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Dear Sebastian

### **Submission on preliminary standardised capex model**

Jemena welcomes the opportunity to provide feedback on the preliminary standardised Standard Control Services (**SCS**) capital expenditure (**capex**) model published by the Australian Energy Regulator (**AER**) for consultation.

We support the use of a standardised capex model across businesses as it will improve consistency in both reporting and decision making. We present below our feedback on the new model with further details on the application of our recommendations in **Annexure A** -

1. **Inflation index calculation** – The model allows nominal cost inputs in either June or December dollars basis which are then converted to real June dollar basis of the start of the next regulatory period. This inflation conversion works well when June dollar basis is selected. However, when December dollar basis is selected, the conversion does not correctly capture the mid-year cash flow timing<sup>1</sup>. This is because the conversion incorrectly removes half-year inflation for the final year of the current regulatory period, instead it should remove half-year inflation of the year in which the cash flow occurs. We recommend the AER update the inflation index formula as shown in point 1 to 3 of Annexure A.
2. **Overhead rates calculation** – The model calculates a historical average overheads rate and then applies this rate to the forecast direct capex to estimate the forecast capitalised overheads. The overheads rate is calculated as the average overhead amount divided by direct capex attracting overheads. However, when there is no direct capex attracting overheads (i.e. the denominator) is zero, it results in a 'divide by zero' error.<sup>2</sup> We recommend the AER update the formula as per point 4 to 6 of Annexure A.

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<sup>1</sup> A regulatory year covers July to June and December reflects the mid-year of a regulatory year

<sup>2</sup> Jemena does not capitalise corporate overheads as per its 2021 Cost Allocation Methodology

3. **Average overhead calculation** – The model provides flexibility to enter either three or four years of historical data which is used for calculating the historical average of overheads. However, when estimating a three year average, the model does not exclude the fourth year input which understates the three year average overheads. We recommend the AER update the formula for the fourth year historical overheads and direct capex attracting overheads as per point 7 and 8 of Annexure A.
4. **Additional mappings of project categories** – The model allows users to map each capex project by ‘AER categories’ and ‘RIN categories’. It provides a summary view of the capex forecast by these two mapping categories in output tables. However, for the purpose of populating Reset RINs and proposal tables for our capex proposal during a price reset, we require further mapping categories. For instance, in Jemena’s capex model, we included four Reset RIN categories and six customised categories for our IT and capex proposal. The additional mapping categories helped us to transparently show the capex projects and calculation steps underpinning each category of the Reset RIN tables and our proposal tables. The addition of mapping categories only requires a small change in the current model. We provide more details on how the changes could be implemented in point 9 of Annexure A and some example mapping categories in Annexure B.
5. **Forecast capex input for the Roll-Forward Model (RFM)** – The model currently allows users to input project costs for five years over the next regulatory period to be ultimately used for inputs into the Post-tax Revenue Model (PTRM). However, during a price reset, businesses are also required to provide capex forecast for the last two years of the current regulatory period. This is required for populating the RFM when actuals are not available at the time of submitting regulatory proposal to the AER. To maintain consistency between RFM and PTRM inputs, we recommend that the model allows for capex forecast inputs for the last two years of the current regulatory period and includes an additional output sheet for RFM.
6. **Optionality to allocate overheads to capital contributions** – In the forecast capitalised overheads calculation, the model allocates overheads to both cash contributions and gifted assets. It then removes the overheads allocated to gifted assets from the capex forecast inputs for the PTRM. Such an approach would create inconsistencies with businesses’ accounting treatments of capitalised overheads. For instance, Jemena does not currently allocate capitalised overheads to gifted assets, which means that the model will understate Jemena’s capitalised overheads and forecast capex inputs used in the PTRM. To better reflect each business’ accounting treatments of capitalised overheads in practice, we recommend that the AER include a switch in the model to allow businesses to select whether capitalised overheads are allocated to gifted assets.
7. **Labour and non-labour proportion** – The model requires the capex proportion attributable to ‘Internal labour’ by each project and calculates the remaining proportion under the heading of ‘Non-labour’. This categorisation does not capture the ‘External labour’ component. The Reset RIN Table 2.11 requires the following categories: in-house labour expenditure, labour expenditure outsourced to related parties, labour expenditure outsourced to unrelated parties, controllable non-labour expenditure and

uncontrollable non-labour expenditure. We therefore recommend the AER to include these categories in the model to assist with populating the reset RIN or reduce the number of reset RIN categories. For completeness, we also recommend that the AER includes input for non-labour real price escalations.

**8. Other recommendations** – In addition to the above the AER could consider the following few minor improvements -

- *Labelling of gross capex inputs* – We recommend that the gross capex is labelled as ‘gross capex including cash rebates’ to ensure it is consistent with the federal court decision.<sup>3</sup> For more details see point 10 of Annexure A.
- *Labelling of cash flow timing* - We recommend that the model specify the cash flow timing required for capex inputs. For more details see point 10 and 11 of Annexure A.
- *Reducing model size* - The model size is currently over 9MB which can be reduced by removing any content or formatting in unused cells.

