

APPENDIX 5

2010-15 Cost Allocation Method

Cost Allocation Method

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ENERGEX LIMITED
ABN 40 078 849 055



positive energy

Document Control

Version number	Date of Issue	Date of Commencement	Nature of Version and / or Amendment Summary
1.a	February 2009	1 July 2010	AER Submitted Version – ENERGEX Approved
1.b	March 2009	1 July 2010	Minor modifications

ENERGEX Limited (ENERGEX) commits to retain a listing of the Cost Allocation Method (CAM) and any modifications. Minor updates will be nominated as sub versions of the approved document, e.g. minor style or wording changes that do not alter the meaning will be designated as version 1.b. Substantive changes that amend content or meaning will be given a new version number, e.g. changes to the attribution of costs or the allocation of costs will be designated as version 2.a. Modifications to this document will be in accordance with the National Electricity Rules (NER) and the Cost Allocation Guidelines (“the *Guidelines*”) requirements.

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1 Background

ENERGEX Limited (ENERGEX) is one of Australia's largest distributors supplying electricity to a population of around 2.8 million residents and businesses in the high growth region of South East Queensland.

ENERGEX is a Government Owned Corporation (GOC) and holds a distribution authority to operate the electricity distribution network in South East Queensland. ENERGEX is also registered as a Distribution Network Service Provider (DNSP) in the national electricity market.

As a DNSP, ENERGEX is required under Clause 6.15.4 of the National Electricity Rules (NER) to submit its Cost Allocation Method (CAM) to the Australian Energy Regulator (AER) for approval. This CAM must give effect to and be consistent with the AER's Cost Allocation Guidelines (the '*Guidelines*').

2 CAM format and contents

Clause 3.2 of the *Guidelines* sets out the format and contents of a DNSP's CAM. This document complies with Clause 3.2 of the *Guidelines* as follows:

- The document control page sets out information regarding ENERGEX's commitment to recording the version number, history and date of issue for the CAM document.
- Section 2 outlines ENERGEX's CAM format and contents summary.
- Section 3 describes:
 - the nature, scope and purpose of ENERGEX's CAM (Clause 3.2(a)(3)); and
 - ENERGEX's commitment to implementing the CAM (Clause 3.2(a)(2)).
- Section 4 articulates:
 - accountabilities for implementation of the CAM (Clause 3.2(a)(3)(A));
 - responsibilities within ENERGEX for updating, maintaining and applying the CAM and for monitoring or reporting on its application (Clause 3.2(a)(3)(B)); and
 - monitoring of compliance with the CAM and *Guidelines* (Clause 3.2(a)(8)).
- Section 5 details:
 - ENERGEX's corporate and operational structure which enables delivery of its distribution services (Clause 3.2(a)(4)); and
 - Related party transactions.
- Section 6 specifies the categories of distribution services that ENERGEX provides, to which costs are to be attributed or allocated and the types of persons to whom these services are provided (Clause 3.2(a)(5)).
- Section 7 outlines the principles and policies to be used for attributing costs directly to, or allocating costs between, categories of distribution services that meet the requirements of Clause 2.2 of the *Guidelines* (Clause 3.2(a)(6)).
- Section 8 discusses the reconciliation and clearance of on-cost and overhead pools.
- Section 9 outlines the methodology for replicating the CAM outcomes on regulatory accounts.
- Section 10 discusses the structure of ENERGEX's work papers.
- Section 11 considers CAM consistency.
- Section 12 describes how ENERGEX will:
 - maintain work papers and records of the attribution and allocation of costs to, or between, categories of distribution services (Clause 3.2(a)(7)); and
 - ensure that allocations and attributions can be verified through assurance, audit or other third party verification process in accordance with Clause 5.3 of the *Guidelines*.
- Section 13 details ENERGEX's monitoring and compliance regime.
- Section 14 provides the operative date for the CAM and its publication details.

3 Statement of nature, purpose and scope of the CAM

3.1 Nature, purpose and scope of this CAM

Nature: This document details ENERGEX's CAM for submission to the AER in accordance with the requirements of Chapter 6 Part F of the NER and the *Guidelines*. ENERGEX has submitted this CAM to the AER for approval.

Purpose: Chapter 6 Part F of the NER requires a DNSP to develop detailed principles and policies to allocate costs between different categories of distribution services. This CAM documents the detailed principles and policies used to allocate costs between different categories of distribution services. This CAM gives effect to and is consistent with the cost allocation principles and the *Guidelines*.

Scope: This document will be used by ENERGEX to demonstrate that ENERGEX's CAM gives effect to and is consistent with the *Guidelines* published by the AER in June 2008. To this end this document sets out the detailed principles and policies for attributing direct costs and the allocation of indirect costs between different categories of electricity distribution services.

This CAM will be used by ENERGEX in the preparation of capital and operating expenditure forecasts included in ENERGEX's regulatory proposal and regulatory financial reporting to the AER in accordance with the NER.

ENERGEX commits to this CAM and its principles and policies. Any modifications required to this document to ensure its ongoing relevance to the business will be undertaken in accordance with the NER and *Guidelines*. ENERGEX will apply the CAM consistently over time, yet retain flexibility to accommodate year-on-year changes to reflect matters such as organisational restructure or refinements to cost drivers, cost behaviour, cost attribution and cost allocation.

4 Accountability for implementing the CAM

Accountability for implementing the CAM resides with the Office of the Chief Financial Officer.

