

**ELECTRICITY TRANSMISSION NETWORK** owners

# Information Guidelines

Response to AER's Draft Information Guidelines

18 July 2007



## Information Guidelines

### Response to AER's Draft Information Guidelines

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## 1. Introduction and Overview

This submission is made by the Electricity Transmission Network Owners Forum, which comprises ElectraNet Pty Limited, Powerlink Queensland, SP AusNet, Transend Networks Pty Ltd and TransGrid (“**ETNOF**”). Collectively, this group own and operate over 40,000 km of high voltage transmission lines and have assets in service with a current regulatory value in excess of \$9.1 billion.

ETNOF welcomes the opportunity to respond to the Australian Energy Regulator's (“**AER**”) Draft Electricity Transmission Network Service Providers Information Guidelines (“**the Guidelines**”).<sup>1</sup> Several responses are also made to the AER's accompanying Explanatory Statement Paper (“**Explanatory Statement**”).<sup>2</sup>

Good regulatory practice demands that regulatory instruments be consistent with their purpose, in this case established by the National Electricity Rules (“**the Rules**”), to promote efficiency and minimise compliance costs. In this context, the specific role of the Guidelines is to set out clearly the information that the AER requires, and the form of that information. This is to enable TNSPs to adapt their internal processes and systems to meet the AER's requirements at least cost — noting that these costs will ultimately be borne by electricity consumers.

ETNOF considers that, in a number of areas, the draft Guidelines require TNSPs to provide the AER with information that is not relevant, or is excessive, to their purpose — that is to inform the AER in its preparation for the next revenue cap review or for another purpose permitted under clause 6A.17.2. This information is beyond the AER's power to require, and will translate into higher costs to electricity consumers, with no commensurate benefit to the AER in performing its functions.

Given the limited purpose of the Guidelines set out in the Rules, ETNOF considers that:

- The only information required by the AER to inform itself for the next revenue cap review is information that facilitates assessment of forecast expenditure (i.e. information on actual expenditure, broken down in a manner that is relevant for forecasting) and information that permits the regulatory asset base to be rolled-forward (i.e. information on actual capitalisations, broken down into classes that permit regulatory depreciation to be calculated). Therefore, this information should be the limit of what TNSPs are required to provide annually.
- The Guidelines should not require:
  - information on accounting asset values (and in particular, any allocation of those to prescribed services);
  - separate information on negotiated services, or any other non-prescribed services;

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<sup>1</sup> AER, 2007, Electricity Transmission Network Service Providers Information Guidelines, Draft, June 2007.

<sup>2</sup> AER, 2007, Electricity Transmission Network Service Providers Information Guidelines, Explanatory Statement, June 2007.

## Information Guidelines

### Response to AER's Draft Information Guidelines

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- information on financial and taxation positions (and in particular, any allocation of those to prescribed services); or
- a map of the network that attempts to convey detailed information about each of the tens of thousands of individual network elements.
- If however the AER continues to require information that is additional to what is reasonably necessary in order to perform its functions under the Rules, then the scope of any audit should be carefully defined to exclude the audit of information that is not directly relevant.

Further, the draft Guidelines lack clarity in a number of important areas, which undermines the efficiency of the regulatory process and increases compliance costs. As a result, ETNOF considers that:

- Those clauses in the Guidelines which outline information or actions the AER may require be replaced either with a definitive requirement (if the benefits of the additional requirement exceed the costs imposed, and that it relates to information that the AER reasonably requires to satisfy the intended purpose of the Guidelines) or be omitted from the Guidelines altogether.
- The scope of any audit requirement must be set out clearly in the Guidelines, including all the AER's requirements with respect to such an audit. The effectiveness of the audit process will be reduced substantially if the Guidelines are not complete in setting out the AER's requirements. In addition, ETNOF considers the following measures would reduce the cost and impost of an audit without compromising the degree of assurance the AER would receive:
  - limit the scope of the audit to information that relates directly to the purpose of the Guidelines;
  - specify that the auditor is required to take, as given, a set of audited statutory accounts; and
  - specifically permit the use of the same audit firm as for the statutory accounts (which is current practice for a number of regulated businesses).