We are committed to working constructively with the AER and welcome any further queries in relation to the above feedback. We can also assist the AER in providing a version of the standardised capex model with the above mentioned recommendations. If you wish to discuss this submission please contact Jerrie Li on [REDACTED]  
[REDACTED]

Yours sincerely

[signed]

Sandeep Kumar  
Group Manager Regulatory Analysis and Strategy

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<sup>3</sup> Federal Court of Australia, Victoria Power Networks Pty Ltd v Commissioner of Taxation [2020] FCAFC 169, 21 October 2020

## Annexure A – Application of recommendation

No	Type	Worksheet	Cell reference	Recommendation
1	Calculation	Input  Escalation	C18:I18	To accurately capture the mid-year cash flow timing of nominal inputs, we recommend changing the formula in cell C18 to – <code>=INDEX(\$C\$17:\$I\$17,MATCH(\$C\$10-1,NUMBERVALUE(LEFT(\$C\$14:\$I\$14,4)),0))/C\$17*(1+C\$15)^IF(\$D\$9='Input  Setup'!\$B\$40,0.5,0)</code> This formula can then be copied across the range C18:I18.
2	Labelling	Input  Escalation	B18	To clearly show cash flow timing of inflation escalation calculated in row 18, we recommend specifying the timing of nominal inputs by changing the formula in cell B18 to – <code>=IFERROR("Index: Nominal "&amp;D9&amp;" to "&amp;"Real "&amp;C10 &amp;" "&amp;LEFT(D10,9),")</code>
3	Calculation	Input  Escalation	J16:J18	As a result of updating formula in point 1 above, the redundant content in range J16:J18 can be removed.
4	Calculation	Calc  Overheads Allocation	C9:G10	To avoid the 'divide by zero' error, we recommend updating the formula in cell C9 to – <code>=IF(C42=0,0,C15/C42)</code> This formula can then be copied across the range C9:G10.
5	Calculation	Calc  Overheads Allocation	E48:E49	To avoid the 'divide by zero' error, we recommend updating the formula in cell E48 to – <code>=IF(C48=0,0,(D48-C48)/C48)</code> This formula can then be copied across to cell E49.
6	Calculation	Calc  Overheads Allocation	E54:E55	To avoid the 'divide by zero' error, we recommend updating the formula in cell E54 to – <code>=IF(H42=0,0,C54/H42)</code> This formula can then be copied across to cell E55.
7	Calculation	Calc  Overheads Allocation	F30:F31	To allow the model to calculate a 3-year average when the fourth year overheads data is not available, we recommend updating the fourth year overheads formula in cell F30 to – <code>=IF('Input  Overheads'!F16="",,"','Input  Overheads'!F16*INDEX('Input  Escalations'!\$C\$18:\$I\$18,MATCH(F\$29,'Input  Escalations'!\$C\$14:\$I\$14,0)))</code> This formula can then be copied across to cell F31.

No	Type	Worksheet	Cell reference	Recommendation
8	Calculation	Calc  Overheads Allocation	F35:F36	<p>To allow the model to calculate a 3-year average when the fourth year direct capex data is not available, we recommend updating the fourth year direct capex formula in cell F35 to –</p> <p><i>=IF('Input  Overheads'!F21="", "", 'Input  Overheads'!F21 *INDEX('Input  Escalations'!\$C\$18:\$I\$18, MATCH(F\$34, 'Input  Escalations'!\$C\$14:\$I\$14, 0)))</i></p> <p>This formula can then be copied across to cell F36.</p>
9	Additional functionality	Multiple sheets	n/a	<p>We encourage the AER to include 10 additional customisable mapping categories to provide more flexibility and functionality to the model. To incorporate this, the AER could consider making the following changes –</p> <ul style="list-style-type: none"> <li>• In sheet 'Input  Setup', include the additional list of mappings and allow users to populate the list, similar to 'PTRM RAB asset categories'</li> <li>• In sheet 'Input  Projects', insert 10 columns after column G to cater for the additional categories. These categories can be grouped and hidden if not required by the user</li> <li>• In sheet 'Output  AER' below the current AER category summary table, insert additional summary tables for those new mapping categories</li> </ul>
10	Labelling	Input  Projects	I6	<p>To improve clarity of the direct unescalated costs inputs (Table 12 in the model), we recommend specifying in the heading –</p> <ul style="list-style-type: none"> <li>• the cash flow timing of the cost input (i.e. December or June)</li> <li>• that the costs include cash rebates in addition to gifted assets</li> </ul> <p>This would require updating the formula in cell I6 to –</p> <p><i>=IFERROR(LEFT(F6,2)+1&amp;" Direct unescalated costs (including gifted assets and cash rebates) (\$'000s "&amp;'Input  Escalations'!\$C\$9&amp;" "&amp;'Input  Escalations'!\$D\$9&amp;"), "")</i></p>
11	Labelling	Input  Disposals	C5	<p>We recommend specifying the cash flow timing (i.e. December or June) in the heading by changing the formula in cell C5 to –</p> <p><i>=IFERROR(LEFT('Input  Projects'!X6,2)+1&amp;" Forecast asset disposals (\$'000s "&amp;'Input  Escalations'!\$C\$9&amp;" "&amp;'Input  Escalations'!\$D\$9&amp;"), "")</i></p>

## Annexure B – Example mapping categories

Categories	RIN table reference
Level 2 RIN subcategories	2.2.1 Replacement expenditure, volumes and asset failures by asset category
	2.3.4 Augex – Total expenditure
	2.5.2 Cost metrics by connection classification
	2.6.1 Non-network expenditure
Level 3 RIN subcategories	2.2.1 Replacement expenditure, volumes and asset failures by asset category
	2.3.4 Augex – Total expenditure
	2.5.2 Cost metrics by connection classification
	2.6.1 Non-network expenditure
Expenditure driver	2.3.5 Augex by driver
	2.3.6 Augex – Greenfields driven
ICT capex	2.6.5 Information & Communications Technology Capex