

17 June 2004

Mr Michael Walsh
Director, Gas Group
Regulatory Affairs Division
Australian Competition and Consumer Commission
GPO Box 3648
SYDNEY NSW 2001

Dear Michael

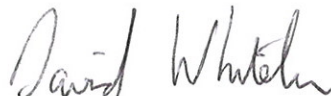
Regulatory reporting guidelines for gas pipeline service providers – release of draft guidelines

Please find attached our preliminary comments on the draft Regulatory Reporting Guidelines. We may wish to make further submissions as the consultation proceeds.

The Guidelines raise a number of regulatory, legal and technical accounting questions, and we believe that their resolution will require extensive dialogue between the service providers and the Commission.

Please contact GasNet if you have any queries on our submission, or if you wish to explore any ideas.

Yours sincerely,

A handwritten signature in black ink, reading "David Whitelaw".

David Whitelaw
Regulatory Manager

Proposed Regulatory Reporting Guidelines - GasNet Comments

The Australian Competition and Consumer Commission has requested comment from Service Providers on a proposed set of Regulatory Reporting Guidelines (May 2004). These Guidelines require Service Providers to keep and maintain a set of regulatory accounts, and to make available audited financial statements from these accounts on an annual basis. The authority to impose these obligations comes from the National Gas Code, specifically the Ring Fencing Obligations in sections 4.1 and 4.2 of the Code.

In particular, the Guidelines require the Service Provider to:

1. Prepare and maintain a Regulatory Accounting Manual which describes the policies and procedures for the construction of the regulatory accounts and the associated financial statements.
2. Provide annually, or as required, Regulatory Financial Statements, an Audit Report on these Statements, and a Statement of Compliance.

The Regulatory Financial Statements consist of the following:

- a) General Purpose Financial Statement (which in the case of GasNet will be the statutory accounts reported annually under Corporation's law).
- b) Disaggregation Statements (showing the disaggregation of the consolidated P&L and Balance Sheet accounts into the costs relevant to the Covered Pipeline and those costs relevant to other activities or businesses of the Service Provider).
- c) Special Purpose Financial Statements (these are adjustments to the Disaggregation Statements which restate the accounts in accordance with special regulatory requirements, such as the regulatory asset schedule).

The Special Purpose Financial Statements must be audited to Auditing Standard AS802. In addition, the annual Regulatory Financial Statements must be approved by the Board of the Service Provider, and signed off by the CEO and a Director.

GasNet Comments

GasNet maintains a regulatory cost allocation system and a regulatory asset schedule for the purpose of satisfying the ring-fencing and regulatory requirements of the Code. These systems were used to support the original 1999-2002 Access Arrangement application and the 2003-2007 Access Arrangement revision. However, as argued below, the proposals put forward in the Guidelines are likely to impose significantly higher costs on GasNet, principally from the requirement to provide an Auditor's report on the Regulatory Financial Statements. Moreover, there will also be additional in-house costs required to prepare the Regulatory Accounting Manual, to obtain approval of this Manual whenever an amendment is required, and to assist the Auditor in undertaking his task.

GasNet believes that the costs of these requirements outweigh the benefits. Additionally, we consider that the overarching objective of ensuring regulatory accounts are true and fair can be materially satisfied without the need for the additional time, costs and resources required to satisfy the regulatory Guidelines. The procedures already in place have worked adequately to establish the original and revised Access Arrangements. The Commission reviewed the methods and approved the operating and capital expenditure forecasts which were derived from these accounts. It is unlikely that the outcome would have been materially different if the Guidelines had been in place over this period. In other words, the gain in precision, if any, is not justified by the significantly higher costs that will be incurred.

GasNet also believes that the timing of these Guidelines is inappropriate, particularly in light of the current Review of the National Gas Code by the Productivity Commission. One of the issues raised by this Review is the costliness and intrusiveness of the information requirements imposed on Service Providers by the regulator. The publication of the Regulatory Reporting Guidelines should await the publication of the Productivity Commission's Final Report and its consideration by the Ministerial Council on Energy.

GasNet notes that there is some doubt about the authority of the Commission to impose legal obligations on GasNet to provide an Auditor's opinion on the Regulatory Financial Statements, and to require a Statement of Compliance from the Directors of the company. The Queensland Competition Authority sought legal advice on this issue, and concluded that the legal authority to impose these obligations does not reside in the Code. Consequently, the Authority removed these obligations from its own Regulatory Accounting Guidelines. GasNet asks the Commission to consider this legal advice before finalising the Guidelines.

The following sections describe our concerns in greater detail.

The auditing requirement is onerous

It is clear from a reading of the draft Guidelines that the ACCC believes the auditing requirement will be a relatively minor increment to the standard auditing task required to approve the statutory financial reports, rather than a wholesale bottom-up approach. For example, section 5.1 of the Draft Guidelines says

"Because the Special Purpose (Regulatory Financial Statements are derived by adjustments made to a Service Provider's General Purpose Financial Statements, the scope of the additional audit work required for the auditor to report to the Commission, would normally be constrained to an examination of the adjustments made to those audited statements..."