4.1 Responsibility for updating, maintaining and applying the CAM

The Office of the Chief Financial Officer has overall responsibility for updating, maintaining and applying the CAM.

Reporting to the Chief Financial Officer, the Group Managers of Financial Control and Regulatory Affairs are responsible for updating, maintaining and applying the CAM.

Specifically the Group Manager Regulatory Affairs is responsible for the application of the CAM for the production of regulatory financial reporting. The Group Manager Financial Control is responsible for the financial systems in ENERGEX.

4.2 Internal monitoring and reporting on the CAM's application

ENERGEX will ensure that accounting records reflect the application of the CAM in the production of regulatory financial reporting.

ENERGEX will internally review and monitor application of the CAM for accuracy and completeness. ENERGEX will formally monitor and report on the CAM's application through its internal and external audit programs.

Audit or other expert opinions will be supplied where required by the NER, to comply with a duly authorised request by the AER, and/or to comply with appropriate legislation. Opinions will be in accordance with standard auditing practice, sampling techniques and materiality. Expert advice will comply with other applicable standards and include the application of professional judgement.

5 Corporate and operational structure

ENERGEX is a company GOC under the *Government Owned Corporations Act 1993*. It holds a Distribution Authority that is administered by the Director-General of the Queensland Department of Mines and Energy to supply electricity using its distribution system across South East Queensland.

5.1 ENERGEX company structure

ENERGEX is an electricity distribution network business, supplying electricity to a population of around 2.8 million people and businesses in South East Queensland. Primarily a network business, ENERGEX also undertakes a range of non regulated activities. These non regulated activities include demand side solutions, embedded generation, Type 1- 4 contestable metering, and energy efficiency products.

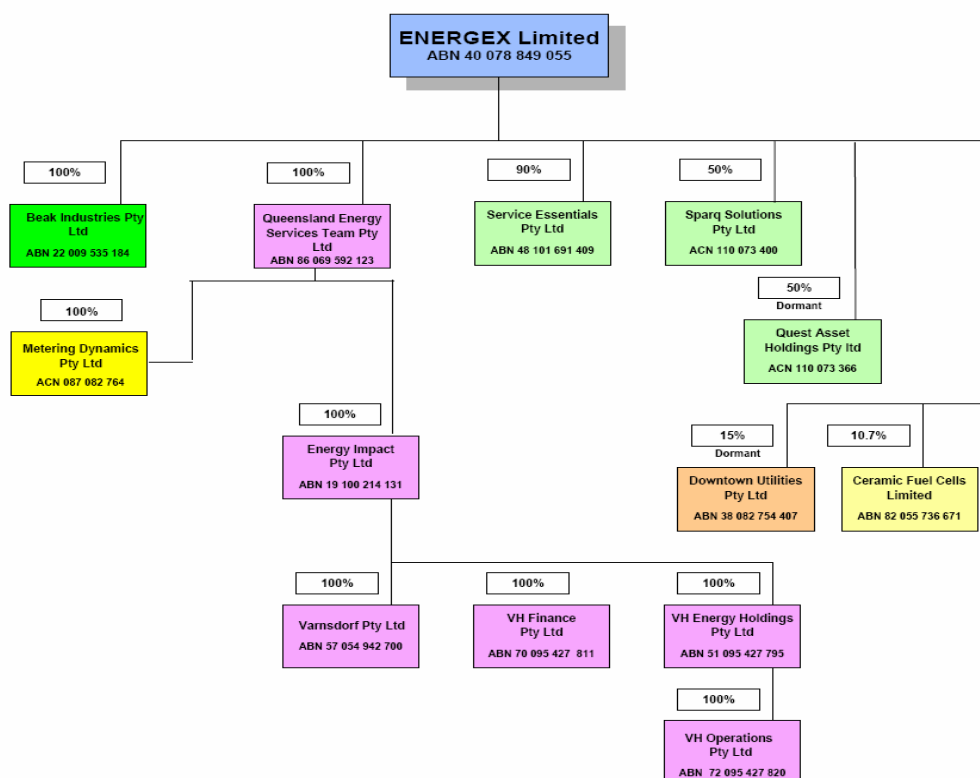
In comparison with ENERGEX core operations, the non regulated activities are not material in terms of ENERGEX's consolidated financial position, financial performance or number of employees.

ENERGEX's legal structure contains a number of entities that are standalone in that their operations, systems, processes and practices are wholly independent of ENERGEX. The majority of these entities do not receive a material level of support from ENERGEX; hence allocations of shared costs to these areas are not material.

ENERGEX's current legal entity structure is shown in Figure 5.1. Some of these entities are dormant and currently inactive, these are discussed in section 5.1.3.

Please note that this CAM and related working papers refer to Metering Dynamics being an active department within ENERGEX. There is also a dormant company that shares the same name but does not trade.

Figure 5.1: ENERGEX company structure – 22 January 2009



5.1.1 Parent Entity within the ENERGEX Group

The parent entity is ENERGEX Limited ABN 40 078 849 055. ENERGEX Limited is the legal owner of the regulated assets associated with its distribution authority in Queensland and is also the entity that is responsible for the provision of distribution services.

5.1.2 Holding companies

Holding companies are subsidiary companies within the ENERGEX group that hold investments in other entities or subsidiaries. Holding companies within the ENERGEX legal structure are as follows:

- Queensland Energy Services Team Pty Ltd ABN 86 069 592 123 is the holding company for:
 - Energy Impact Pty Ltd ABN 19 100 214 131 which is a holding company for landfill gas assets and embedded generation assets. Energy Impact Pty Ltd also provides services to third parties such as large users on options for reducing their energy consumption.

