Attachment - Citipower's governance overview

Summary

This attachment describes Citipower's robust governance framework that ensures achievement of the best balance of outcomes for owners, customers, employees and customers. This attachment includes:

- a description of how Citipower integrates its corporate and regulatory objectives into its business investment decisions;
- a description of Citipower's rigorous cost control which ensures that all capital investment is appropriately appraised, monitored and managed to ensure delivery of optimum outcomes; and
- a description of how Citipower's procurement process ensures efficient spend on key plant and equipment

Governance policies and systems

Corporate governance is the processes and policy framework for the management, control and administration of an organisation. In the case of Citipower this includes the policies, procedures, systems, processes and regulations that are used to make decision relating to all aspects of the conduct of that business.

Corporate governance control covers the entire life of the project from identifying the need for the investment which typically emerges from the asset management plan and IT/Network strategy documents; establishing a business case which identifies and analyses the options in meeting the need for the investment, to project selection and approval processes. The investment approval process is outlined in more detail in the next section.

Citipower's Board has overall responsibility for corporate governance of the business including critical responsibilities of strategy setting, policy definition and compliance and monitoring of business performance. The Board has established Audit, Risk Management, Compliance, Remuneration and Capital Investment Committees (**CIC**) to assist in the execution of its duties.

The business plan sets the strategic direction of Citipower. The business plan is submitted annually to each respective Board for approval.

The Board's overall vision is:

"To profitably grow our business, as a key member of the Cheung Kong Group and Spark Infrastructure, such that we are a leading infrastructure and related services business"

The vision is integrated into the CitiPower investment decisions through two important elements. Firstly, all business cases must provide adequate information about how the

investment contributes towards the businesses' longer term strategic behaviour. Secondly the business case requires approvals from sub-committees of the Board including the Network Planning Committee (**NPC**) and the CIC. This ensures that Citipower's network planning and management objectives align with its regulatory and corporate strategic objectives.

All of Citipower's proposed capital investment is appraised and approved through a single process. This ensures that a consistent investment appraisal criterion is applied to all investment decisions. The approval process delegates approval responsibility appropriately to the NPC (>$150k), the CIC (>$300k) and the Board (>$5m), further, the process is subject to periodic review and audit.

It is a fundamental group requirement that investment appraisal requires that all capital expenditure must either enhance or protect existing shareholder value or is incurred to satisfy a non-financial requirement such as regulatory, quality, legal, environmental or health and safety compliance.

Citipower has provided the AER with a copy of the *Capital Expenditure Evaluation Policy Manual, Authorisation and Payment of Project Expenditure and Services Manual* and *Post Investment Review of Financial Planning Analysis* that outlines the investment evaluation process, in accordance with 1.1(c) of the RIN.

Cost control

Citipower has rigorous cost control process which ensures that all capital investment is appropriately appraised, monitored and managed to ensure delivery of optimum outcomes for shareholders, customers, the community and employees.

Citipower's cost control approach is dependent upon the nature and size of the project or program of works. Work activities are defined in three categories:

- program unit costs;
- project estimates; and
- project quotes;

Program unit costs refer to high volume, low cost programs of work for which discrete unit costs can be generated from historical figures. Project estimates and project quotes are provide for non-homogenous projects for which specific cost projections are required. Project estimates relate to projects costing less than $300k; project quotes relate to projects costing greater than $300k.

The program costing process employed by Citipower involves a number of stages:

- pre-optimisation;
- optimisation;

- approval; and
- periodic review and post-optimisation.

Pre-optimisation

Pre-optimisation begins approximately 9 months prior to the start of the financial year. Each business area collates a list containing a program of works likely to be required to be completed in the upcoming financial year. At this stage the timing of projects has not been finalised.

Each project is assigned to a Responsible Officer who will be responsible for the project. The Responsible Officer develops the scope and need for the project at the inception stage, and continues to control and monitor the budget through delivery of the project.