However, in GasNet's opinion, this presumption is incorrect. In fact, as discussed below, the responsibility imposed on the Auditor to approve the disaggregated accounts is likely to be considerably greater than that required to approve the consolidated accounts.

GasNet operates a number of businesses in addition to the Covered Pipeline. These are principally the LNG and metering businesses, and the ownership and operation of the Telfer pipeline. When the Telfer pipeline is complete, approximately 30% of GasNet revenues will come from these unregulated activities. However, these activities are not completely ring-fenced operationally from the regulated activities. GasNet manages all its business activities within a common management framework, as this optimises operating and management efficiencies.

GasNet currently allocates costs to the regulated and unregulated activities using a form of activity-based costing. The system uses data from a job costing system, and is supplemented by the use of allocation factors applied to specific departmental costs.

An audit of the regulatory accounts would be significantly more onerous than the standard statutory audit task. For example, the audit of the consolidated business is not concerned with the breakdown of labour costs, utilities, occupancy, outside services etc. into the various departments, nor with the operation of the job costing system.

In addition, the Regulatory Accounting Manual may require amendments during the year. These changes will require revisions to the Manual during the year, which the Auditor would have to take into account. Therefore the Auditor will have to identify and examine costs for each section of a year to which different Manuals apply. In contrast, in respect of the General Purpose Financial Statement, the Auditor only examines annual costs.

In summary, it is envisaged that the audit task for the Regulatory Financial Statements will be considerably greater and more expensive than that required for the statutory accounts.

The greater formality of the process will be costly

In our experience, departmental structures must be modified from time to time, in response to management initiatives to improve operational efficiency, or as business and operational activities go through cyclical changes. These changes may require technical modifications to the activity-based costing model. However, the Guidelines envisage a formal process of submission, debate and approval by the ACCC for every amendment to the Manual. This will complicate the process and add considerably to GasNet's in-house costs.

There is no avenue for appeal or arbitration

The Guidelines state that the ACCC can require amendments to the Manual at its discretion. There is no mechanism in the Guidelines which allows for the resolution of disputes. For example, disagreements could arise about the appropriate allocation factors or activity drivers to be used. GasNet believes that a process should be in place for arbitration of disagreements by a qualified, independent third party.

Reporting may be required outside the normal reporting timeframes

The ACCC reserves the right to require submission of the Annual Regulatory Report at an earlier date (section 4.2). However under normal circumstances the Regulatory Financial Statements will be prepared shortly after the statutory reports, which are prepared annually at year end. If a report is required earlier, then GasNet would have to prepare a set of audited reports based on accounts covering less than one year. It is doubtful that reports based on a partial year's data would have any meaning.

In any case, a report required outside the normal reporting timetable would be additional to the standard statutory reporting which is required at year end, and would therefore add significantly to costs.

Reconciliation of the Regulatory and Statutory Asset Schedules is impractical

The Guidelines require the reconciliation of the disaggregated Statutory Accounts to Special Purpose Regulatory Accounts such as the regulatory asset schedule, by means of regulatory accounting adjustments. However the regulatory asset schedule is so far removed from the statutory accounts that reconciliation on an asset or even asset class basis is impractical.

The statutory and regulatory asset schedules diverge significantly for a number of reasons.

1. When the asset is first covered, a Regulatory Asset Base is determined based on an optimised physical configuration. Some assets on the statutory asset schedule might not exist in the regulatory asset schedule.
2. Different depreciation profiles apply over the whole period since the Regulatory Asset Base was created. Hence asset values will diverge substantially between the two schedules.
3. Regulatory adjustments to the Regulatory Asset Base, such as normalisation depreciation, are not asset specific and must be applied to the assets in the Regulatory Asset Base in an arbitrary way.
4. Assets which are written down or redundant in the Regulatory Asset Base may still exist in the statutory accounts.

The regulatory asset schedule is effectively a stand-alone document, and not a document derived from and linked to the statutory accounts (excepting for the date when the Regulatory Asset Base is first established). Whilst it is possible to link the two documents on an on-going basis, the linkage is in many respects arbitrary, and provides no particular insights.

Allocation of debtor/creditor balances is unnecessary

The Guidelines require the allocation of debtor and creditor balances (section 2.7). It is unclear what purpose is served by this requirement. Whilst changes in debtor and creditor balances reflects movements in cashflow, these cashflows are of marginal relevance and are not likely to be material:

- these cashflows are very small relative to overall costs,
- no Access Arrangement has ever included consideration of these cashflows,
- the true cashflow impact is in the monthly profile of debtors and creditors, which is not captured in the year-end balances.