18 January 2023

Mr Arek Gulbenkoglu
General Manager, Network Expenditure
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Email: AERInquiry@aer.gov.au

Dear Mr Gulbenkoglu

Submission on the AER's draft guidance note - impact of capitalisation on benchmarking

SA Power Networks welcomes the opportunity to comment on the Australian Energy Regulator's (AER's) draft guidance note – 'How the AER will assess the impact of capitalisation differences on our benchmarking', released for consultation on 31 October 2022.

Economic benchmarking is intended to be used to assess how productively efficient distribution network service providers (DNSPs) deliver electricity distribution services, enabling efficiency comparisons over time and between DNSPs. The benchmarking results should demonstrate DNSPs' relative efficiencies, with all other major sources of differences in operating environments accounted for in the modelling.

The AER's benchmarking model is currently based on operating expenditure (opex) derived under the 'frozen' 2014 Cost Allocation Methods (CAMs), it does not include any adjustment for differences in capitalisation practices across DNSPs. Capitalisation policies differ substantially between DNSPs. For example, SA Power Networks allocates 100% of corporate overheads to opex while other DNSPs allocate corporate overheads between opex and capex. Capitalisation differences should be accounted for directly in the AER's benchmarking modelling where possible, reducing non-efficiency related variability in reported benchmarking outcomes.

SA Power Networks is supportive of the AER's proposal to allocate a fixed proportion (100%) of corporate overhead expenditure to opex for benchmarking purposes. Adopting a consistent corporate overhead allocation rate across all DNSPs will improve the comparability of benchmarking results.

The core functions included within corporate overheads are reasonably consistent across DNSPs, including Finance, Information Technology, Human Relations, Regulation, Legal, Work Health and Safety and Property Services.

In comparison, the build-up of network overheads tends to vary more significantly across DNSPs, with some DNSPs allocating a greater proportion of costs as direct costs compared to other businesses. For example, in 2020/21 the proportion of direct costs that DNSPs attributed were between 61% and 80%[1], with the remaining costs allocated as corporate and network overheads. Noting the level of variability and complexity, we do not consider adjustments would be practical for network overheads at this time.

[1] Based on published 2020/21 Category Analysis RIN data.

Most DNSPs will need to update their benchmarking data to reflect the proposed corporate overhead allocation approach (ie 100% allocated to opex), this provides an ideal opportunity to transition to the current CAMs (frozen) for benchmarking purposes. This will provide greater alignment with current cost allocation practices and allowances and reduce reporting burden on some DNSPs, with only one set of data required for DNSPs that have made material changes to their 2014 CAM.

SA Power Networks has not made any material changes to its CAM since its inception in 2008. Changes have been limited to minor corporate structure and service classification changes[2]. Our cost allocation principles have remained materially consistent over this time. Noting this, and that SA Power Networks already allocates 100% of corporate overheads to opex, we do not foresee a need to recast any of our benchmarking data in response to the AER's draft guidance note.

In relation to the Software as a Service (SaaS) accounting treatment changes[3], we agree these changes are unlikely to impact the historical data set, with DNSPs continuing to account for implementation costs associated with SaaS as capex for regulatory accounting purposes until commencement of their next regulatory control period. We strongly believe this change in accounting practice, if adopted for regulatory accounting will have a material impact on benchmarking across the industry. The SaaS implementation costs will be incurred as non-recurrent opex costs, which will vary annually based on the cyclical nature of system implementations and upgrades required. For example, in 2020/21 SA Power Networks incurred costs of approximately $8.0 million in the implementation of SaaS systems, with approximately $4.5 million incurred in 2021/22.

We acknowledge the AER's proposal to capture additional cost information as these SaaS changes occur to enable greater understanding of the magnitude of the cost and its impact on benchmarking. Noting the SaaS accounting treatment change will be implemented by most businesses at the commencement of their next regulatory control period, we strongly encourage the AER to further consider how these non-recurrent costs may be isolated for benchmarking purposes as a priority.

Please contact Debbie Voltz on [redacted] if you require any further discussion or clarification of the above.

Yours sincerely

[redacted]

Patrick Makinson
EXECUTIVE GENERAL MANAGER GOVERNANCE AND REGULATION
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[2] Service classification changes related to the AER's reclassification of SA Power Networks' negotiated distribution services to alternative control services from 1 July 2020. These changes did not impact SA Power Networks provision of standard control services nor, therefore, benchmarking results.

[3] In April 2021, IFRIC specifically considered how an entity should account for configuration and customisation costs incurred in implementing these (SaaS) service arrangements and concluded that these costs should be expensed, unless the criteria for recognising a separate asset are met. Consequently, all costs associated with implementing a SaaS arrangement that do not meet the criteria of being separately recognised as an asset will need to be opex.