Amendment of the draft Guidelines to reflect the comments above would still result in the AER receiving the information necessary to undertake its functions and be consistent with good regulatory practice — the Guidelines would be consistent with their purpose, promote efficiency of the regulatory process and minimise TNSPs' compliance costs.

## Information Guidelines

### Response to AER's Draft Information Guidelines

## **2. Guidelines are not consistent with their intended purpose and role**

For some time, TNSPs have commented that the current Information Requirement Guidelines do not focus on the purpose for which the information is required. The principal purpose of the Guidelines is to collect a base set of information on historical outcomes to inform future revenue cap reviews (the remaining purposes are set out below). As a consequence, TNSPs currently incur substantial compliance costs in providing information to the AER that does not support this purpose. ETNOF is disappointed that the draft Guidelines fail to correct the current mismatch — rather the Guidelines continue to require TNSPs to provide the AER with information that is not relevant, or is excessive, to the AER's preparation for the next revenue cap review (or another purpose permitted under clause 6A.17.2).

In addition, the specific role of the Guidelines is to set out clearly the information that the AER will require TNSPs to provide to it, and the form of that information. This is to enable TNSPs to adapt their internal processes and systems to meet the AER's requirements at least cost — noting that these costs will ultimately be borne by electricity consumers. As a result, ETNOF is also concerned that the draft Guidelines lack clarity in a number of important areas, which undermines the efficiency of the regulatory process and increases compliance costs.

These points are elaborated on below.

### **2.1 Purpose of the Guidelines**

ETNOF considers that much of the information a TNSP would be required to provide to the AER under the draft Guidelines cannot reasonably be taken to satisfy the principal intended purpose of the Guidelines, which is to aid the AER's preparation for a TNSP's next revenue cap review.

The draft Guidelines are made under clause 6A.17.2, which requires the AER to prepare and publish guidelines that set out the manner and form in which *certified annual statements* are to be provided to the AER (clause 6A.17.2(d)). The purpose of the *certified annual statements* is limited to the following four matters:

- to collect 'financial, economic and operational' information in preparation for the next revenue cap review (of which assessing compliance with cost allocation principles is an important part) (6A.17.1(d)(3));
- to monitor and report on the TNSP's service performance under the applicable service performance incentive scheme (although the application of the results of this scheme to transmission prices presumably would be covered by the previous purpose) (6A.17.1(d)(4));
- to assess compliance on a year-by-year basis with the revenue cap and other constraints that apply under the prevailing regulatory determination (clauses 6A.17.1(d)(1)-(2)); and
- to provide information in relation to prudent discounts (clause 6A.17.2(e)(2)-(4)).

## Information Guidelines

### Response to AER's Draft Information Guidelines

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In addition, the Guidelines may, but are not required, to set out:

- a de facto submission guideline for pass through applications (clause 6A.17.2(f));
- a de facto submission guideline for prudent discount applications (clause 6A.17.2(g)); and
- information that TNSPs must provide to a coordinating TNSP where relevant (clause 6A.17.2(h)).

These seven (mainly independent) matters define the extent of matters the Guideline is required or permitted to deal with.

#### *Information for revenue cap review*

The AER's tasks during the review of a TNSP's revenue cap that are relevant to the information sought under the Guidelines are to assess:

- the TNSP's proposed forecast of operating expenditure;
- the TNSP's proposed forecast of capital expenditure;
- the TNSP's proposed allowance for regulatory depreciation; and
- the TNSP's proposed roll-forward of its regulatory asset base.

The historical financial information that the AER could reasonably require to undertake these tasks is very limited, and extends only to a TNSP's:

- historical expenditure, disaggregated in a manner that may be relevant to assessing forecasts of expenditure (such as under the same headings that were adopted during the last review); and
- historical capitalisations, disaggregated in a manner that is relevant to the calculation of regulatory depreciation and hence population of the roll-forward model.

