Attachment 20.51

SA Power Networks: Expenditure governance procedures

October 2014

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24 October 2014

SA Power Networks

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EXPENDITURE GOVERNANCE PROCEDURES

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EXPENDITURE GOVERNANCE PROCEDURES

This document describes the robust planning and governance processes employed by SA Power Networks in its business planning and annual budget cycles. It should be read in conjunction with SA Power Network's policies and directives, in particular the following:

- Board Governance Policy
- Financial Management Policy
- Asset Management Policy
- Risk Management Policy

1. CORPORATE GOVERNANCE COMMITMENT

SA Power Networks is committed to the highest standards of corporate governance. Corporate governance is the method by which the business is directed, administered and controlled, and its ultimate aim is to achieve the best balance of outcomes for customers, owners, and the community.

2. GOVERNANCE POLICY AND FRAMEWORK

The Board is responsible for the overall corporate governance of SA Power Networks, including the strategic direction and values, ensuring adequate systems for the identification and management of risk and monitoring and evaluating financial and operational performance.

To enable best practice corporate governance, the Board has approved a Governance Policy, and a Corporate Governance Framework and Model. The key elements of the framework are:

- SA Power Networks Partnership – SA Power Networks is a business owned and operated by a partnership of companies.
- Partnership Agreement – the instrument of delegation that sets the primary requirements for corporate governance on behalf of the members of the partnership;
- SA Power Networks Board – the body representing the members of the partnership which is responsible for the conduct of the SA Power Networks business and strategic direction;
- Board Sub-Committees – bodies established under the Partnership Agreement to assist the Board;
- Business Plan – what SA Power Networks is aiming to achieve;
- Policies – the manner by which SA Power Networks will achieve the Business Plan;
- Delegations of Authority – authorities delegated by the Board to SA Power Networks officers to enable day to day conduct of the business;
- Performance Management – the process of monitoring by the Board to ensure the Business Plan is achieved; and
- Assurance – providing assurance to the Board that SA Power Networks is achieving its objectives, as per the Business Plan, in the manner intended.

SA Power Networks' Corporate Governance Model is shown in Figure 1 below.

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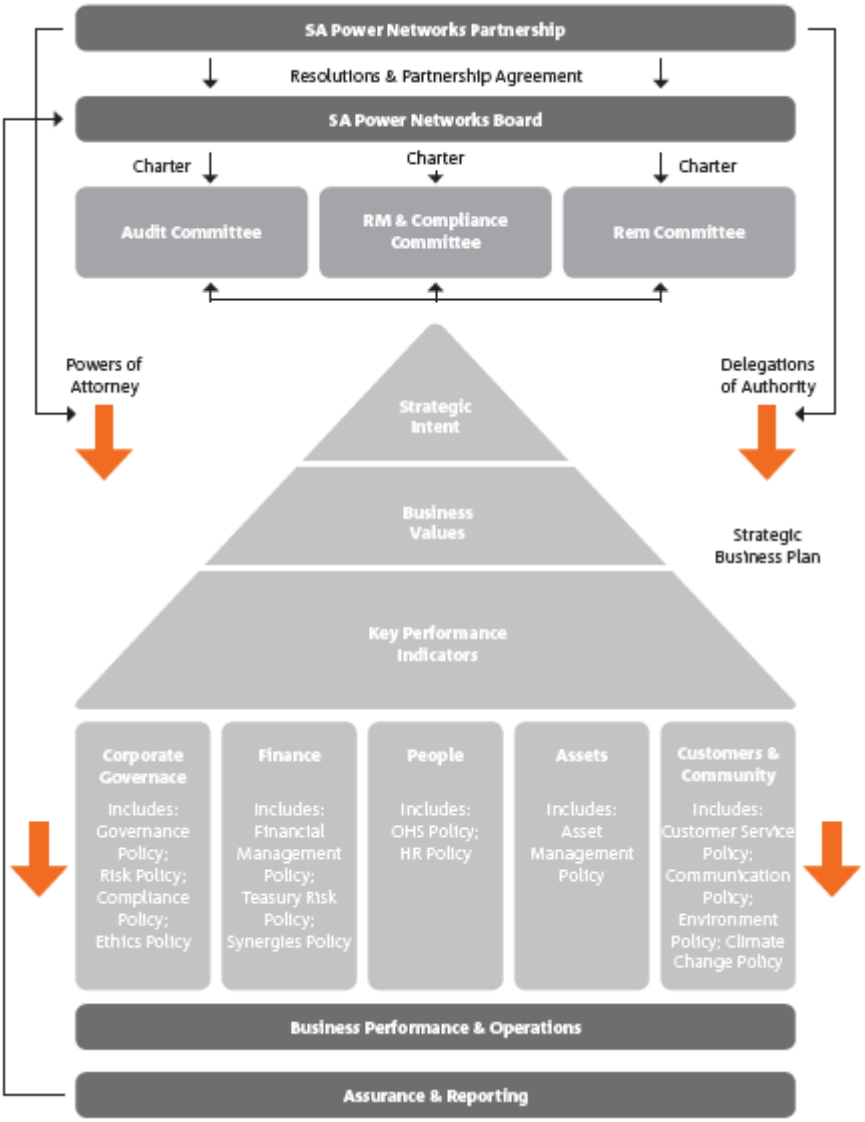
Figure 1: SA Power Networks' Corporate Governance Model



