



1 Introduction

Meritec's review of ElectraNet SA's opex supports the refurbishment programme proposed by ElectraNet SA. However, Meritec states that the ACCC has directed that refurbishment expenditure be removed from the opex budget and be included in capex instead.

In this submission, Powerlink Queensland would like to express its concern over what appears to be a fundamental change in a key regulatory principle. A sweeping policy change that indiscriminately treats all plant refurbishment as capital has a number of undesirable consequences, in particular:

- ❖ it incentivises the inefficient practice of replacing entire assets when refurbishing sub-components of assets may be appropriate;
- ❖ it incentivises transmission entities to change the level at which a "unit of plant" is defined to a much more micro level to reduce revaluation risk, in the process increasing the administrative costs and the costs that the ACCC will incur in future determinations; and
- ❖ it will make it necessary to keep a separate set of "regulatory asset accounts" as a broad policy of capitalising all refurbishment works is not compliant with Australian Accounting Standards. Again, this increases administrative costs without delivering any benefit to the network capability.

During its revenue reset process, Powerlink submitted to the ACCC its capitalisation policy, which complies with Australian Accounting Standards. The policy was endorsed by the ACCC and its consultants. The ACCC's stated intentions (if Meritec is representing the situation correctly) with respect to ElectraNet SA appear to be a material deviation from the approach adopted for Powerlink and from accepted accounting practices.

Powerlink believes that the ACCC should not be sacrificing regulatory principles on the altar of expediency – to do so introduces a level of regulatory risk which will lead to a loss of investment in transmission assets.

2 Refurbishment: opex versus capex

Initially, a refurbishment programme is derived from a technical assessment of the needs of the network without regard for how the expenditure will be recovered. Whether a refurbishment project is treated as operating or capital expenditure depends on a number of factors. An important factor here is whether the work affects the entire asset or just a part of the asset. Conventionally, expenditure incurred on parts of units of plant is expensed while expenditure on entire units is capitalised.

Having accepted that the work is required, a debate of whether the expenditure should be capitalised or expensed amounts to a debate of how and when the expenditure is recovered by the company.

3 Revaluation risk

The level at which a “unit of plant” is defined is crucial during an asset valuation. To avoid revaluation risk, it is important that the asset valuation definition of unit of plant is consistent with the level at which the capex versus opex decision is made. This is because expenditure that has been capitalised for a sub-component of a unit of plant is likely to be missed during an asset valuation on the modern equivalent value of the unit of plant. This would result in the TNSP not being fully compensated for the refurbishment investment.

3.1 Incentivising inefficient refurbishment

An undesirable effect of a broad policy to capitalise all refurbishment without appropriate measures that eliminate regulatory risk is that it incentivises TNSPs replacing entire assets (at the “unit of plant” level) rather than refurbishing sub-components. This is an inefficient practice in many cases.

Meritec make similar observations on page 15 of their opex review:

“Good asset management practices should seek to defer as long as possible equipment replacement, provided it is economically sound to do so and system performance measures such as security and reliability are not reduced below what the customer is prepared to fund.”

3.2 Changing the “unit of plant”

Changing the approach of which refurbishment can be expensed, in effect, changes the level at which a “unit of plant” is defined. Revaluation risk can only be managed by adopting a much smaller unit of plant. However, the process of asset valuations becomes more complex and costly when assets are defined at a micro level. Adding to the complexity introduced are the additional administrative inefficiencies in disaggregating a project into much more detail for financial and maintenance registers and the subsequent management of those registers.

4 Separate “regulatory asset accounts” required

A policy approach adopted of capitalising all asset refurbishment is not supported by the Australian Accounting Standards - notably SAC 4 and AASB 1021. AASB 1021 states *inter alia*:

Subsequent Costs

- 5.7 **Costs incurred relating to a non-current asset subsequent to it having been first put into use or held ready for use must be added to the carrying amount of the asset when and only when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the asset, will flow to the entity in future financial years. All other such costs must be recognised as an expense in the financial year in which they are incurred.**
- 5.7.1 Subsequent expenditure on non-current assets is only recognised as part of an asset when the expenditure improves the condition of the asset beyond its originally assessed standard of performance or capacity. Examples of improvements which result in increased future economic benefits include:
- (a) modification of an item of plant to extend its useful life, including an increase in its capacity
 - (b) upgrading machine parts to achieve an improvement in the quality of output
 - (c) adoption of new production processes enabling a reduction in previous operating costs.

Each refurbishment undertaken can be assessed by applying the above criteria, and the expenditure classified as either capex or opex.

If the ACCC changes its policy to impose an approach that does not conform with the above Australian accounting standards, then TNSPs would be forced to carry a separate “set of books” for regulatory purposes. We cannot see any benefits to the network that outweigh the extra cost that this would represent.