5.1.3 Dormant companies

Dormant companies are companies that are currently inactive. In the ENERGEX legal structure they include:

- Metering Dynamics Pty Ltd ACN 087 082 764.
- Service Essentials Pty Ltd ABN 48 101 691 409.
- Quest Asset Holdings ACN 110 703 366.
- Downtown Utilities Pty Ltd ABN 38 082 754 407.

5.1.4 Standalone entities

Standalone companies are not dependent on ENERGEX for day to day operational, systems, processes and practices, managerial, or strategic assistance. Standalone entities in the ENERGEX legal structure are as follows:

- SPARQ Solutions Pty Ltd ACN 110 073 400. SPARQ is a related party being a joint venture company with Ergon Energy that provides Information Technology services to both companies.
- The Varnsdorf group (Varnsdorf Pty Ltd ABN 57 054 942 800, VH Finance Pty Ltd ABN 70 095 427 811, VH Energy Holdings Pty Ltd ABN 51 095 427 795, and VH Operations Pty Ltd ABN 72 095 427 820). The Varnsdorf group's principle business is the cogeneration of electricity and steam for six Victorian hospitals under an Energy Services Agreement with the Victorian Minister for Health. The contracted term of the business extends until 30 June 2010.
- Beak Industries Pty Ltd ABN 22 009 535 184, holds the Sunshine peaking co-generation plant in Victoria.
- Ceramic Fuel Cells Limited ABN 82 055 736 671 is a standalone company that is not included in ENERGEX's consolidation. ENERGEX's relationship with Ceramic Fuel Cells is one of shareholder.

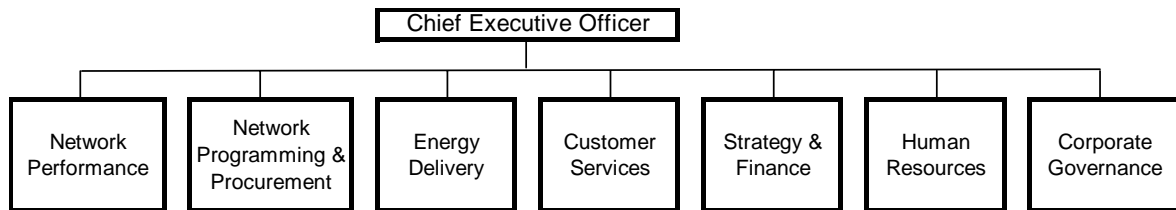
5.2 Operational structure

ENERGEX is primarily an electricity distribution business. Although ENERGEX also provides a range of non regulated activities, these activities are not material¹ in the context of ENERGEX's overall business operations.

The operating divisions within ENERGEX are Corporate, Network and Customer Services. These divisions provide the services associated with the operation of the network business in Queensland. Figure 5.2 below sets out ENERGEX's current organisational structure.

¹ An item is material if its omission, misstatement or non-disclosure has the potential to prejudice the understanding of the financial position of the DNSP, gained by an assessment of financial information relating to the DNSP. AASB 1031 provides quantitative thresholds to guide the materiality assessment.

Figure 5.2: ENERGEX organisational structure



Below is a list of divisions in order as they appear in figure 5.2 from L-R:

- Network Performance (NP): Network Capital Planning, Network Reliability and Maintenance, Technical Standards and Safety Coordination (Health, Safety and Environmental), Network Property Data and Coordination, Demand and Risk Management.
- Network Programming and Procurement (NP&P): Program of Work Planning and Development, Major Electricity Network Project Management, Program Delivery Coordination, Procurement and Services, and Network Commercial.
- Energy Delivery: Design, Construction, Maintenance and Operation of Distribution Electricity Networks, and Network Customer Services.
- Customer Services: Business Support Services, Information Communications and Technology, Property Services, Customer Contact Centre, Corporate Communication, Customer Advocacy, and Government Liaison.
- Strategy & Finance: Financial Control, Tax and Treasury, Revenue and Business Strategy, Regulatory Affairs, Performance Management, Strategic Program Management, Commercial and Finance (Energy Delivery; NP&P/NP; Commercial Development; and Customer Services).
- Human Resources: Human Resources and Internal Communication.
- Corporate Governance: Legal, Internal Audit, Secretariat, Governance, Risk Management and Compliance.

5.3 Related parties

As mentioned previously in Section 5.1.4, SPARQ Solutions is a related party. SPARQ Solutions is joint venture company with Ergon Energy that provides information, communication and technology services to both companies. Services provided by SPARQ Solutions are:

- Service Desk Services
- Desktop Services
- Communications Services
- Business Application Services
- Project Services, Business Consulting Services and Software Asset Management.

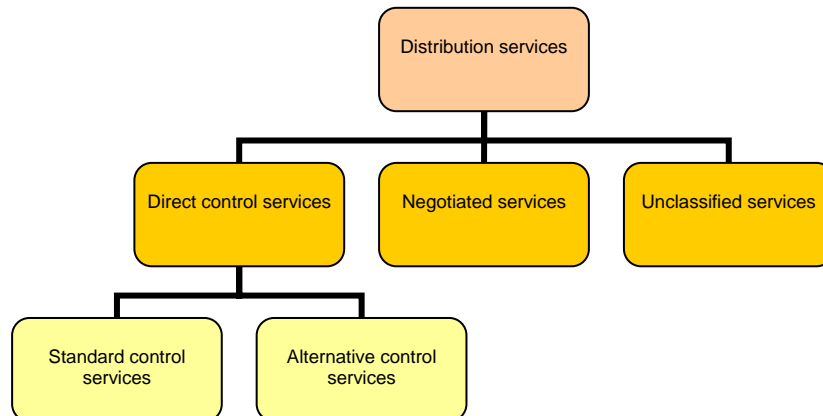
SPARQ Solutions costs to ENERGEX are included the indirect cost pool and allocated as outlined in Section 7.6.

ENERGEX does not provide any support services to related parties.

6 Categories of distribution services

The likely classification of ENERGEX's distribution services are outlined in the AER's final decision on the Framework and Approach paper on Classification of Services and Control Mechanisms, August 2008². The distribution service classifications in accordance with the NER are illustrated below in figure 6.1.

Figure 6.1: Distribution service classifications³



Consistent with the AER's requirement to allocate costs to distribution services, this CAM will be used to attribute and allocate costs to the services as approved by the AER, that is standard control and alternative control services.

In ENERGEX and for the purpose of this CAM, 'distribution assets' has the meaning in accordance with the jurisdictional derogation specified in Clause 9.32.1(b) of the NER which states that:

In Queensland the transmission network assets are to be taken to include only those assets owned by Powerlink Queensland or any other Transmission Network Services Provider that holds a transmission authority irrespective of the voltage level and does not include any assets owned by a Distribution Network Service Provider.

ENERGEX distribution services are outlined below⁴.

Distribution service group	AER service classification
Network services	Standard control services
Connection services	Standard control services
Metering services	Standard control services
Street lighting services	Alternative control services
Quoted services	Alternative control services
Fee based services	Alternative control services
Unregulated	Unclassified

² AER Framework and Approach decision for ENERGEX August 2008:
<http://www.aer.gov.au/content/index.phtml/itemId/721654>

³ AER Framework and Approach decision for ENERGEX August 2008 page 4

⁴ Table source ibid: page 27

6.1 Standard control services

The NER defines that a standard control service is “a direct control service that is subject to a control mechanism based on a DNSP’s total revenue requirement”⁵.

6.2 Alternative control services

The NER states that an alternative control service is a “distribution service that is a direct control service but not a standard control service”⁶.

6.3 Unclassified services

ENERGEX currently provides a range of distribution services that are not subject to regulation by the AER and are unclassified as per the table above.

6.4 Types of persons to whom distribution services are provided

ENERGEX provides distribution services to:

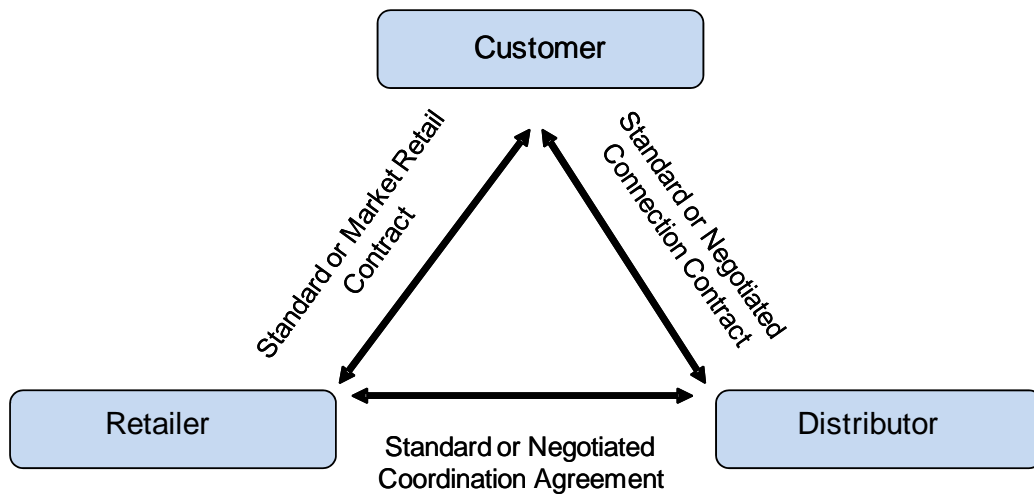
- **Electricity retailers:** Retailers purchase wholesale energy that is transported through Powerlink’s transmission system, and ENERGEX’s distribution system, to end-use customers;
- **End-use customers:** ENERGEX provides ‘customer connection services’ to over 1.3 million connections in its distribution area; and
- **Community:** Services such as asset relocation works or conversion to aerial bundled cables that are requested by a third party (i.e. network user or other person or body such as a council).

A tripartite contractual relationship was established between ENERGEX, end-use customers and retailers upon the introduction of full retail competition (FRC) in Queensland on 1 July 2007. The contractual model of this relationship is illustrated in Figure 6.2:

⁵ National Electricity Rules Chapter 10

⁶ *ibid*

Figure 6.2: Triangular contractual relationship



ENERGEX provides connection services to customers under either a Standard or Negotiated Connection Contract. The interaction with retailers is managed through a Standard or Negotiated Coordination Agreement.

ENERGEX provides certain distribution services directly to the customers with no involvement from a retailer as an intermediary.

ENERGEX's Standard Connection Contract and Standard Coordination Agreement are detailed in Annexure A and C (respectively) of the Queensland Electricity Industry Code.

7 Principles and policies

7.1 Compliance with the Guidelines

In accordance with Clause 2.2.5 of the *Guidelines* ENERGEX commits to the following principles:

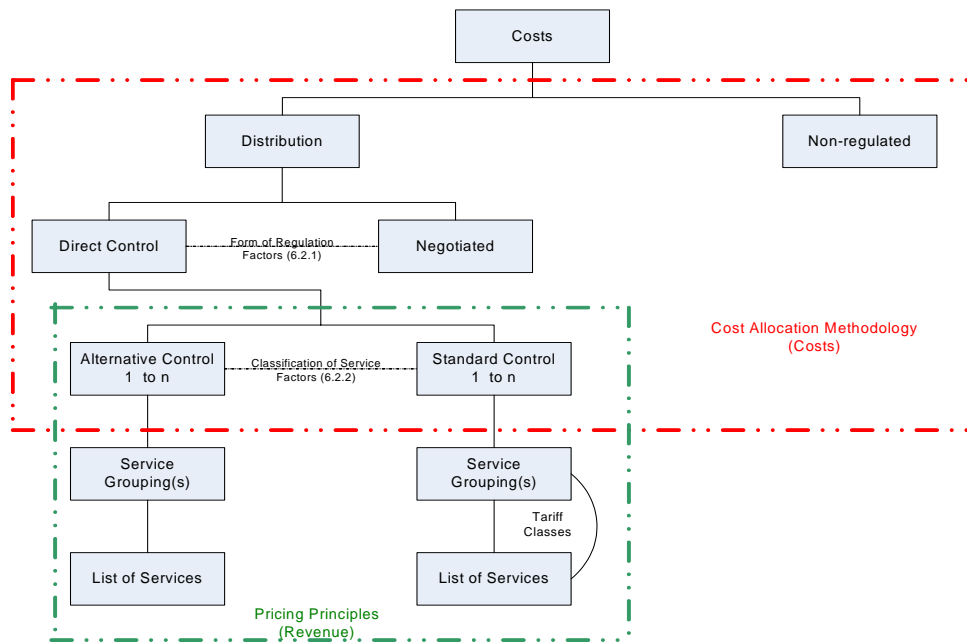
- not to allocate the same cost more than once;
- a direct cost will only be allocated to one category of distribution service;
- an indirect cost will only be allocated once between categories of distribution services;
- the same cost will not be treated as both a direct and an indirect cost; and
- ENERGEX will recover the same cost only once through the charges for its distribution services.

In accordance with the requirements of Clause 2.2.2 of the *Guidelines* ENERGEX confirms that the application of this CAM will ensure that it attributes costs directly to, or allocates costs between, categories of distribution services on the substance of the underlying transaction or event, rather than the legal form. In addition ENERGEX:

- will not allocate indirect costs using an avoided cost approach without prior approval by the AER (Clause 2.2.4(e)); and
- confirms the compliance of this CAM with the distribution ring fencing obligations (Clause 2.2.6).

ENERGEX's CAM will employ the principles outlined above to attribute or allocate costs to distribution services as defined in the *Guidelines*. Figure 7.1 represents a conceptual outline of the CAM as it applies to the various services outlined in section 6. Further, it defines the point of interface between the CAM and ENERGEX's pricing methodology. Figure 7.1 demonstrates graphically how the CAM will interact with the Pricing Principles to attribute and allocate costs to distribution services. This CAM does not include an avoided cost allocation approach.

Figure 7.1: Conceptual model of interface to pricing model



7.2 Application of principles

ENERGEX applies the above principles in the following manner:

- **Attribution of direct costs:** Opex and/or capex to distribution services or non regulated activities where causation supports attribution.
- **Allocation of on-costs:** On-costs for labour, materials storage and logistics and fleet for direct opex and/or direct capex.
- **Allocation to non regulated activities:** A portion of indirect overheads will be allocated to non regulated activities as outlined in section 7.7.
- **Allocation of general overheads:** These costs will be allocated to distribution services as a proportion of total opex and capex direct spend on the service. Any capitalisation of these overheads is considered within ENERGEX's capitalisation policy.

The guiding principles of ENERGEX's CAM ensure that costs consumed by each activity or service are reflected accurately and more specifically that the costs attributable to non regulated activities are segregated from the regulated business.

7.3 De-link the CAM from organisational structure

ENERGEX's Cost Allocation Methods and Procedure (CAMP) under the Queensland Competition Authority (QCA) was based on an integrated electricity network, gas network and retail businesses. With the sale of the retail and gas network businesses in 2007, ENERGEX is now principally a DNSP and the vast majority of ENERGEX's costs relate solely to the distribution business. Therefore, this CAM will be used to map costs to distribution services and to allow ongoing flexibility to accommodate organisational changes or refinements to cost drivers, cost allocators and cost attribution whilst still achieving the cost allocation principles and objectives within the *Guidelines* and the NER.

ENERGEX's CAM focuses on attributing costs to activities which are mapped directly to a distribution service. This will enable ENERGEX to de-link its CAM from its organisational structure.

7.4 Direct costs

A direct cost is an expenditure item that is directly attributable, via a source document, to the provision of distribution services. Direct costs are attributed to activities which are mapped to associated services. Direct costs are therefore directly attributed by a source document to each of the service classifications as outlined in section 6 of this CAM.