The model provides for a hierarchy of the requirements governing expenditures:

- Policies – approved by the Board determining the broad conduct of the business.
- Directives – approved by the Chief Executive Officer providing direction and rules.
- Processes – approved by a management executive prescribing direction and rules for specific work groups and operational activities.

3. BUSINESS PLANNING

3.1 Enterprise Business Planning

The annual planning cycle is incorporated into the strategic planning process and commences with the Executive Management Group (**EMG**) reviewing and assessing performance against stated objectives. Goals and strategies are refreshed, and broad targets are established for the forthcoming five year planning period.

The strategies and targets provide a broad framework for departments to undertake detailed business planning, including the establishment of a capital program and related capital and operating budgets.

3.2 Departmental Business Planning

After the establishment of broad strategies and targets by the EMG, individual departments prepare their business plans. Planning includes analysis of forthcoming capital projects, and the formulation of the capital and operating plans and budgets.

4. CAPITAL EXPENDITURE GOVERNANCE

4.1 Capital Expenditure Cycle

The capital expenditure process is overseen by the Financial Expenditure Review Committee (**FERC**). The FERC comprises the Chief Executive Officer, Chief Financial Officer and General Manager Corporate Strategy.

Responsibilities of the FERC include:

- review and approve material changes to capital expenditure related procedures;
- review and endorse projects proposed for the subsequent year's capital budget;
- establish a capital expenditure proposal for the subsequent year for approval by the EMG and Board;
- review and endorse submissions to increase funding for budgeted and previously approved projects;
- review and endorse unbudgeted projects during the year; and
- monitor and evaluate the progress of projects and their completion.

The capital expenditure process can be broken down into discrete stages, with each stage the subject of a separate documented procedure:

- Business planning and budgeting;
- Capital project evaluation and approval; and
- Capital project monitoring and completion.

Table 1 overleaf summarises the capital expenditure cycle involving these procedures.

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Table 1: Capital Expenditure Cycle

Capital Expenditure Cycle					
Description	Business Planning	Capital Budget	FERC	Project Authority Approval	Expenditure Monitoring
Business Planning					
Executive Management Group (**EMG**) reviews and assesses performance against stated objectives.					
Goals and strategies refreshed, and broad targets established for forthcoming five year planning period, including budget year.					
Capital Budget Process - Departmental					
Corporate Finance group determines & advises initial budget targets by department.					
Departments advise of committed prior year capex deferred to next budget year.					
Departments prepare initial project costings for budget.					
Departments undertake Risk Assessment & Ranking of individual projects.					
Departments provide FERC with ranked project list.					
Capital Budget Process - Financial Expenditure Review Committee (FERC)					
FERC reviews rankings and determines projects accepted for budget.					
FERC endorses a final capital programme.					
Budget submitted to the Board for approval.					
Project Authority Approval					
Individual projects approved by Project Authority (**PA**).					
Risk Assessment and Financial Evaluation					
Projects above $100,000 require a detailed risk assessment and in limited circumstances a financial evaluation.					
Expenditure Monitoring					
Actual and forecast project expenditure monitored against approved PA.					
Project Revisions					
Over / Under expenditure in excess of threshold requires PA revision.					
Project Close-out and Other					
Projects must be closed out in a timely manner, as well as ensuring WIP and inactive SAP project codes are regularly monitored					
Post Implementation Review (PIR)					
PIRs are required for all projects that exceed $500,000, or are significantly varied from budget, or at General Manager discretion.					

4.2 Capital Budget Process

4.2.1 Development of Departmental Budgets

Annual departmental budgets are developed for submission to the FERC by the identification of projects that are individually costed and ranked in order of risk (the following section outlines the ranking methodology).

In their submission to FERC, Departments are required to identify projects, to which commitment has been made within previous budgets, but which are yet to be completed.

Department General Managers are required to review project rankings prior to submission to the FERC.

4.2.2 Risk Assessment and Ranking Methodology

4.2.2.1 Expenditure categories

Mandatory expenditure
Certain Standard Control Services expenditures are Mandatory, as they are required by legislation or a regulatory requirement or are driven by externally determined factors. Examples of expenditure categorised as *"Mandatory"* are:

- Customer driven projects, such as customer connections, and underground residential distribution (**URD**) and underground industrial distribution (**UID**);
- Electricity Transmission Code (**ETC**) driven projects;
- