Attachment 4

Regulatory Depreciation

Revenue Proposal 2023-24 to 2027-28

31 JANUARY 2022

ElectraNet

Company Information

ElectraNet Pty Ltd (ElectraNet) is the principal electricity transmission network service provider (TNSP) in South Australia.

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Note

This attachment forms part of our Revenue Proposal for the 2023-24 to 2027-28 regulatory period. It should be read in conjunction with the other parts of the Revenue Proposal.

Our Revenue Proposal comprises the overview and attachments listed below, and the supporting documents that are listed in Attachment 14:

- Revenue Proposal Overview
- Attachment 1 – Maximum allowed revenue
- Attachment 2 – Regulatory asset base
- Attachment 3 – Rate of return
- Attachment 4 – Regulatory depreciation (this document)
- Attachment 5 – Capital expenditure
- Attachment 6 – Operating expenditure
- Attachment 7 – Corporate income tax
- Attachment 8 – Efficiency benefit sharing scheme
- Attachment 9 – Capital expenditure sharing scheme
- Attachment 10 – Service target performance incentive scheme
- Attachment 11 – Pricing methodology
- Attachment 12 – Pass through events
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- Attachment 14 – List of supporting documents

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4. Regulatory Depreciation

4.1 Key points

- We continue to apply accepted practice to depreciation consistent with the Rules requirements and the AER's recent revenue determinations. This includes the standard 'year by year' tracking approach.
- We have maintained the same asset classes and standard asset lives as approved in the current determination. Consistent with established practice, we have calculated the applicable asset life related to our line refurbishment projects to be undertaken during the period as a separate asset class. We have also added a new asset class in relation to leases, reflecting a change in accounting standards that requires certain lease expenses to be capitalised.
- Consistent with accepted practice, we are fully depreciating assets that will be decommissioned in the forthcoming regulatory period and no longer provide transmission services.
- Our total depreciation allowance will increase by approximately 11% from $307 million over the current regulatory period to $341 million over the forthcoming regulatory period. This largely reflects the growth in the size of the asset base driven by the large investments being completed in the current regulatory period.

4.2 Introduction

This attachment presents our forecast regulatory depreciation in relation to prescribed transmission assets during the 2023-24 to 2027-28 regulatory period. The information and calculations presented in this attachment are consistent with the Rules requirements and the AER's recent determinations on regulatory depreciation.

The remainder of this attachment is structured as follows:

- Section 4.3 describes our depreciation methodology;
- Section 4.4 sets out our asset classes and standard asset lives; and
- Section 4.5 sets out our depreciation forecast for the 2023-24 to 2027-28 regulatory period.

4.3 Depreciation methodology

Our regulatory depreciation methodology is consistent with Accounting Standard AASB 116 (property, plant and equipment), and meets the requirements of clause 6A.6.3 of the Rules.

We apply economic depreciation based on a straight-line method and standard asset lives for each regulatory asset class. Straight-line depreciation is a well-established method used to reflect the decline in the service potential of an asset over its economic life.

The key inputs to determining regulatory depreciation are:

- the opening RAB as of 1 July 2023, which is explained in Attachment 2;
- the expected inflation rate for the 2023-24 to 2027-28 regulatory period, which is set out in Attachment 3;
- the forecast net capital expenditure for the 2023-24 to 2027-28 regulatory period, which is explained in Attachment 5; and
- the standard asset life for each asset class, which is explained below.

We will continue to apply the year-by-year tracking method, consistent with our current approach. This method captures the timing of new additions for each asset class in the relevant year, which provides accurate information on the remaining asset lives. This method provides a more accurate depreciation allowance compared with the previous 'weighted average remaining life' approach, which establishes a single average remaining life for each asset class.

A significant number of network service providers now adopt the year-by-year tracking method. As a consequence, in 2020 the AER updated its Roll Forward Model (RFM) to include year-by-year tracking as a separate template file (depreciation tracking module), as an attachment to the RFM template file. We have completed this template in the RFM which is submitted with this Revenue Proposal.

We note that Schedule S6A.1.3(7) of the Rules requires us to provide the depreciation schedules by location. We understand that this requirement relates to clause 6A.6.3, which requires special treatment of assets dedicated to one user or a small group of users (not being a DNSP) with value exceeding $20 million. We do not have any transmission assets in this category. Our depreciation schedules are also supplied with this Revenue Proposal.

4.4 Asset classes and standard asset lives

Accounting standards recognise that a characteristic common to all physical assets held on a long-term basis, with the exception generally of land and easements, is that their useful lives are limited because their service potential declines over time. This decline can occur due to factors such as wear and tear, technology obsolescence and commercial obsolescence.[1]

The useful life of an asset is "*the period over which an asset is expected to be available for use by an entity*"[2] usually assessed and expressed on a time basis defined in terms of the asset's expected utility to the entity.

1 The possibility of obsolescence, both technical and commercial, is a factor which exists regardless of the physical use of an asset.

