

## DEPRECIATION

The impact of the assumption of remaining economic life in the calculation of depreciation (and the calculation of the return of capital) is that it acts as the denominator for calculating the rate at which an asset is depreciated (or that capital is returned). For example an asset that is worth \$100 and has an expected economic remaining life of 5 years, the calculation of depreciation and the return of capital would be  $100/5 = \$20$  per year.

Therefore where the assumed economic remaining life changes the expected future rate of depreciation, the return of capital will be impacted inversely to the change that occurs in the expected remaining life. If the expected remaining life increases, the future recovery of capital will be slowed, and vice versa.

### *Assets have different types of lives assigned*

The assets in EnergyAustralia's network have a number of different lives assigned to them. All assets have a standard life applied to them which is set on the basis of an engineering expectation of new equipment's serviceable life under standard operating conditions. This is usually based on industry experience and would tend to relate to manufacturer's expectations when the technology is new.

Engineering expectations can be proven wrong however, through experience and more importantly the operating conditions within which the new asset will be used. These conditions will impact on the standard economic life assumption of specific classes of assets in any particular system.

Therefore, EnergyAustralia has used a combination of economic standard lives, using industry accepted standard economic lives, but adjusting these where appropriate based on EnergyAustralia's experience with certain technologies and the operating conditions of EnergyAustralia's network. The result is that the economic life of an asset is often different to the standard life originally assigned.

Assets also have lives assigned to them for tax purposes. Tax lives are generally assigned to specific classes of assets on the basis of a ruling published by the Australian Taxation Office. Traditionally, Australian businesses have been allowed to accelerate tax depreciation in the initial years of an investment. However, one of the results of the Ralph taxation review was to remove that option. This attempts to better align the remaining tax life of an asset with the remaining economic life of the asset.

The tax remaining lives are not specified by the ATO per se but are set by the ATO through the "safe harbour" standard tax lives discussed above. Tax lives typically do not alter over time and are always subject to challenge from the ATO should they differ from the "safe harbour" lives. However, economic lives will change according to operating conditions, etc. Given that there is a difference between the economic and taxation lives of the assets at the beginning of the asset's life, the remaining economic and tax lives will continue to differ throughout the life of the asset. Furthermore, the specific remaining lives for assets are often changed as information about the specific asset becomes available over its life. Whilst, the tax regime does allow for such new information to be used, revising tax lives every 5 years in line with EnergyAustralia's accounting and regulatory policies is likely to result in ongoing and costly debates with the ATO, which can result in the rejection of the "self assessed" lives. Therefore it is generally viewed that using and reviewing "self assessed" tax lives is impractical on large scales, and tends to only be used in extreme circumstances for specific assets.

### *Ralph taxation reforms*

EnergyAustralia has assets that were subject to accelerated depreciation (prior to the Ralph reforms) and assets that have not been subject to accelerated depreciation. For EnergyAustralia's grand-fathered "pre-Ralph" assets, the remaining life is a function of the acceleration class to which the assets belong. Having determined the standard tax life, the asset's age will determine what, if any, tax life remains when applied to the appropriate acceleration approach.

The remaining tax life for post Ralph assets is simply the standard tax life (from above) less the age of the assets.

### *Straight line depreciation*

EnergyAustralia's approach to depreciation uses a straight line methodology for all post Ralph assets. Those assets that were in service prior to the introduction of the Ralph review changes are depreciated on an

accelerated basis, as permitted by the grand-fathering provisions within the Ralph reforms. This mix is consistent with the treatment of EnergyAustralia's and TransGrid's tax positions in the 1999 determinations. The primary reason why the PTRM was originally developed with the normalisation function was to address the timing difference of the tax shield generated from accelerated tax lives and economic lives.

#### *Depreciation in the PTRM and the proforma*

The numbers quoted by EnergyAustralia in the PTRM and in the proformas with respect to depreciation are consistent. The regulated asset proforma provides the total ODRC value for transmission assets, the historical cost of the assets for tax purposes and the tax shield claimed to date. The value included in the PTRM is equivalent to the historical cost less the tax shield claimed to date. Therefore the value quoted in the PTRM is the remaining value of assets for tax purposes.

#### *Working capital*

EnergyAustralia created a separate sheet in which to calculate the allowance for working capital as it wasn't explicitly included in the ACCC PTRM. It was decided that this was preferable to the including it in the Analysis worksheet. The working capital allowance is included explicitly in the smoothing worksheet.