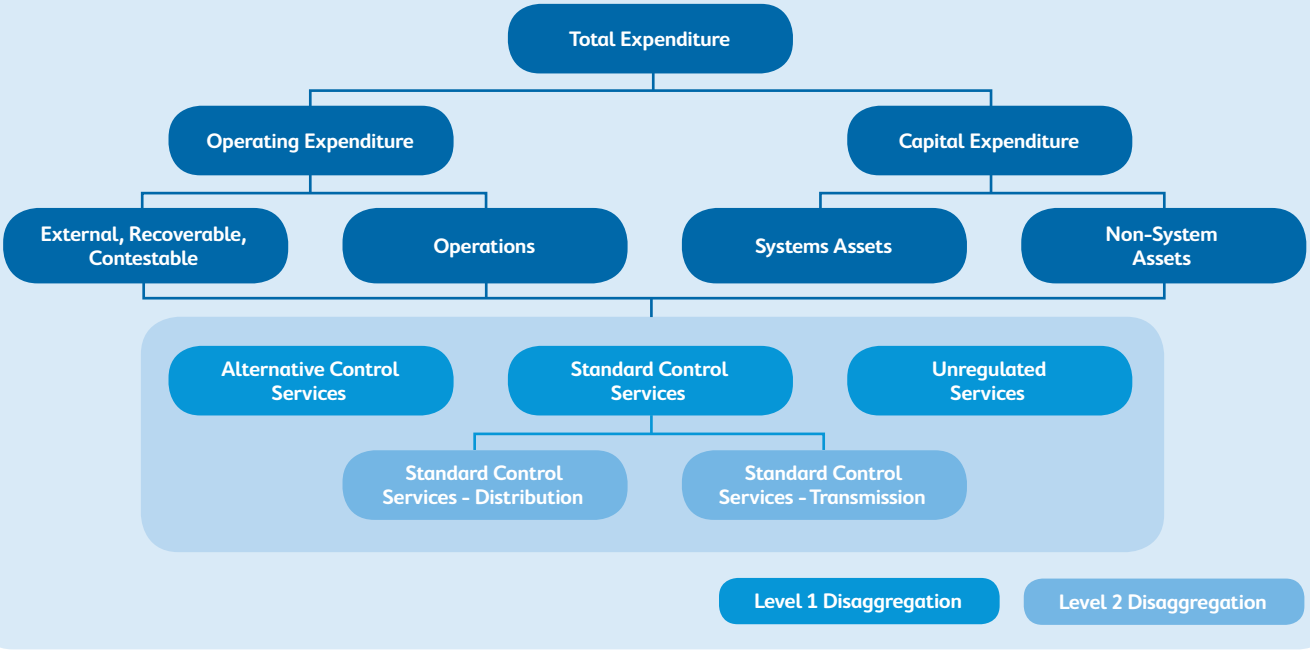
6.1 Ausgrid's costing overview

Figure 2 below summarises the cost hierarchy and cost disaggregation process for Ausgrid, which is reflected in Ausgrid's financial accounting and reporting systems.

[4] AER, Stage 1 Framework and approach paper, Ausgrid, Endeavour Energy and Essential Energy, Transitional regulatory control period 1 July 2014 to 30 June 2015; Subsequent regulatory control period 1 July 2015 to 30 June 2019, March 2013, p 8.

[5] Clauses 6.25(b) and 6.8.1(b)(1)(ii).

Figure 2: Summary of Ausgrid's cost hierarchy and cost disaggregation



Ausgrid's costing hierarchy and cost disaggregation process is summarised as follows:

1. Costs are captured in Ausgrid's financial management reporting system, SAP. Cost objects and cost elements (defined in section 6.2 below) are used within SAP to identify the nature and source of the expenditure incurred and identify the costs as either operating expenditure or capital expenditure. The distinction between operating expenditure and capital expenditure is based on the requirements of Australian Accounting Standards, NSW Treasury policies and generally accepted industry practice, all of which Ausgrid adheres to.

2a. Operating expenditure is identified as either external, recoverable, contestable or operations works. Costs incurred for external, recoverable and contestable works are directly attributed to unregulated services, as these services are provided in an effective competitive environment and are therefore not subject to regulation.

Costs incurred for operations work are directly attributed to, or allocated between, standard control services, alternative control services and/or unregulated services respectively. This is based on the nature of the expenditure and in accordance with the CAM. This is referred to as Level 1 disaggregation.

2b. Capital expenditure is identified as either relating to system assets or non-system assets. Costs incurred for system assets are directly attributed to either standard control services or alternative control services. Costs incurred for non-system assets are either directly attributed to, or allocated between, standard control services, alternative control services and/or unregulated services respectively. The attribution or allocation of capital expenditure to the relevant service category is based on the nature of the expenditure and in accordance with the CAM. This is referred to as Level 1 disaggregation.

3. Operating and capital expenditure attributed and/or allocated to standard control services are further disaggregated between distribution standard control services and transmission standard control services. This is based on the nature of the expenditure and in accordance with the CAM. This is referred to as Level 2 disaggregation and is discussed in section 6.7 below.

Costs that have been attributed or allocated to a category of distribution service are not reattributed or reallocated to another distribution service within a regulatory control period.

The remainder of section 6 outlines the detailed principles and policies applied in performing the above cost attributions and allocations with respect to operating and capital expenditure.

6.2 Overview of systems and costing principles

Ausgrid utilises SAP and TM1 as its main financial management reporting systems for both statutory and regulatory reporting purposes. SAP is used for cost collection, asset management and maintenance and transactional reporting purposes. TM1 receives extract data from SAP for analytical and summary reporting purposes. Together these systems are used to give effect to Ausgrid's CAM. Further, capital expenditure cost allocations and the calculation of allocation percentages are performed and maintained predominantly in Excel files.

6.2.1 SAP

SAP is Ausgrid's primary financial management reporting system. It is an Enterprise Resource Planning ('ERP') application designed to collect and organise data from each area of Ausgrid's business. SAP provides the functionality to record and report costs based on their attribution to, or allocation between, the categories of services which Ausgrid provides. This is done from a number of perspectives including by cost object and by cost element.