The Responsible Officer ensures that options analysis has been undertaken and that the proposed project is the most efficient and prudent to be implemented.

The business case for the proposed project must include:

- a description of the project, including works proposed to be undertaken, planning permits required etc;
- reasons for the investment. The business base must illustrate how the investment contributes towards the business' longer term strategic objective;
- alternatives considered. All reasonable alternative options and their respective advantages and disadvantages need to be described. In most cases alternatives considered should include a do nothing scenario and a deferred commencement date scenario;
- implications for the budget and long term financial plan. The business case will need to identify whether the project has been included in the budget/long term plan; and
- financial analysis (including a costs and benefits net present value calculation). The costs include direct expenditure, local overheads and corporate overheads. The benefits include cost reductions in labour, contracts and other expenses. Benefits may also include increases in revenue such as improvement in service levels, eg enhanced communications, or upgraded IT systems. Improvements in health and safety, regulatory compliance and reductions in risk are not included in the financial evaluation due to the difficultly of accurately quantifying these benefits. However, these benefits are still included and considered in the business case.

Approval

All of Citipower's proposed capital investment is approved through a single process. The approval process delegates approval responsibility appropriately to the NPC (>$150k), the CIC (>$300k) and the Board (>$5m).

Citipower's rigorous approval process is reflected by the level of requirements and delegation responsibility for assessing investments greater than $300k. The CIC ensures that an appropriate level of diligence has been undertaken for each investment case and that all investment is in-line with Citipower's strategic direction. CIC ensures this is achieved by;

- reviewing all capital investments greater than $300k;
- reviewing annual capital investment programs through the mechanism of annual budget meetings; and
- reviewing post investment.

The CIC consists of the following members:

- Chief Executive Officer;
- Chief Financial Officer;
- Manager Network Engineering;
- Manager Financial Planning & Economic Analysis; and
- Voting Members.

Project and program optimisation

The identification of the need for network investments and the timing of those investments are central to the demonstration of prudent expenditure. Projects and programs of work are developed in accordance with strategic planning documents such as the asset management plan and network operation and maintenance strategies. This process includes the identification of risk at a project level. Based on this risk assessment, the suite of projects is then optimised through the application of an optimisation tool. If the project has a high risk level it will be given a higher priority and approved, whilst a project with a low risk level might not be accepted. The output of this optimisation process is the initial capital works program for the coming year.

Figure 1 outlines the process used by Citipower to optimise its work program.