It follows that, in preparing for the next regulatory review, only this information is of relevance to the AER. Consequently the draft Guidelines should only require a TNSP to provide this information to the AER. However, ETNOF notes that the draft Guidelines:

- require a TNSP to provide a significant amount of information on the book value of assets and book depreciation, even though accounting asset values are of no relevance to setting revenue caps. Moreover, the Guidelines appear to assume that accounting and regulatory asset values can be reconciled, even though the two are calculated under a different accounting convention, may have had a different starting value and may have different amounts recorded as capital expenditure.<sup>3</sup> In practice, there is unlikely to be any simple or meaningful way to undertake such a reconciliation;

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<sup>3</sup> Capital contributions are treated as an offset to capital expenditure for regulatory purposes but are treated as revenue (and the asset capitalised) for accounting purposes.

## Information Guidelines

### Response to AER's Draft Information Guidelines

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- continue to require detailed information about past capital expenditure, even though under the new *ex ante* regime for capital expenditure this is of little consequence for future revenue reviews. The Rules require actual past capital expenditure to be included in a TNSP's regulatory asset base and that the expenditure not be subject to an *ex post* regulatory assessment of prudence or efficiency;
- require disaggregated information to be provided for transmission services other than *prescribed transmission services* – namely for negotiated transmission services to be separately identified. The purpose of the Guidelines would only permit a requirement for *prescribed services* to be separately identified - that is, any non-prescribed services should be permitted to be aggregated; and
- would appear to require some allocation of 'below the line' items across business units, specifically costs relating to financing decisions and taxation. While these costs cannot be allocated in a meaningful way between activities, they are also irrelevant to the purpose of a revenue cap review. In particular, as financing and taxation costs are required by the Rules (consistent with standard regulatory practice in Australia) to be calculated using benchmark assumptions rather than actual costs.

The draft Guidelines also require TNSPs to supply the AER with a map of their respective current networks which identifies: the ratings of transmission lines; network plant; capital works projects (and anticipated completion dates); and the ages of network assets. This information is of no relevance until the time of a TNSP's next revenue cap review. Hence information of this nature more appropriately rests in the Submission Guidelines. That said, while much of the information noted above is available, it would be extremely difficult and very costly to attempt to consolidate all such information on a single map (which would need to be extremely large), without any apparent link to an improved regulatory outcome.

Further, the accompanying Explanatory Statement indicates that the AER intends to use the disaggregated statements provided under the Guidelines to assess whether a TNSP is sufficiently financially robust to continue to deliver on the National Electricity Market Objective. Testing the financial robustness of TNSPs is not one of the tasks or assessments the AER is required to make during a revenue cap review. Neither does the AER have any general role of undertaking such assessments. Accordingly, information required for this purpose is clearly outside of the scope of the Guidelines.

This issue raises an important matter of principle, as it suggests the AER may form a view on the appropriateness or otherwise of a TNSP's financing decisions — which would represent a significant shift from the use of benchmark assumptions about financing decisions that has characterised regulation in Australia to date.

ETNOF acknowledges the role of ongoing information provision to assist the AER in preparing for the next revenue cap review. However, it must be recognised that the provision of information is not costless (and in the cases highlighted above, is also unlikely to increase the efficiency of the regulatory process).

## Information Guidelines

### Response to AER's Draft Information Guidelines

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In summary, given the limited purpose required of the Guidelines, ETNOF considers that TNSPs should only be required to provide information on actual operating and capital expenditure, broken down in a manner that is suitable for that purpose. The Guidelines should not require:

- information on accounting asset values (and in particular, any allocation of those to prescribed services);
- separate information on negotiated services , or any other non-prescribed services;
- information on financial and taxation positions (and in particular, any allocation of those to prescribed services); or
- a map of the TNSP's network that attempts to convey detailed information about each of the tens of thousands of individual network elements.

However, if the AER continues to require information that is additional to what is reasonably necessary to fulfil its functions in accordance with the Rules, then such information requirements should be minimalist, and the AER should ensure its staff appreciate that accounting values essentially represent irrelevant information for regulatory purposes. In addition, the Guidelines should carefully constrain the scope of any audit to exclude such information, so as to minimise compliance costs and not unduly impede the efficiency of the regulatory process.