Cost objects are the lowest level at which transactions are aggregated in SAP and therefore the categorisation of costs by cost objects provides a means of capturing costs by the nature and source of the expenditure incurred. Cost objects also provide the ability to disaggregate costs between operating and capital expenditure based on the type of work undertaken. Table 1 below outlines the cost objects utilised by Ausgrid.

Table 1: Cost objects utilised by Ausgrid

Cost Object	Description
Project specific cost objects	
Network activities and Work Breakdown Structure ('WBS') elements	Network activities and WBS elements are used to collect costs related to operational and capital projects. Costs recorded and posted to these cost objects combine to provide the total cost for a specific project.
Plant maintenance work orders	Plant maintenance work orders are used to collect costs related to system maintenance and service processing. These cost objects are predominantly operational in nature with the exception of one particular plant maintenance order type that captures minor capital expenditure.
Service orders	Service orders are used to collect costs related to customer service work (external or third party activities). These cost objects are part of total business operating expenditure.
Other cost objects	
Internal orders	Internal orders are used to collect, monitor and settle direct and indirect costs at a lower level for relatively uncomplicated activities. These cost objects are part of operating expenditure. Each internal order is linked to a cost centre upon creation.
Cost centre	Cost centres are business units that perform or engage in specific types of work. Cost centres enable Ausgrid to capture costs according to their source within the organisation. Any expenditure that cannot be directly costed to another cost object remains on the cost centre as operating expenditure and is then recovered via an overhead cost centre.

Each network activity, WBS element, plant maintenance work order and service order will have various attributes assigned when the cost object is created. These attributes are used by Ausgrid to identify the nature of the expenditure incurred, the type of service provided and the type of asset created (for capital expenditure). Expenditure captured in cost centres and internal orders (which are linked to specific cost centres), relate to business units that engage in specific types of work.

Using the attributes assigned to cost objects and identifying the type of work performed by specific cost centres, Ausgrid can identify the nature and source of the expenditure incurred and perform the cost disaggregation process outlined in Figure 2 (on page 8).

While cost objects are used to capture and report expenditure according to the type of project, business activity or service provided, the nature of the specific costs incurred by Ausgrid are categorised according to "cost elements". Cost elements capture cost categories such as:

- Labour (normal pay, overtime and labour on-cost such as superannuation, workers compensation, sick leave and annual leave).
- Materials.
- Contracted services and consultancy.
- Other (this includes items such as vehicle expenditure, IT expenditure, rent, insurance and taxes).

These cost categories are common to both operating and capital expenditure. A cost object can incur different types of costs relating to multiple cost elements that make up the total expenditure for the particular cost object.

6.2.2 TM1

TM1 is a Microsoft Excel based application which summarises data extracted from SAP for analytical and reporting purposes. TM1 enables Ausgrid to apply calculations in accordance with the CAM to attribute costs to, and allocate costs between, the relevant service categories for operating expenditure. TM1 is the application that gives practical effect to the CAM.

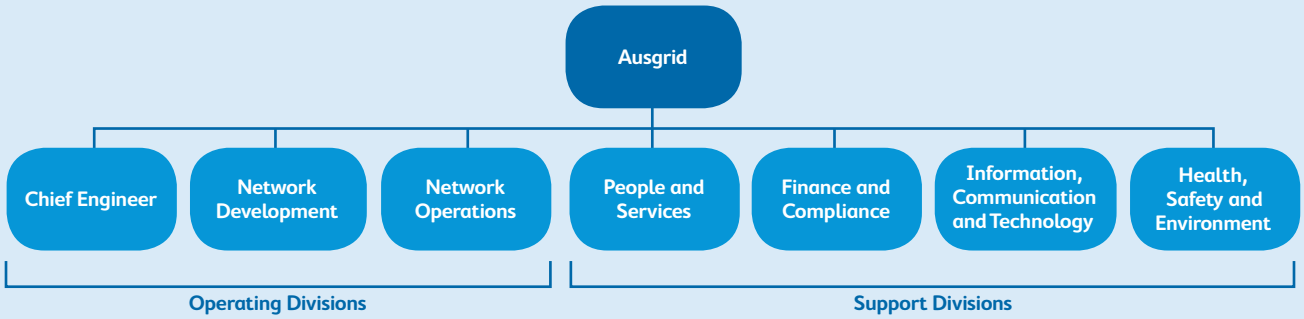
6.2.3 Microsoft Excel

To perform cost allocations for capital expenditure, Ausgrid obtains relevant data from SAP and uses Microsoft Excel to perform cost attribution and allocation calculations. Further, the calculation of allocation percentages is performed and maintained predominantly in Excel files, which are stored in Ausgrid's IT network directories.

6.3 Divisional costing procedures

As outlined in section 6.2 above, Ausgrid's financial system utilises multiple cost collection objects to capture expenditure. Cost objects aggregate to form a profit centre which identifies the division in Ausgrid for the operating and capital expenditure incurred. Profit centres are grouped into different divisions that reflect Ausgrid's organisational structure and are used for reporting purposes only. Figure 3 below illustrates Ausgrid's divisional structure for cost collection and reporting purposes.

Figure 3: Ausgrid's divisional structure for cost collection and reporting purposes



The support Divisions are responsible for corporate wide functions and include several business functions such as Information & Communications Technology, Finance (including TSA delivery), People & Services (included Human Resources, Internal Audit, Property, Fleet and Procurement), and Health, Safety & Environment.

Given the distinct differences in services provided between the operational divisions of Ausgrid and the support divisions, the costing procedures differ between these two groups.

6.3.1 Operational divisions

The operational divisions employ an absorption costing methodology for the allocation of costs incurred to project specific cost objects and operational cost centres[6]. The absorption costing methodology is used to identify the total cost to the organisation of undertaking specific services and includes a cascade of both specific corporate support functions and divisional management and business support costs. This results in costs incurred by specific corporate support functions, divisional management and business support cost centres being allocated to project specific cost objects or to operational cost centres engaged in a particular service activity.