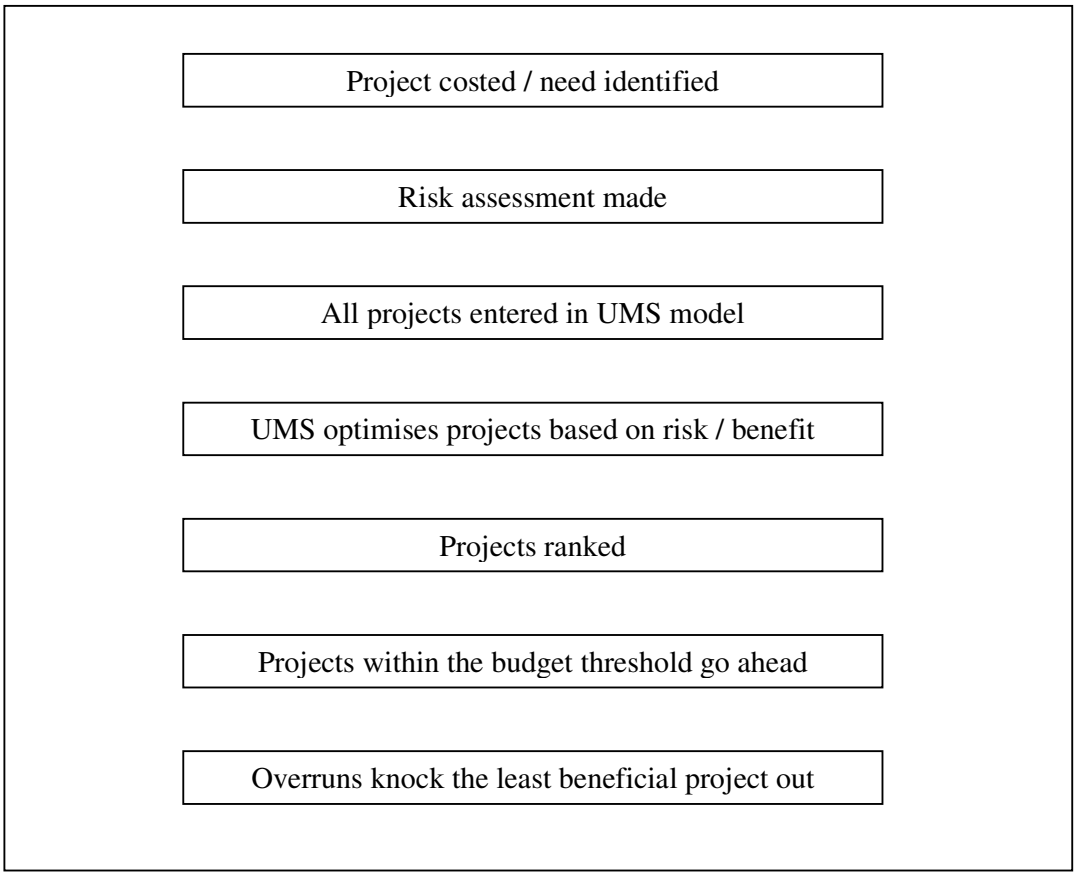

Figure 1 Project optimisation process

The model ranks the projects from the highest to lowest value based on a comparative assessment of risk categories: finance, customer and community, regulatory and compliance and employee commitment, which have been based on the strategic objectives of the company. A financial threshold is then applied that limits the total expenditure for the proposed projects.

The project and program optimisation approach to network planning and asset management results in:

- avoiding expenditures being made too early;
- consideration of the more expensive plant and equipment when making investment decisions;
- co-ordination across projects to gain synergies and economies of scale and scope;
- co-ordination across projects to ensure high risk items are addressed prior to lower risk items; and

- risk management, risk-assessment and asset condition monitoring.

Periodic review and post optimisation

Citipower ensures a tight control over expenditure with periodic reviews of each project. It is important that cost analysis and comparisons of actual expenditures against estimates be conducted on a continuous basis so that irregularities in expenditure can be investigated without delay.

The Citipower Responsible Officer is expected to monitor and control project expenditure and to assess and approve cost overspends and underspends. If the cost of a project is over or under a specified threshold the Responsible Officer will seek re-approval of the project through the same approval delegations as used for all projects.

At the conclusion of some projects, Citipower completes a Post Implementation Review detailing performance against a range of criteria, including comparison of actual project costs against initial budgeted costs.

The post optimisation review is a process aimed at assessing the efficiency and effectiveness of a capital expenditure decision and management of its implementation. The key objectives are to:

- support continuous improvement in the investment decision and implementation process; and

- allow for the identification and implementation of corrective actions on the project under review or in similar projects.

Procurement process of key plants and equipment

Citipower ensures tight budget control over the purchase of all its key plant and equipment. The purchase of key plant and equipment complies with the Business' Purchasing and Procurement Policy. The policy establishes principles and practices that govern purchasing and procurement activities for all goods, materials, services and intellectual property assets.

The Procurement Group is responsible for the procurement of direct and indirect goods and services. Direct goods and services relate to the network operations and core business activity such as the purchase for transformers etc. Indirect spend is non revenue generated and includes areas such as IT, stationary, print, engagement of consultants etc.

Figure 2 below represents the operational structure for procurement within the Business.