On-costs associated with direct costs will be attributed directly to each service based on the proportion of direct costs incurred by that service. On-costs are discussed in more detail in Section 7.5 below.

The nature of direct costs and associated on-costs for ENERGEX include:

- Labour and Labour related costs;
- Contractor costs;
- Materials, storage and logistics costs; and
- Fleet.

All of ENERGEX's services generate direct costs. Direct costs are primarily attributed directly to the relevant service via work orders, invoices and journal entries in the general ledger system. The direct cost is booked by cost element (i.e. labour, material or contractor) to the work order or invoice which has a unique number that relates to a specific service or activity within a service.

Nature of Cost	Description	Attributed to	Basis of Costing
Labour and Labour related costs: directly incurred in the provision of distribution services.	Salaries, wages and other employee related costs (superannuation, payroll tax, workers compensation, annual and long service etc)	<ul style="list-style-type: none"> • Standard Control Services • Alternative Control Services • Unregulated Activities 	Directly attributed based on timesheets attached to work orders and invoices etc which provides for the entry of labour hours The payroll related costs (labour on-costs) are charged as part of the standard rate.
Contractor Costs: directly incurred in the provision of distribution services.	Payments to contractors for their salaries, wages and other associated costs	<ul style="list-style-type: none"> • Standard Control Services • Alternative Control Services • Unregulated Activities 	Directly attributed based on work orders and invoices etc which provide for contractor costs to be costed directly to services.
Materials and Materials related costs: directly incurred in the provision of distribution services.	Material costs, including an associated charge to cover the costs of administration, warehousing and logistics	<ul style="list-style-type: none"> • Standard Control Services • Alternative Control Services • Unregulated Activities 	Directly attributed based on work / purchase orders and invoices etc which provide for materials to be costed directly to services. The logistics and warehousing related costs (materials and logistics on-costs) are charged as a standard rate on direct materials spend in each service.
Fleet charges: directly incurred in the provision of distribution services.	Motor vehicle leasing and internal fleet operating, management and administration costs; Registration and Fuel.	<ul style="list-style-type: none"> • Standard Control Services • Alternative Control Services • Unregulated Activities 	Fleet on-cost is charged as a standard rate on direct labour spend in each service.
Journals	Correction Journals	<ul style="list-style-type: none"> • Standard Control Services • Alternative Control Services • Unregulated Activities 	Corrective journals as required.

Direct attribution via work orders and invoices takes place in the ENERGEX general ledger system. Work orders, invoices and the ledger have a clear audit trail.

7.5 On-cost attribution

On-costs are expenditure items that do not meet the definition of direct operating expenditure, but arise as a consequence of incurring direct costs. Therefore the expenditure categorised as on-costs is added to direct operating expenditure that has been attributed to services.

ENERGEX is proposing three specific types of on-costs:

- Labour On-costs;
- Materials Storage and Logistics On-Costs; and
- Fleet On-Costs.

As detailed in the previous section direct costs are directly attributed to services primarily via work orders and/or invoices. On-costs are attached to the relevant direct expenditure and are therefore allocated on the basis of direct spend. For example Materials Storage and Logistics On-Cost is attached to each dollar of direct materials expenditure and therefore will be attributed to a service on this basis.

Each on-cost rate is calculated at the beginning of the year based on forecast expenditure. The method for calculating each rate is discussed below. The process for reviewing and reconciling the on-cost rates is outlined in Section 8.

It should be noted that depreciation expense is not included in any of the on-cost pools.

7.5.1 Labour on-cost

Labour on-cost comprises expenditure associated with the following items:

- Payroll tax;
- Superannuation; and
- Other similar types of employee costs (e.g. long service leave provisions).

Labour On-cost will be calculated as follows:

$$\frac{\text{Total labour expenditure on-costs (\$)}}{\text{Total wages and salaries expenditure (\$ spend)}}$$

These costs are on-costed (added on) to basic employee wages and salaries as this better reflects the true labour cost.

Labour on-costs were part of ENERGEX's CAMP under the QCA and will continue to apply in the same way during the 2010-15 regulatory period.

7.5.2 Materials storage and logistics on-cost

Materials Storage and Logistics On-cost reflects expenditure incurred to store and coordinate physical items that are expensed or capitalised as direct materials expenditure. This expenditure is primarily employee, materials handling and storage costs associated with operating this function.

Materials Storage and Logistics On-cost charge will be calculated as:

$$\frac{\text{Total materials storage \& logistics expenditure on-costs (\$)}}{\text{Total direct materials expenditure (\$ spend)}}$$

Materials stores and logistics on-cost charge will be attached to direct material expenditure, in accordance with the above ratio, to reflect the true cost associated with the purchase of material components.

7.5.3 Fleet on-cost

The Fleet On-cost comprises expenditure incurred to operate and maintain vehicles owned or leased by ENERGEX Ltd that are used in the construction, operation or maintenance of the electricity network. These costs include items such as:

- Employee costs (for staff involved in fleet operations);
- Fuel & Oil;
- Vehicle Maintenance;
- Registration & Insurance; and
- Other similar types of fleet costs.

Fleet On-cost charge will be calculated as:

$$\frac{\text{Total fleet expenditure on-costs (\$)}}{\text{Total direct labour expenditure (\$ spend)}}$$

This expenditure is 'on-costed' to direct labour expenditure associated with the network, on the basis that wherever direct labour is utilised, fleet would have been required to transport employees. Fleet charges will be attached to direct labour (inclusive of the labour on-cost).

7.6 Indirect costs

Indirect costs (overheads) are costs that are necessarily incurred in the provision of distribution services, but are not directly attributed by a work order or invoice to a specific activity or service. Overhead costs in ENERGEX's context include common or shared functions that support all distribution services such as:

- Corporate support costs including the CEO, Finance, Human Resources, Legal;
- Staff Training & Travel;
- Consultants Costs that are not directly attributable; and
- Occupancy Costs.

Costs associated with these functions would only be classified as indirect to the extent that they can not be directly attributed to a service.

Indirect costs are incurred as a result of the services provided by ENERGEX. A method of allocation is required to allocate them to the appropriate service.

ENERGEX has determined that overheads will be allocated to services on the basis of total direct spend as this reflects a strong correlation with the consumption of the indirect overhead.

The allocation of indirect costs will give rise to two separate rates in line with the application of principles described in section 7.2:

- non regulated activities allocation; and
- regulated general overhead rate - reflecting the remaining overhead cost pool.

Each overhead rate is calculated at the beginning of the year based on forecast expenditure. The method for calculating each rate is discussed below. The process for reviewing and reconciling the general overhead rate is outlined in Section 8.

7.6.1 Non regulated overhead allocation

The non regulated overhead allocation will be based on operating costs associated with the services provided as per section 7.7. This allocation will be used to allocate the indirect costs associated with the non regulated activities. The total allocation is determined after taking into account the size, scale and scope of the non regulated activities compared to the total ENERGEX business.

7.6.2 General overhead rate

The general overhead rate reflects the remaining indirect expenditure related to ENERGEX's services. The general overhead pool is determined on the basis of the total overhead pool after deducting the non regulated activities allocation.

The general overhead rate will be determined by the size of the pool divided by the direct operating and capital expenditure (including contractor spend, labour spend and material spend inclusive of on-costs) of the distribution services.

The rate is calculated as follows:

$$\frac{\text{Total general overheads (\$)}}{\text{Total direct expenditure (opex and capex \$ spend)}}$$

7.7 Allocation of costs to non regulated activities

In addition to its distribution services, ENERGEX also conducts non regulated activities. As mentioned in section 7.2 direct costs (capex and opex) are allocated to non regulated activities on a causation basis.

ENERGEX has documented the services and determined that the most appropriate basis for overhead cost allocation to non regulated activities is by a three factor method based on Assets, Headcount and Revenue. ENERGEX will calculate the indirect cost allocation to be charged to the non regulated activities, via a services protocol, on a three factor basis.

ENERGEX considered a range of alternative methods to allocate indirect overheads to non-regulated activities including allocation by direct spend. Given the size, scale and scope of the non regulated activities, allocation by direct spend would result in an amount of costs being allocated to unregulated activities that would be in excess of the stand alone costs of these services and therefore not reflective of the economic value of services provided. For

this reason the 3 factor method is considered a more appropriate⁷ approach as it better reflects the economic and efficient costs of the services provided. Utilising the three factor method allows consideration to be taken of the materiality, scale and size of the non regulated activities in comparison to the regulated activities.

The three factor method will be applied to each year's forecast to determine the appropriate cost allocation for that year. This will ensure that the allocation is current and reflects changes in size, scale and scope of the non regulated activities.

The services protocol will include a review clause linked to a material change in size, scale and scope of the non regulated activities or a material increment or decrement in the services provided to adjust the allocation accordingly.

The allocation of indirect costs to the non regulated activities will be deducted from the pool of indirect costs applicable to the regulated business, ensuring that indirect costs are only allocated once.

7.7.1 Calculation of the non regulated overhead allocation

The non regulated overhead allocation is calculated via the three factor method as detailed below.

Factor 1: Asset % is calculated as follows:

$$\frac{\text{Total Non Regulated Assets}}{\text{Total Regulated and Non Regulated Assets}}$$

Factor 2: Headcount % is calculated as follows:

$$\frac{\text{Total Non Regulated Headcount}}{\text{Total Regulated and Non Regulated Headcount}}$$

Factor 3: Revenue % is calculated as follows:

$$\frac{\text{Total Non Regulated Revenue}}{\text{Total Regulated and Non Regulated Revenue}}$$

The average of the 3 percentages forms the percentage of indirect costs to be allocated to the non regulated services.

⁷ The three factor method is the most appropriate when considering simplicity in its application, capable of been replicated by the AER and the most representative cost drivers.

8 Reconciliation and clearance of pools

All on-cost and overhead rates are established at the beginning of the financial year. The rates are based on forecast data and each represents a separate pool of costs. As the year progresses a process will track the rates to actual expenditure and be adjusted where necessary. This process is discussed below.

8.1 On-cost pool

Each on-cost rate is calculated at the beginning of the year based on forecast expenditure. The method for calculating each rate was discussed above in Section 7.5. The rates will be applied to actual direct expenditure throughout the year. On a quarterly basis the forecast rate will be reviewed against actual expenditure. Where there are material variances an adjustment will be made to the rate, however the methodology applied will be consistent.

8.2 Overhead pool

As stated previously this rate will be based on forecast data. The method for calculating the rate was discussed above in Section 7.6.2. The rate will be applied to actual direct expenditure throughout the year. On a quarterly basis the forecast rate will be reviewed against actual expenditure. Where there are material variances an adjustment will be made to the rate, however the methodology applied will be consistent.