Project specific cost objects and operational cost centres in turn define the nature of the work undertaken, or the type of asset constructed (for capital expenditure), and can therefore be identified as relating to a specific service category. As a result, the majority of costs incurred in each of the operational divisions are directly attributed to standard control services (distribution or transmission), alternative control services or unregulated services.

6.3.2 Support divisions

Costs incurred by the Corporate Support divisions are allocated to project specific cost objects by either:

- Direct allocation to project specific cost objects.
- Indirect allocation to project specific cost objects via an overhead allocation process.

It should be noted only a number of specific corporate support functions allocate their costs either directly or via an overhead allocation process to project specific cost objects. These groups and their costing procedures are set out below:

- ***Information & Communication Technology ('ICT')*** – the Information & Communication Technology division captures the costs associated with the delivery and support of ICT activities within the organisation. The ICT division allocates costs to project specific cost objects (operating and capital) when work is performed.

- ***TSA Services to Energy Australia*** – the Finance & Compliance division captures costs associated with TSA delivery. Costs relating to the delivery of the retail business activities on behalf of EnergyAustralia are allocated to TSA specific cost objects and treated as unregulated services.

- ***Property Management*** – the People & Services division captures the costs associated with property management. Costs incurred on property development and construction are allocated to project specific cost objects.

- ***Energy Services*** – costs incurred by the Energy Services branch within People & Services are captured on project specific cost objects which are directly attributed to, or allocated between, the relevant service categories.

- ***Commercial & Decision Support*** – the Finance & Compliance division captures costs associated with providing both financial and business support activities to the operational divisions. Costs incurred in the provision of these support activities are allocated to the operational divisions and subsequently allocated to project specific cost objects (operating and capital) when work is performed.

- ***Finance & Transaction Services*** – the Finance & Compliance division captures costs associated with providing both payroll and accounts payable functions to the overall business. Costs incurred in the provision of these activities are allocated to the operational divisions and subsequently allocated to project specific cost objects (operating and capital) when work is performed.

[6] Operational cost centres are those cost centres which perform specific operational tasks and exclude divisional management and business support cost centres.

- ***Human Resources*** – the People & Services division capture costs associated with providing employee relations and recruitment services to the operational divisions. Costs incurred in the provision of these support activities are allocated to the operational divisions and subsequently allocated to project specific cost objects (operating and capital) when work is performed.

- ***Procurement Services*** – the People & Services division captures the costs associated with providing procurement services to the operational divisions. Costs incurred in the provision of these support activities are allocated to project specific cost objects (operating and capital) in the form of a percentage applied to the direct cost of materials expenditure.

- ***Safety Operations*** – the Health, Safety & Environment division captures the costs associated with providing safety support services to the operational divisions. Costs incurred in the provision of these support activities are allocated to the operational divisions and subsequently allocated to project specific cost objects (operating and capital) when work is performed.

The expenditure captured in cost centres and internal orders (which are linked to specific cost centres), relate to business units that engage in specific types of work. Based on the nature of the work performed by the relevant cost centre, expenditure is directly attributed to, or allocated between, standard control services, alternative control services and/or unregulated services.

6.4 Expenditure attributed to cost objects

Cost objects can incur expenditure directly or via overhead allocations. Expenditure incurred by a cost object can be broadly categorised into labour and related expenditure, materials, contracted services and overhead. These are discussed in more detail below.

6.4.1 Labour and related expenditure

Labour and related costs include costs associated with Ausgrid's internal resources. Costs are attributed to cost objects by way of labour rates calculated for each employee based on individual salary and are inclusive of labour on-costs. Total labour costs for employees are calculated to include normal and overtime salaries and wages, associated payroll on-costs and employee / industry allowances. Payroll on-costs include public holidays, leave and superannuation.

Labour and related costs are charged at the applicable labour rates directly to cost objects by way of employee timesheets.

6.4.2 Materials

Material costs are attributed to cost objects. They include stock items distributed through Ausgrid's centralised warehouse and specific purchases of irregular or low turnover items such as specialised transformers, plant and equipment and computer hardware. For materials purchased and handled by Ausgrid's central warehouse, an on-cost is added to stock materials to cover the cost of warehousing and delivery of materials held in the central store. This is in the form of a percentage applied to the direct cost of the material.

Material costs also include items purchased from third parties for specific projects or services. The associated expenditure is attributed to the relevant cost object based on the invoiced amount.

6.4.3 Contracted services

Costs relating to services provided by external parties are treated similarly to materials in that they are attributed to the relevant cost object as incurred. They include costs relating to the external provision of consultancy services, contracted labour, capital construction, maintenance services, legal services and other professional services.

6.4.4 Overheads

Cost centres

Overheads are allocated to cost centres as incurred. Generally, overhead costs such as vehicle costs, course fees, travel expenditure, subscriptions, IT hardware leasing and desktop support expenditure are allocated to cost centres based on the individual utilising the service or incurring the expenditure.

Project specific cost objects

Overheads are allocated to project specific cost objects via the use of labour and non-labour overhead costing rates. Each operational cost centre will have a labour and non-labour overhead costing rate. When an employee from an operational cost centre charges time to a project specific cost object, the cost object will incur labour and non-labour overhead based on the application of the costing rates associated with the employee's cost centre. The driver for the application of the costing rates is direct labour dollars.

Costing rates allocate a portion of distributed corporate support and divisional overheads to project specific cost objects in order to identify the total cost to the organisation of undertaking specific activities or constructing specific assets. Costing rates are calculated based on budgeted figures and are reviewed periodically in order to ensure the correct amount of overhead is being allocated to relevant cost objects.

6.5 Directly attributable costs

Ausgrid utilises a comprehensive costing hierarchy that incorporates the use of various cost objects and cost elements. The attributes assigned to project specific cost objects when set up in SAP, or the nature and source of the expenditure for other cost objects, defines the following important characteristics of the costs incurred:

- Whether the costs are related to operating expenditure or capital expenditure.

Costs are allocated to services according to the substances of the transactions or events.

- If related to operating expenditure, whether the costs relate to external, recoverable, contestable or operations works.
- If related to capital expenditure, whether the costs relate to system assets or non-system assets.
- The nature of the expenditure incurred and the source of the expenditure.