#### **2.2 Role of the Guidelines**

As noted previously, the specific role of the Guidelines is to clearly set out the information that the AER will require TNSPs to provide, and the form of that information. This is to enable TNSPs to adapt their internal processes and systems to meet the AER's requirements at least cost — noting that these costs will ultimately be borne by electricity consumers.

In this context, ETNOF believes that the draft Guidelines lack clarity in a number of important areas, which is likely to undermine the efficiency of the regulatory process and increase compliance costs.

For example, the Guidelines include a number of clauses which describe material or actions on the part of TNSPs that the AER may or may not require, albeit with little guidance as to when such requirements may be imposed. For example, the Guidelines contemplate that the AER may require:

- ad hoc information to be provided (clause 2.6);
- that an audit be performed (clause 2.8);
- regulatory adjustments to the disaggregation statements or to the statutory accounts (clause 2.10);
- that a TNSP provide Corporations Law compliant audited financial statements and regulatory financial statements at times other than the normal reporting period or other regulatory accounting dates (clause 2.13); and

## Information Guidelines

### Response to AER's Draft Information Guidelines

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- a TNSP to obtain an independent assessment of its one-year demand forecast (clause 3.3).

ETNOF questions whether the AER has the power to provide itself with the ability to make a decision on a matter in the future. However, more importantly, merely setting out the positions the AER may or may not reach provides little in the way of certainty to TNSPs about what is required. The ability for the AER to require 'regulatory adjustments' without setting out those requirements upfront in the Guidelines will also reduce the effectiveness of the audit process – this matter is discussed further in section 3.1.

As a general principle, ETNOF considers that those clauses in the Guidelines which outline information or actions the AER may require should be replaced either with a definitive requirement (if the benefits of the additional requirement exceed the costs imposed, and that it relates to information the AER reasonably requires to satisfy the intended purpose of the Guidelines) or alternatively be omitted from the Guidelines.

The AER has ample power to gain relevant information should it require it at a later date, or to perform a different regulatory function, through other parts of the regulatory regime (namely the National Electricity Law and the Rules). Therefore, removing mention of matters from the Guidelines will not affect the AER's ability to obtain information where this is required and passes the relevant statutory tests.

#### **2.3 Structure of Guidelines**

ETNOF suggests a more effective structure for the Guidelines would be around the seven largely separate topics that the Guidelines are required or permitted to deal with, which are:

- the *certified annual statement* that presents annual financial information (expenditure, revenue etc);
- the *certified annual statement* that presents information required to assess compliance with the revenue cap and other elements of the revenue determination (which may overlap with the above);
- the *certified annual statement* that presents information related to service performance;
- the *certified annual statement* that presents information related to prudent discounts;
- the (de facto) submission guidelines for pass through applications;
- the (de facto) submission guidelines for prudent discount applications; and
- the information required to be provided to a coordinating TNSP (where relevant).

ETNOF considers that adopting such a structure would be a useful discipline to ensure that each element of the Guidelines is clearly linked to a defined purpose.



## Information Guidelines

### Response to AER's Draft Information Guidelines

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### 3. Other high level issues

In addition to its concern that the draft Guidelines are inconsistent with their intended purpose and role under the Rules, ETNOF considers that a number of other matters require attention. These are discussed below.

#### 3.1 Audit provisions

##### (a) Requirement for an audit

It is imperative for the scope of any audit requirement be set out clearly in the Guidelines, including all the AER's requirements with respect to such an audit:<sup>4</sup>

- First, auditors will be obliged to comply with Australian Auditing Standards and undertake the audit against the requirements of the Guidelines. As a result, the effectiveness of the audit process will be reduced substantially if the Guidelines are not complete in setting out the AER's requirements.
- Secondly, additional (and unexpected) requirements for independent verification or audit will also have a substantial effect on the time required for a TNSP to prepare and to submit the information required by the Information Guidelines, and hence would need to be factored into a TNSP's planning from the outset.

These measures would go a long way to promoting the efficiency of the regulatory process and minimise compliance costs.

In addition, ETNOF considers it would be appropriate to minimise the cost, and impost, of an audit if the Guidelines were to:

- limit the scope of the audit to information that relates directly to the purpose of the Guidelines;
- specify that the auditor is to take, as given, a set of audited statutory accounts; and
- specifically permit the use of the same audit firm as for the statutory accounts (which is current practice for a number of regulated businesses).