8.3 Year end process

At year end any non material surplus or deficit in the on-cost or overhead pools will be cleared to a central pool. This pool will be cleared via an allocation across the services based on direct spend.

For material variances a review will be carried out to determine the most appropriate treatment for each over or under recovery.

9 Replicating the CAM

The purpose of this chapter is to fulfil Clause 2.2.1(b)(1)(B) of the *Guidelines* which requires that a DNSP include information to the extent necessary to enable the AER to replicate its reported outcomes.

The AER will be able to replicate the outcomes of the CAM utilising ENERGEX's regulatory accounts with the provision of the following additional information:

- overhead allocations to services;
- on-cost allocations;
- direct labour expenditure; and
- direct material expenditure.

Non system assets predominantly relate to standard control services however they are also utilised to a lesser degree by alternative control services. On this basis all non system assets are held in the RAB with an adjustment made to the Annual Revenue Requirement (ARR) to reflect their use in providing alternative control services. This is in accordance with the Transitional Rules 11.16.3.

It should also be noted that ENERGEX's reporting categories may change for the 2010-2015 regulatory control period pending finalisation of the AER's Regulatory Information Order.

10 Work papers

Applying, reconciling and auditing the CAM at an operational level within the business requires detailed work papers. The work papers provide detailed information specific to ENERGEX's various systems and general ledger. This information is required at an operational level to ensure the high level outcomes and principles of the CAM are achieved.

The work papers include items such as:

- Specific expenditure items that relate to direct costs
- Specific expenditure items that form each on-cost pool
- Specific expenditure items that form the overhead pool
- The basis of allocation of each on-cost and overhead pool
- The calculation method for each on-cost rate
- The calculation of the general overhead rate
- The reconciliation process to be undertaken for any over or under recovery of on-costs or overheads.

These work papers will be further refined during actual implementation of the CAM, subject to AER approval.

11 CAM consistency

Policies and principles relating to allocations will be consistently applied across accounting periods to ensure that regulatory financial reports are prepared on a consistent basis over time.

ENERGENX will apply the CAM consistently each year throughout the regulatory period. As the nature of costs may change from time to time, ENERGENX will periodically review the CAM and make appropriate changes to ensure that its application results in:

- consistency with prior accounting and regulatory periods; and
- that the basis of cost attribution or cost allocation is considered on the substance of the transaction over its legal form.

12 Maintenance of records and verification

12.1 Work papers

ENERGEX will maintain all accounting records and ensure they are prepared in accordance with all applicable corporate policy, practice or method, approved accounting standards and legislative requirements.

ENERGEX will ensure that accounting records reflect the application of the CAM in the production of regulatory financial reporting.

As part of the annual audit of accounts, supporting work papers are submitted to the auditors for their review in accordance with their professional judgement. Each work paper is provided with supporting calculations, where appropriate.

12.2 Record retention

In accordance with Clause 3.2(a)(7) of the *Guidelines*, ENERGEX will maintain the following records:

- Whenever financial information is submitted to the AER, work papers will be prepared and supplied if requested. The work papers will explain how the numeric quantity or percentage of each allocator has been calculated for each cost item and the source of the data for determining the numeric quantity or percentage.
- Accounting information records will be maintained in accordance with generally accepted accounting practice, ENERGEX Policy, approved accounting standards, applicable Taxation requirements, the Corporations Law and any other relevant legislative requirements.
- Source documents, general ledger, trial balances, transactions listings, and cost allocation work papers will be retained in accordance with legislative requirements.

ENERGEX will maintain these records within its integrated financial and assets management systems, such as but not limited to ENERGEX's current general ledger system Ellipse, as well as other specialist application systems and supporting analysis in spreadsheet packages.

12.3 Assurance, audit or otherwise verified

Audit opinions or other expert opinions will be supplied where required by the NER, to comply with a duly authorised request by the AER, or to comply with appropriate legislation. Auditors and experts' opinions will be obtained where required and will be in accordance with standard auditing practice, which includes the application of professional judgement, sampling techniques and materiality.

13 Monitoring compliance with the CAM and *Guidelines*

The Chief Financial Officer is responsible for monitoring and ensuring compliance with the CAM across ENERGEX. Operationally, the Group Manager Financial Control and Group Manager Regulatory Affairs will be responsible on a day to day basis for compliance.

13.1 Compliance regime

ENERGEX's annual statutory financial statements and the system that captures financial information and develops the statements (Ellipse) are reviewed by our external auditor, the Queensland Audit Office.

ENERGEX may undertake, as negotiated with the AER, an independent audit of its regulatory financial reports to ensure they are compliant with regulatory reporting requirements, including the CAM.

ENERGEX can also independently monitor and report on the CAM's application through internal and external audit programs that are in addition to those specified above. This includes scheduled or ad hoc audit programs of specific areas identified by either management or auditors on their own volition.

14 Operational date of commencement and publication

14.1 Date of commencement

This CAM is to commence from the start of the next regulatory period, 1 July 2010 and will remain in force until such time as a new or amended CAM is approved by the AER in accordance with the NER and the *Guidelines*.

14.2 Publication and availability of approved CAM

In accordance with the requirements of Clause 6.15.4(h) of the NER, ENERGEX will maintain a current copy of its approved CAM on its website, www.energex.com.au. Further, ENERGEX will supply the AER with an electronic version (in PDF form) and printed copies if required.