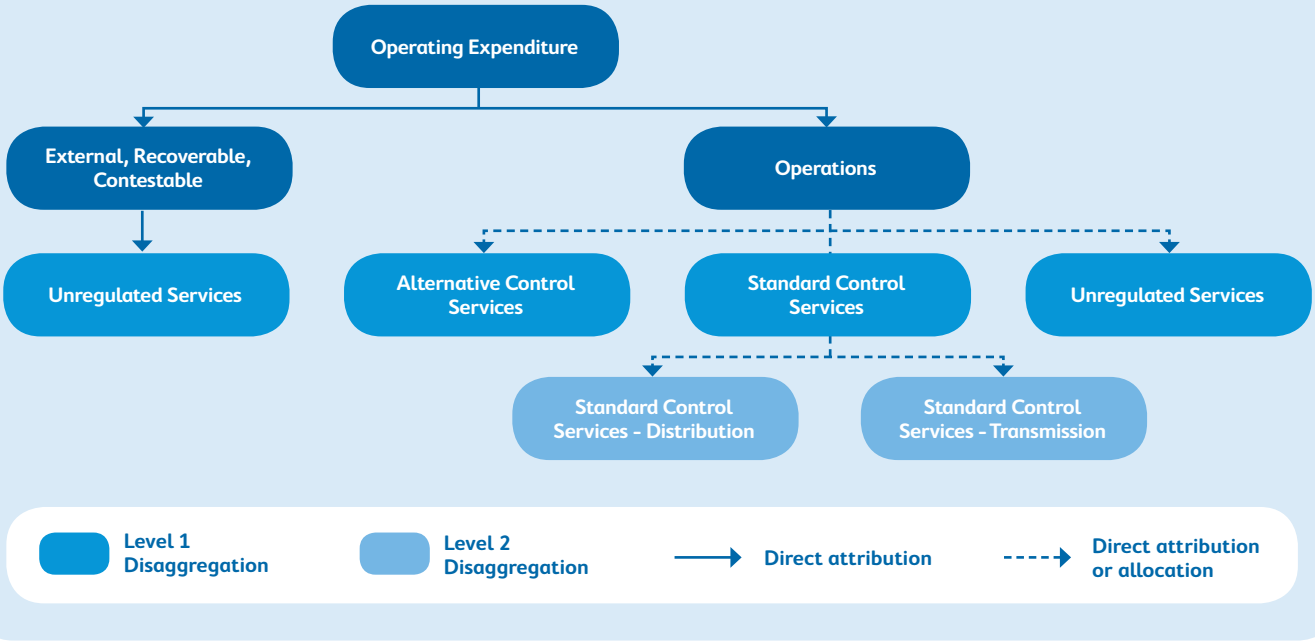
Using the attributes specific to each cost object (for project specific cost objects), or the nature and source of the expenditure (for other cost objects), and therefore based on the substance of the underlying transactions, Ausgrid identifies those cost objects which are directly attributable to a specific service category. For those cost objects identified as not being of a directly attributable nature (i.e. the cost is shared between several service categories), Ausgrid allocates the costs in accordance with section 6.6 of this document. A cost can only be either directly attributed to a service or allocated to a service based on the relevant allocator, and cannot be allocated more than once.

The procedure by which costs are directly attributed to a specific service category differs between operating expenditure and capital expenditure.

6.5.1 Operating expenditure

The disaggregation of Ausgrid's operating expenditure into different service categories involves the application of the cost allocation principles at different levels of disaggregation. This is shown in Figure 4 below.

Figure 4: Disaggregation of operating expenditure



The following procedures are applied to identify and directly attribute operating expenditure:

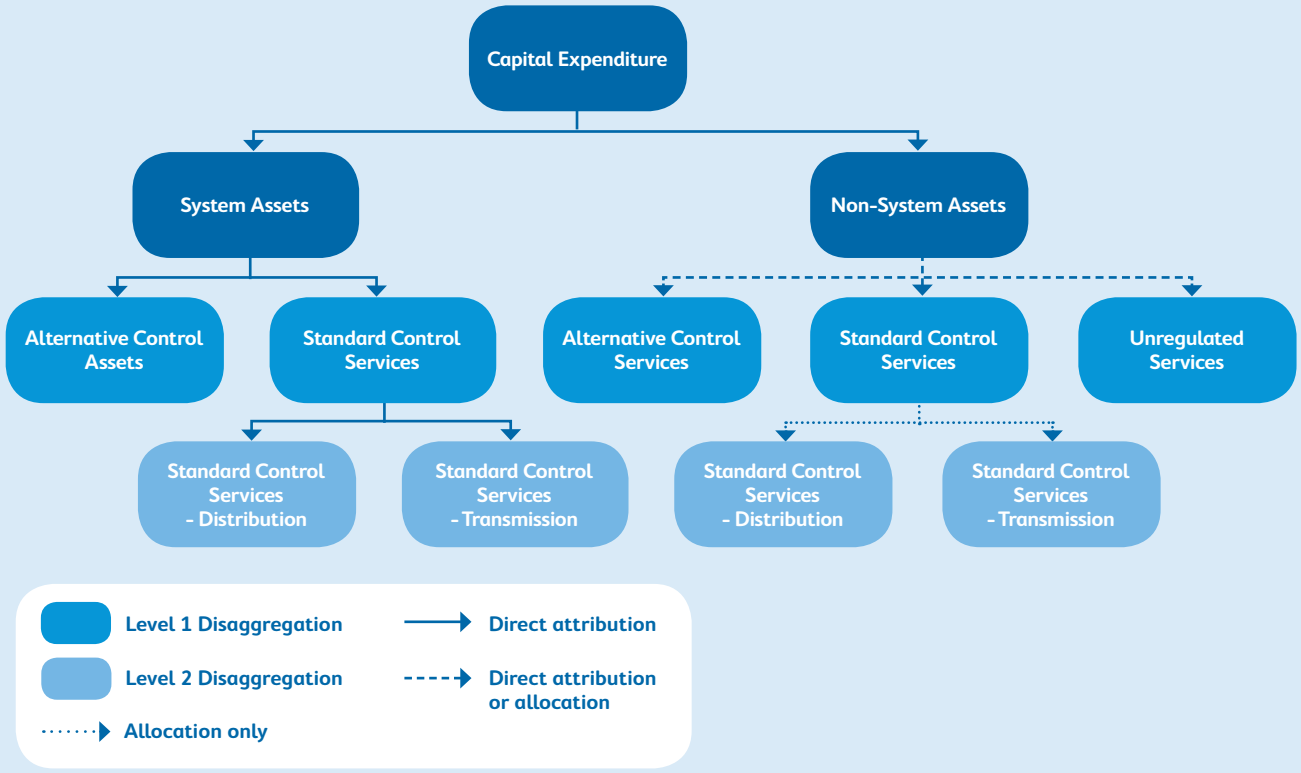
- All costs relating to external, recoverable and contestable works are directly attributed to unregulated services. This is because these services are provided in an effective competitive environment and are therefore not subject to regulation.
- Costs relating to operations work are directly attributed, if possible, to standard control services, alternative control services or unregulated services based on the attributes specific to each cost object (for project specific cost objects), or the nature and source of the expenditure incurred (for other cost objects).