As noted in section 2.1, ETNOF considers that much of the information a TNSP would be required to provide under the draft Guidelines is not necessary to aid the AER's preparation for the next revenue cap review. To the extent that the AER nevertheless determines such information must be provided by a TNSP, and essentially represents only 'contextual' information, that information should be explicitly excluded from the scope of any audit of the annual statements.

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<sup>4</sup> Accordingly, it is inappropriate for the Guidelines to refer, as they currently do (clause 2.8) to the need for the audit to "satisfy the AER's requirements" rather than setting out the AER's requirements in the guidelines.

## Information Guidelines

### Response to AER's Draft Information Guidelines

In any event, ETNOF considers that the scope of an audit of the annual statements should explicitly exclude the underlying statutory accounts (i.e. the base accounts). This approach would allow the auditor of the annual statements to accept a TNSP's statutory accounts (which are subject to an independent audit as a matter of course) as given, and avoid any potential obligation that might otherwise exist to audit such information where it was used to derive the annual regulatory statements. For similar reasons, an audit of the annual regulatory statements should be limited only to the current financial year, explicitly excluding prior year information that would already have been subject to an audit.

Finally, ETNOF considers there is no reason why TNSPs should not be permitted to use the same audit firm to audit both their statutory accounts and annual statements, and considers this flexibility should be explicitly permitted under the Guidelines.

ETNOF considers that amendment to the draft Guidelines to reflect these comments would substantially promote the efficiency of the regulatory process and assist in minimising a TNSP's compliance costs.

ETNOF notes that the AER may elect to undertake a further audit or other type of independent verification process after the submission of required information by the TNSP. However, such an audit or verification is beyond the purpose of the Guidelines and, consequently, any references to such an audit or verification should be deleted.

#### *(b) Provision of work papers and other supporting material*

The draft Guidelines require TNSPs to provide a large amount of supporting information to demonstrate or reconcile the values reported in the annual regulatory statements with their statutory accounts. For example, clauses 4.3 and 4.4 require TNSPs to reconcile certain expenditure and allocations with the statutory accounts, and the accompanying pro forma statements require TNSPs to include a workpaper that demonstrates this reconciliation.

However, the provision of workpapers or other material to reconcile or otherwise justify a TNSP's reported expenditure imposes further costs on TNSPs but serves no useful purpose. In particular, the purpose of the audit process is to provide assurance about how the reported expenditure has been derived, and the Guidelines provide the capacity for the AER to set out the standards required of audits. Accordingly, the requirements in the Guidelines to reconcile information back to statutory accounts, and the related requirements to provide supporting workpapers, should be deleted.

#### **3.2 Consistency with TNSP's Revenue Proposal**

In the context of the Submission Guidelines, and given that the National Electricity Rules contemplate that TNSPs would develop their revenue proposal, ETNOF commented that it would be appropriate for the AER to provide examples of proposals that it considered would meet the different elements of a Revenue Proposal, with this guidance being equivalent to the 'safe harbour' provisions common in tax law.

## Information Guidelines

### Response to AER's Draft Information Guidelines

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ETNOF acknowledges the importance to the efficiency of the regulatory process of maintaining consistency between information provided to the AER as part of a revenue proposal under the Submission Guidelines, and periodic information provided under the Information Guidelines. Such consistency would also be likely to minimise compliance costs on the part of TNSPs and regulatory costs that may be incurred by the AER.

Consequently, ETNOF notes that the final form of the Information Guidelines will, in a number of instances, be informed by the AER's consideration of comments received to the draft proposed Submission Guidelines.

#### **4. Issues of Detail**

##### ***4.1 Duplication of requirements in other instruments***

Clause 2.8 of the Information Guidelines, the audit assurance provision, replicates a requirement in the AER's Cost Allocation Guidelines. Given in both cases, the clause relates to information provided to the AER under the Information Guidelines, ETNOF considers that the efficiency and clarity of the regulatory process would be improved by deleting that clause in the Cost Allocation Guidelines.

##### ***4.2 Role of these Guidelines (1.3)***

ETNOF notes there are a number of inconsistencies through the draft Guidelines with respect to a TNSP's obligations. For example, the first paragraph of clause 1.3 states that "...TNSPs should submit the following information...", and clause 3.1 states that "Appendix A sets out the pro forma statements that should be used...". Whereas the second paragraph of clause 3.2 states that "...the pro formas must follow the pro forma statements set out in Appendix A."

##### ***4.3 Accounting principles and policies (2.2)***

ETNOF notes there is an apparent inconsistency between a TNSP being required to provide adopted regulatory accounting principles and policies only if requested by the AER, but being obliged to bring any changes to the attention of the AER.

ETNOF suggests that the obligation to quantify the impact of a change in a TNSP's accounting principles and policies on the financial reports be required only where the change is material.

##### ***4.4 Information to be provided shall be verifiable (2.7)***

ETNOF considers this clause should be definitive (consistent with the approach for the definition of materiality). For example, "the AER will apply the following standards of verifiable. Information will be verifiable if that information can be traced to a source document or assumption by the AER or an independent party such as an auditor" (note that the AER may also undertake verification under Clause 2.8).

In addition, ETNOF considers that the reference to "if the AER requires more detailed information than the TSNP provides,..." should be amended to "if more detailed information is required to verify the information,..." as more detailed information must be required in the context of verification.

## Information Guidelines

### Response to AER's Draft Information Guidelines

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#### **4.5 Depreciation (4.5)**

Given that the AER's PTRM model is most likely to form the basis for calculating regulatory depreciation, ETNOF suggests that for clarity, this section should be amended as follows:

"The AER will allow a TNSP to nominate its regulatory depreciation method.

Accounting Depreciation charges should be attributed to business segments in accordance with the disaggregation of assets that give rise to these charges.

Regulatory accounting adjustments shall be made to state the regulatory depreciation charge attributed to the prescribed services segment.

A TNSP shall disclose the basis for calculating the regulatory depreciation charge."

#### **4.6 Extraordinary items (4.7)**

This clause is no longer relevant as Accounting Standard AASB101 now prohibits the presentation of any income or expense items as an extraordinary item.

#### **4.7 Definitions**

ETNOF noted that clauses (g) and (i) of the definition of *related parties* appears to be inconsistent with, and may be more wide ranging than, Accounting Standard AASB124.

#### **4.8 Pro forma sheets**

- Cash Flow Statement – Prescribed Transmission Services (RFS Cf) and Disaggregation Statement – Cash Flows (DISAGG Cf) — the requirement to disaggregate the Cash Flow Statement should be removed for the reasons discussed above.
- Disaggregation Statement – Income (DISAGG Inc)— items below EBIT should not be disaggregated (all disaggregation items below EBIT should be shaded).
- Reconciliation of Property, Plant and Equipment – Prescribed Transmission Services (PTS Rec Assets) — the level of detail required in this statement is inconsistent with the regulatory determination methodology to calculate and roll forward the regulatory asset base. The level of detail provided should be based on written down values by class of asset and regulatory adjustments should be at total financial asset base level only.
- Asset Aging Schedule – Prescribed Transmission Services (PTS Asset Aging) — information required in this template is not consistent with the regulatory determination methodology. The regulated asset base is defined at the asset class level only and not at the individual asset level. A breakdown of the regulatory asset base by useful remaining life is not readily producible or reconcilable. This template is not relevant to regulatory reporting requirements and should be deleted.

## Information Guidelines

### Response to AER's Draft Information Guidelines

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- Summary of Provisions (DISAGG ProvSum) and Provisions Reconciliation – Prescribed Transmission Services (PTS ProvRec) — for the reasons discussed above, this template should be deleted.
- Related Party Transactions (INF RelPartTrans) — this statement should be relevant to “Prescribed Transmission Services” only. The requirement to disaggregate “Commitments” should be removed.
- Historic Capex by project category (HCE Cat) — This template is only relevant to the TNSPs’ regulatory determination submission and should not be required on an annual basis.
- Historic Capex (HCE Netw) (HCE Non Netw) — the level of detail requested in these templates is inconsistent with the Rules and should be deleted.