2 Accounting Standard AASB 116 Property, Plant and Equipment.

In determining the useful life, the accounting standard AASB requires the following factors to be considered:[3]

- the expected usage of the asset assessed by reference to the asset's expected capacity or physical output;
- expected physical wear and tear, which depends on operational factors such as the environmental conditions in which the asset is to be used and the repair and maintenance program;
- the anticipated technical life of the asset, that is, the period of time over which the asset can be expected to remain productive having regard to technical obsolescence;
- the expected commercial life of the asset, corresponding to the commercial life of its product or output; and
- legal or similar limits on the use of the asset, such as the expiry dates of related leases.

We propose to maintain the same asset classes and standard asset lives as approved in the current determination, as set out in Table 4-1 below. Average remaining lives of each asset category as at 1 July 2023 are also shown.

Consistent with established practice, we have also calculated the applicable asset life related to our line refurbishment projects to be undertaken during the period as a separate asset class.

We have also added a new asset class in relation to leases. The addition of this new asset class reflects a change in the accounting standards (AASB 16) which requires certain lease costs pertaining to 'right of use assets' to be capitalised.

Our lease costs are minor, comprising annual office rental, equipment leases and motor vehicle leases totalling $0.84 million. Given the limited costs involved, we have adopted a pragmatic and proportional approach so that the regulatory treatment of these costs reflects the new accounting standard. In particular, our approach is:

- to recognise the capitalisable lease payments as annual capex of $0.84 million incurred in each year of the 2023-24 to 2027-28 regulatory period;
- adopt a 1-year asset life for this new asset category (capitalisable leases); and
- receive the return on and return of capital in the following year.

Assets that are scheduled to be decommissioned following the completion of an asset replacement or augmentation project have been subject to accelerated write down. As decommissioned assets, they no longer provide prescribed transmission services and should therefore be removed from the RAB as soon as practicable. We conducted a review of asset replacement projects to identify the residual value attributable to each asset on decommissioning. From this analysis, we developed a forecast of asset write downs for the forthcoming regulatory period, which is $18.9 million.

Table 4-1 shows our proposed asset classes, standard lives and average remaining lives as of 1 July 2023.

3 The drafting presented here paraphrases paragraph 56 of AASB116.

Table 4-1: Asset classes and asset lives (years)

Asset Classes	Standard Life	Average Remaining Life
Substation Primary Plant	44.8	31.0
Substation Establishment	55	48.0
Substation Demountable Buildings	15	10.6
Substation Fences	35	31.4
Substation Secondary Systems – Electromechanical	27	6.7
Substation Secondary Systems – Electronic	15	9.7
Transmission Lines – Overhead	55	37.9
Transmission Lines – Underground	40	27.9
Transmission Lines – Insulators replacement 2013-18	27	22.4
Transmission line refit - 2018-23	48.1	48.1
Transmission line refit – 2024-2028	42.5	-
Network Switching Centres (e.g. SCADA)	5	3.0
Communication – Civil	55	46.6
Communication – Other	15	7.9
Communication – Other (post-2018)	10	7.8
Commercial Buildings	30	22.6
Computers, Software and Office Machines	4	3.2
Office Furniture, Movable Plant and Miscellaneous	10	5.0
Accelerated write down	5	5.0
Refurbishment	10	0.0
Refurbishment projects 2008-13	12.5	0.0
Equity raising costs – 2003 opening RAB and 2003-08 capital expenditure	43	28.0
Equity raising costs –2013-18	43	n/a
Right of use assets	1	0.0
Easements	n/a	n/a
Land	n/a	n/a
Synchronous Condensers	40	39.0
Equity Raising Costs	43.1	39.1

4.5 Forecast depreciation for the 2023-24 to 2027-28 regulatory period

Our forecast depreciation for the 2023-24 to 2027-28 regulatory period has been prepared in accordance with the methodology described in Section 4.3.

The resulting regulatory depreciation allowance for the forthcoming regulatory period is shown in Table 4-2.

Table 4-2: Forecast regulatory depreciation schedule ($m nominal)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Straight line depreciation	146.2	163.0	165.0	173.1	171.6	**818.8**
Inflation adjustment on RAB	86.2	88.6	90.8	92.6	94.2	**452.4**
Regulatory depreciation	59.9	74.4	74.3	80.5	77.4	**366.4**

This results in a depreciation forecast that is approximately 11% higher than actual and forecast depreciation in the current regulatory period, rising from $307 million (real) over the current period to $341 million (real) for the forthcoming regulatory period.

This increase largely reflects the growth in the size of the opening RAB from the major capital projects in the current regulatory period, including Project EnergyConnect and the Main Grid System Strength project, which will deliver substantial benefits to customers.

Increased depreciation reduces the value of the closing RAB at the end of the forthcoming regulatory period, which will reduce the level of revenue required from customers in future periods.

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