Ausgrid identifies and disaggregates directly attributable operating expenditure at the cost object level, based on the characteristics unique to each cost object. Ausgrid maintains and reports on a significant number of cost objects (over one thousand per year), each of which is separately identified and analysed to determine if it represents a directly attributable cost for the purposes of the CAM. Ausgrid does not aggregate its directly attributable cost objects into broader categories, and for this reason, Ausgrid has not included the list of cost object classifications in this CAM. This information is available and can be provided to the AER upon request.

6.5.2 Capital expenditure

The disaggregation of Ausgrid's capital expenditure into different service categories involves the application of the cost allocation principles at different levels of disaggregation. This is shown in Figure 5 (on page 13).

Figure 5: Disaggregation of capital expenditure



The following procedures are applied to identify and directly attribute capital expenditure:

- Capital expenditure on system assets[7] is directly attributed to either standard control services or alternative control services. This attribution is performed based on the asset class.
- Capital expenditure on non-system assets which directly and entirely supports the provision of standard control services, alternative control services or unregulated services, are attributed to standard control services, alternative control services or unregulated services, respectively.

Table 2 (on page 14) contains the categories of directly attributable asset classes and the service category to which the capital expenditure is attributed.

[7] System assets are those assets that form the distribution, transmission or public lighting system network.

Table 2: Directly attributable capital expenditure

Asset class	Description	Service(s) allocated to
System assets		
System assets (excluding public lighting & metering)	Capital expenditure associated with planning, purchasing, replacing and constructing Ausgrid's electricity distribution network (excluding public lighting). Asset classes comprising system assets (excluding public lighting) include: • System land, easements and network buildings. Sub-transmission substations, transformers, mains, operational technology and network communications. • Distribution substations, transformers and mains.	Standard control services
Public lighting system assets	Capital expenditure associated with the provision of public lighting services.	Alternative control services
Metering system assets	Capital expenditure associated with the provision of type 5 and type 6 metering services.	Alternative control services[8]
Asset class	**Description**	**Service(s) allocated to**
Non-system assets		
Land and buildings	Capital expenditure associated with non-system land and buildings which directly and entirely supports the provision of standard control services, alternative control services or unregulated services. Directly attributed based on the purpose and use of the asset.	Standard control services, alternative control services or unregulated services
IT	Capital expenditure associated with IT infrastructure and systems which directly and entirely supports the provision of standard control services, alternative control services or unregulated services. Directly attributed based on the assessment of the business case and the divisions of the business benefiting from the project.	Standard control services, alternative control services or unregulated services
Meters contestable	Capital expenditure associated with the construction of meters for the contestable market.	Unregulated services
Energy light	Capital expenditure associated with the construction of security and display lighting for Ausgrid's commercial and industrial customers.	Unregulated services
Generation	Capital expenditure associated with the construction of renewable energy electricity generation facilities.	Unregulated services

6.6 Shared cost allocation

Once all directly attributable cost objects have been identified and attributed to the relevant service category, the remaining cost objects are considered to be shared costs (operating and capital). The majority of Ausgrid's shared costs (operating and capital) originate from the support divisions and Networks NSW and are allocated based on an appropriate causal or non-causal allocator. For each cost object comprising a shared cost, Ausgrid identifies:

- A causal allocator for the cost.
- A non-causal allocator if a causal allocator cannot be established without undue cost and effort.

Ausgrid calculates allocation percentages for each of these causal and non-causal allocators to allocate expenditure to standard control services, alternative control services and unregulated services.

6.6.1 Operating expenditure

As illustrated in Figure 4 above, shared costs relate only to operations work and are allocated to standard control services, alternative control services and unregulated services. Ausgrid has undertaken a detailed analysis and assessment of its shared cost allocators to identify the most appropriate cost drivers for each shared cost category. This includes the application of appropriate non-causal allocators for shared costs which are not material, or where a causal based method of allocation cannot be established without undue cost and effort. Table 3 below outlines the categories of shared operating costs[9], the relevant services to which the cost is allocated and the basis of the allocation.

[8] Operational cost centres are those cost centres which perform specific operational tasks and exclude divisional management and business support cost centres.

[9] These cost categories can be traced to vario us cost objects of Ausgrid's financial system.

Table 3: Shared operating expenditure

Shared cost item	Description	Service(s) allocated to	Basis of allocations (driver)	Casual/ Non-casual	Reason for allocator
Information and Communications Technology					
Office of the CIO Management	Costs associated with management of the Office of the CIO branch, ICT vendor & sourcing, IT strategy, IT systems architecture and IT governance.	• Standard control • Alternative control • Unregulated	Costs are allocated between the relevant services on the basis of FTE splits.	Causal	Reflects the strong causality between the number of staff and the need for CIO branch management and IT vendor sourcing.
Business Systems	Costs associated with the provision, maintenance and support of IT system software. This includes solutions management, portfolio delivery and management and technical services.	• Standard control • Alternative control • Unregulated	Costs are allocated between the relevant services on the basis of FTE splits.	Causal	Reflects the strong causality between the number of staff and the need and use of business technology services by Ausgrid personnel.
Infrastructure Services	Costs associated with the provision, maintenance and support of IT system hardware such as desktop delivery, server operations and infrastructure project management.	• Standard control • Alternative control • Unregulated	Costs are allocated between the relevant services on the basis of FTE splits.	Causal	Reflects the strong causality between the number of staff and the need and use of IT infrastructure services by Ausgrid personnel.
Distribution Systems and Telecommunications	Costs associated with the provision, maintenance and support of tele-communications systems.	• Standard control • Alternative control • Unregulated	Costs are allocated between the relevant services on the basis of FTE splits.	Causal	Reflects the strong causality between the number of staff and the need and use of telecom-munications infrastructure services by Ausgrid personnel.

Shared cost item	Description	Service(s) allocated to	Basis of allocations (driver)	Casual/ Non-casual	Reason for allocator
Finance and Compliance					
Finance & Compliance Management	Costs associated with management of the Finance & Compliance division.	• Standard control • Alternative control • Unregulated	No causal allocator: Costs allocated on the basis of weighted average revenue.	Non-causal	Reflects the relationship between strategic business management and overall business activity and performance.
Financial Controller	Costs associated with the management of the finance branch, corporate accounting and reporting, taxation, and treasury & cash management functions.	• Standard control • Alternative control • Unregulated	No causal allocator: Costs allocated on the basis of weighted average revenue.	Non-causal	Reflects the relationship between the work performed by the finance branch and overall business activity and performance.
Finance Transactions & Services	Costs associated with the operation of a centralised accounts payable and payroll services function.	• Standard control • Alternative control • Unregulated	No causal allocator: Costs allocated on the basis of weighted average revenue.	Non-causal	Reflects the relationship between the work performed by the finance branch and overall business activity and performance.
Commercial & Decision Support	Costs associated with the management of corporate financial systems and corporate budget process.	• Standard control • Alternative control • Unregulated	No causal allocator: Costs allocated on the basis of weighted average revenue.	Non-causal	Reflects the relationship between the work performed by the commercial branch and overall business activity and performance.
Project Management Office and Corporate Planning	Costs associated with the management of the PMO & Corporate Planning function.	• Standard control • Alternative control • Unregulated	No causal allocator: Costs allocated on the basis of weighted average revenue.	Non-causal	Reflects the relationship between the role of information services and overall business activity and performance.

Shared cost item	Description	Service(s) allocated to	Basis of allocations (driver)	Casual/ Non-casual	Reason for allocator
Finance and Compliance					
Legal services	Legal counsel and legal compliance	• Standard control • Alternative control • Unregulated	No causal allocator: costs allocated on the basis of weighted average revenue.	Non-causal	Reflects the relationship between the work performed by the legal branch and overall business activity and performance.
Information Services	Costs associated with document distribution services, document management and operation of the internal courier service, filing system and a corporate wide research and information service.	• Standard control • Alternative control • Unregulated	No causal allocator: costs allocated on the basis of weighted average revenue.	Non-causal	Reflects the relationship between the role of information services and overall business activity and performance.
Insurance	Insurance premiums and associated costs to cover general risks including: • Public liability (general, bush fire and professional) • Directors and officers liability • Workers compensation • Industrial special risk • Contract works • Fidelity guarantee • Corporate travel • Mobile plant and equipment • Motor vehicle • Personal accident.	• Standard control • Alternative control • Unregulated	Insurance cost relates to the premiums paid by Ausgrid for various policies. These premiums are allocated between the various services (e.g. standard control services and alternative control services) based on the nature of insurance. For example, the premium for bushfire liability insurance is directly attributed to standard control services as a cost of operating the network. There are also common insurance policies that are corporate wide and should be allocated to all services as they are shared costs. For example, director indemnity insurance and general liability insurance are allocated across services on the basis of weighted average revenue.	Causal	Reflects the relationship between type of risk insured, the assets covered by the insurance and the parts of the business benefiting from the insurance.
Contact Centre	Operation of Ausgrid's contact centres.	• Standard control • Unregulated	Costs are allocated on the basis of contact centre work load and the type of call received. Work load is calculated as call volume multiplied by average handling time.	Causal	Reflects the strong causality between the costs incurred by the contact centre and the volume of activity for the contact centre.

Shared cost	Description	Service(s) allocated to	Basis of allocations (driver)	Casual/ Non-casual	Reason for allocator
People and Services					
Human resources	Costs associated with the management of the human resources function and employee relations including personnel issues, industrial relations, organisational capability and change.	• Standard control • Alternative control • Unregulated	Costs are allocated between the relevant services on the basis of FTE splits.	Causal	The activity of the human resources business unit is driven by the size of the workforce. Therefore, this allocator reflects the strong causality between the resource effort to achieve the objectives of the human resources business unit and the size of Ausgrid's workforce.
Internal Audit	Costs associated with Ausgrid's Internal Audit function, including independent review of business strategies, systems and processes	• Standard control • Alternative control • Unregulated	Costs are allocated on the basis of the audit plan for the year and the areas of the business subject to audit. The audit plan for each year details the various audit projects to be undertaken for that year, as approved by the Audit & Risk Committee. The nature of each audit project would then determine the services to which the costs would be allocated based on the hours for each project.	Causal	Reflects the strong causality between internal audit's focus on specific areas of the business and the costs incurred by the internal audit function.
Corporate Communications	Costs associated with Ausgrid's Corporate Communications function, to include stakeholder management and sponsorships.	• Standard control • Alternative control • Unregulated	No causal allocator: costs allocated on the basis of weighted average revenue.	Non-causal	Reflects the relationship between stakeholder management, advertising and marketing and overall business activity and performance.
Property	Costs associated with management of the property branch and management of the property portfolio including rates, utilities and taxes, property acquisition and disposal and easement management relating to non-system assets.	• Standard control • Alternative control • Unregulated	Costs are allocated on the basis of floor space weighted by premium / non-premium rent.	Causal	Reflects the strong causality between the size and value of properties in Ausgrid's property portfolio and property management costs incurred by Ausgrid.

Shared cost	Description	Service(s) allocated to	Basis of allocations (driver)	Casual/ Non-casual	Reason for allocator
Health Safety and Environment					
Safety Management	Costs associated with the management of the safety services function including workers compensation and work health and safety.	• Standard control • Alternative control • Unregulated	Costs are allocated between the relevant services on the basis of FTE splits.	Causal	The activity of the safety services function is driven by the size of the workforce. Therefore, this allocator reflects the strong causality between the resource effort to achieve the objectives of the safety services function and the size of Ausgrid's workforce.

Shared cost	Description	Service(s) allocated to	Basis of allocations (driver)	Casual/ Non-casual	Reason for allocator
Networks NSW					
Office of the Chief Executive Officer	Costs associated with the Chief Executive Officer's office.	• Standard control • Alternative control • Unregulated	No causal allocator: costs allocated on the basis of weighted average revenue.	Non-causal	Reflects the relationship between strategic business management and overall business activity and performance.
Networks NSW including Corporate Secretary	Services associated with Networks NSW and provided to Ausgrid's Board, governance and compliance.	• Standard control • Alternative control • Unregulated	No causal allocator: costs allocated on the basis of weighted average revenue.	Non-causal	Reflects the relationship between the activities of the corporate secretary in supporting the Board of Directors and overall business activity and performance.
Ausgrid Board	Costs associated with the operation of Ausgrid's Board of Directors.	• Standard control • Alternative control • Unregulated	No causal allocator: costs allocated on the basis of weighted average revenue.	Non-causal	Reflects the relationship between the activities and focus of the Board of Directors and overall business activity and performance.

For operating expenditure, cost allocation percentages are calculated and updated annually. The information used for the calculation of allocation percentages is sourced from the business units in Ausgrid responsible for reporting the relevant information. For example, information for FTE splits is obtained from the Human Resources business unit. The percentages are then uploaded to TM1 to enable the allocation of operating expenditure between standard control services, alternative control services and unregulated services.

An example of allocations using weighted average revenue is contained in Table 4 below. The example weightings are based on the 2012/13 financial position as at 30 June 2013. These allocation percentages are updated annually based on forecast budget data.

Table 4: Example of weighted average revenue allocator calculation

Allocator	Standard control services		Alternative control services		Unregulated services	
	$'000	%	$'000	%	$'000	%
Weighted Average Revenue	2,923,559	89.8%	44,129	1.4%	289,782	8.9%

6.6.2 Capital expenditure

As illustrated in Figure 5 above, shared capital costs relate only to non-system assets and are allocated to standard control services, alternative control services and unregulated services respectively. Table 5 below outlines the categories of shared capital costs, the relevant services to which the cost is allocated and the basis of the allocation.

Table 5: Shared capital expenditure

Shared cost	Description	Service(s) allocated to	Basis of allocations (driver)	Casual/ Non-casual	Reason for allocator
Non-system land and buildings	Capital expenditure associated with non-system land and buildings which are used by Ausgrid personnel in the provision of standard control services, alternative control services and unregulated services.	• Standard control • Alternative control • Unregulated	Allocated between the relevant services on the basis of floor space weighted by premium / non-premium rent.	Causal	Reflects the strong causality between the size and value of the properties in Ausgrid's property portfolio and capital expenditure on non-system land and buildings to support Ausgrid's existing properties.
Furniture	Capital expenditure associated with furniture which is used by Ausgrid personnel in the provision of standard control services, alternative control services and unregulated services.	• Standard control • Alternative control • Unregulated	Allocated between the relevant services on the basis of FTE splits.	Causal	Reflects the strong causality between the number of staff and the need and use of furniture by Ausgrid personnel.
Plant and tools	Capital expenditure associated with plant and tools which are used by Ausgrid personnel in the provision of standard control services, alternative control services and unregulated services.	• Standard control • Alternative control • Unregulated	Allocated between the relevant services on the basis of FTE splits.	Causal	Reflects the strong causality between the number of staff and the need and use of plant and tools by Ausgrid personnel.
Fleet	Capital expenditure associated with the purchase and fit-out of vehicles.	• Standard control • Alternative control • Unregulated	Allocated between the relevant services on the basis of fleet charges which have been directly attributed to a category of service.	Causal	Reflects the strong causality between fleet costs which have been directly attributed to a category of service and the need and use of vehicles.
IT	Capital expenditure associated with IT infrastructure and systems which are used by Ausgrid personnel in the provision of standard control services, alternative control services and unregulated services.	• Standard control • Alternative control • Unregulated	Allocated between the relevant services on the basis of FTE splits.	Causal	Reflects the strong causality between the number of staff and the need and use of IT infrastructure by Ausgrid personnel.

The allocation of shared capital expenditure (which relates solely to non-system assets) is performed in Microsoft Excel and based on allocation percentages which are calculated and updated annually. The information used for the calculation of allocation percentages is sourced from the business units in Ausgrid responsible for reporting the relevant information. For example, information for FTE splits is obtained from the Human Resources business unit.

6.7 Disaggregation of standard control services between distribution and transmission

The disaggregation of standard control services costs between distribution standard control services and transmission standard control services is performed by identifying the relationship between:

- The nature of the cost captured by each cost object.
- The asset classes that are classified under the NER as either distribution network assets or transmission network assets.

The specific procedures applied to disaggregate standard control services costs are set out below.

6.7.1 Operating expenditure

The disaggregation of the total standard control services operating expenditure between distribution standard control services and transmission standard control services is performed using three allocation methods. These methods are:

A. Direct allocation to distribution standard control services or transmission standard control services of costs that specifically relate to these services, respectively. For example, costs incurred in the maintenance of distribution overhead cables are directly allocated to distribution standard control services[10].

B. Allocations based on distribution and transmission asset values. For example, land tax and IT operations and infrastructure costs are allocated between distribution standard control services and transmission standard control services based on the proportion of distribution and transmission asset values.