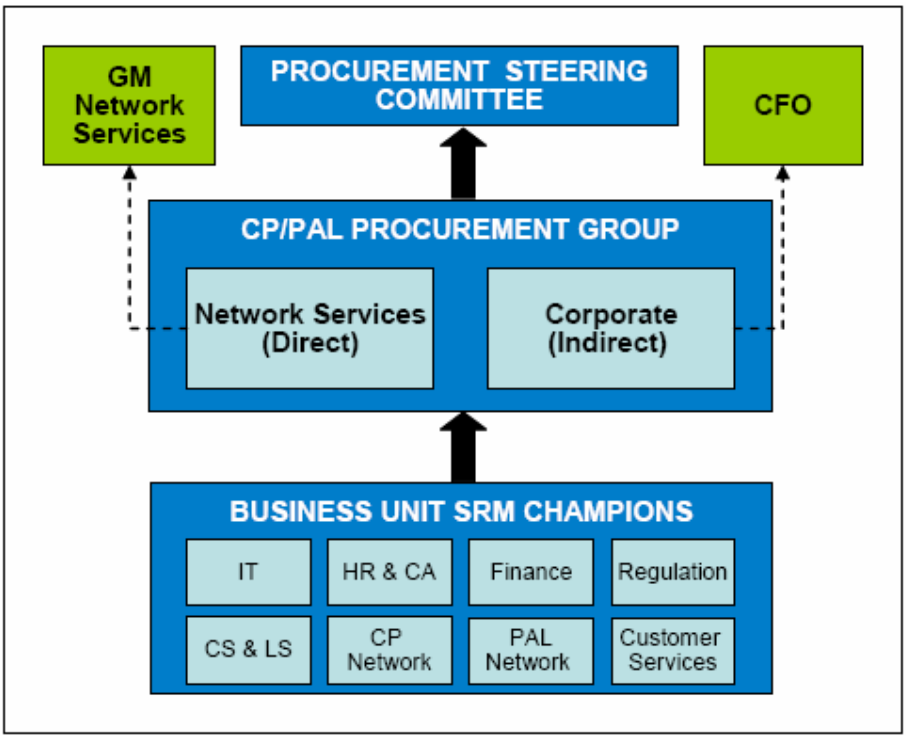

Figure 2 : Operational structure for procurement within the Business

The Procurement Group has responsibility for achieving best overall value for the business when acquiring or contracting for goods and services. Procurement will run the supplier engagement and is therefore responsible for facilitating the selection of the best supplier and assuring fair value for the price. The Procurement Group will seek quotations from at least three suppliers for contracts valued above $50,000.

The approval for a contract value from $150,000-$500,000 must be given by the CEO and CFO. The approval for a contract value above $500,000 must be given by the CEO and CFO (plus the Chairman of the Board).

The contract projected value is monitored. If the total aggregate of the extensions raised exceeds 20 percent of the contract value or timeframe of the contract within a 12 month period, the Procurement Group must re-evaluate the contract and determine if the price, terms or conditions should be renegotiated.

The contracts typically get renewed every three years and every contract has a fixed schedule of prices and must have terms and conditions that are 'technically acceptable'. As a consequence, the decision in determining the best supplier largely comes down to price and deliverability.

Review of Citipower's policies, practices and governance arrangements

Citipower engaged PB Associates to undertake a review of the policies, practices and procedures and governance arrangements used to develop the forecasts costs for capital expenditure. PB Associate's review is aimed at providing an independent view of the extent to which the application of these policies, procedures, practices and governance arrangements would lead to the expenditures being considered prudent and efficient, and in general accordance with what might be expected of good electricity practices.

PB Associates found a large number of indicators of good asset management practice. Citipower has provided the AER with a copy of PB Associates review, *Review of Citipower's policies, practices, procedures and governance arrangements* in accordance with 1.1(c) of the RIN.