C. Indirect allocation of remaining support and corporate costs based on the proportion of costs that have been allocated between distribution

[10] Actual maintenance costs are directly allocated to distribution standard control services and transmission standard control services as these are recorded in our financial system. However, for forecast standard control services operating expenditure proposed in our regulatory proposal, we allocate this total forecast opex between transmission and distribution using actual operating expenditure as a proxy.

standard control services and transmission standard control services using the methods described in A and B above.

The allocation percentages for methods B and C above are calculated at the beginning of each regulatory control period based on operating expenditure forecasts and remain constant throughout the regulatory control period.

6.7.2 Capital expenditure

The disaggregation of the total standard control services capital expenditure between distribution standard control services and transmission standard control services is performed using two allocation methods. These methods are:

A. Capital expenditure on system assets is directly attributed to either distribution standard control services or transmission standard control services based on the type of asset constructed and whether the asset is considered a distribution or transmission asset in accordance with the definitions set out in the NER; and

B. Capital expenditure on non-system assets is allocated between distribution standard control services and transmission standard control services based on the value of distribution assets and transmission assets as a proportion of total assets, respectively.

The allocation percentage for method B above are calculated at the beginning of each regulatory control period based on capital expenditure forecasts and remain constant throughout the regulatory control period.

6.8 Related party costs

All related party transactions undertaken by Ausgrid are contained in its audited financial statements and audited Regulatory Accounts. Costs and revenues for related party transactions are directly attributed or allocated in accordance with the CAM, consistent with the methodology applied for transactions with external parties.

6.9 Negotiated distribution services

Whilst it is possible, Augrid does not anticipate any negotiated distribution services during the 2014-19 period. The AER in its Framework and Approach paper stated that none of the services provided by the NSW distributors are suited to being classified as negotiated distribution services[11] and consequently did not indicate that it would classify any services as negotiated distribution services.

There would be some scope for services provided by means of Ausgrid's transmission network to be negotiated distribution services. Clause 6.24.2(c) of the NER provides that "any service that is provided by a DNSP by means of or in connection with, the DNSP's dual function assets that, but for this Part would be a

negotiated transmission service under Chapter 6A is deemed to be a negotiated distribution service."

A negotiated transmission service is defined in Chapter 10 of the NER and includes connection services that are provided to serve transmission network users at a single connection point, (excluding connection services between network service providers) as well as use of system services agreed at the time of a connection where the network service provider has augmented or extended the network. Consequently a new connection to Ausgrid's transmission network would be a negotiated transmission service which must be treated as a negotiated distribution service. All costs associated with such a connection would need to be recovered from the relevant connection customer and they would be determined by applying the cost allocation principles and approach described in this CAM.

7. Record Maintenance

For the purposes of clause 3.2(a)(7) of the CAG, Ausgrid confirms that it maintains financial source documentation and records consistent with the accounting standards and statutory requirements to adequately demonstrate compliance with the CAM and the CAG.

Ausgrid will maintain records of cost attribution and allocation as follows:

- As described in section 6, cost collection and reporting is undertaken electronically using Ausgrid's integrated business management system (SAP). Cost attribution and allocation

[11] AER, Stage 1 Framework and approach paper, Ausgrid, Endeavour Energy and Essential Energy, Transitional regulatory control period, 1 July 2014 to 30 June 2015, Subsequent regulatory control period 1 July 2015 to 30 June 2019, March 2013, p8.

in accordance with the CAM is based on information sourced from SAP and performed in TM1 (for operating expenditure) and Microsoft Excel (for capital expenditure). This approach currently forms the basis for the independent verification of the annual Regulatory Accounts.

- The CAM will be applied to Ausgrid's audited annual financial statements to prepare the annual Regulatory Accounts and assign costs to their relevant services. As a result, the audited annual financial statements will form the basis of the annual Regulatory Accounts.
- Ausgrid will prepare and maintain appropriate documentation and information that supports the preparation of the Regulatory Accounts for submission to the AER. These records are provided to external auditors for the purpose of providing an opinion that the Regulatory Accounts are presented fairly in accordance with the approved CAM and the AER's Regulatory Information Notice ('RIN').
- As part of the audit of the Regulatory Accounts, Ausgrid's Chief Executive Officer, Chief Operating Officer, General Manager Finance & Compliance and other senior executives sign a Management Representation Letter, attesting to the auditors that the Regulatory Accounts have been prepared in accordance with the CAM. In addition, the Chief Executive Officer will sign a Statutory Declaration attesting that the Regulatory Accounts, to the best of his/her knowledge, is true and accurate in all material respects.
- Full documentation is maintained in preparation of the annual RIN. Supporting cost reports are generated and working files prepared, including cost allocations containing bases, as well as numeric and percentage values consistent with the approved CAM.
- Ausgrid's records management policy requires financial records to be retained for 7 years. In addition, records of expenditure and cost attribution and allocation are maintained in SAP and TM1 for at least 7 years.

8. Compliance with the Cost Allocation Method and the Cost Allocation Guidelines

The General Manager Finance & Compliance has overall responsibility for the governance and sign-off of the CAM. This includes ensuring Ausgrid complies with the CAM and the CAG. Ausgrid will monitor compliance with the CAM and the CAG through the following measures:

- The annual financial statements, SAP transactions and TM1 processes are reviewed by external audit. This audit is overseen by the General Manager Finance & Compliance.
- The Financial Controller is responsible for preparing annual Regulatory Accounts in accordance with the approved CAM and the CAG. Compliance is endorsed by executive management and reviewed by independent auditors. Furthermore, the Chief Executive Officer will sign a Statutory Declaration attesting that the Regulatory Accounts, to the best of his/her knowledge, is true and accurate in all material respects.

Ausgrid confirms that the detailed principles, policies and approach of this CAM are consistent with the ring-fencing guidelines as required by clause 2.2.6 of the CAG and clause 6.17 of the NER.

9. Effective Date

The CAM, once approved by the AER, will formally come into effect on 1 July 2014. However, the CAM will be applied for the purposes of developing expenditure forecasts for the regulatory proposals of the transitional regulatory control period and the subsequent regulatory control period.

Ausgrid will inform the AER of any material changes that occur during the period in which the approved CAM applies.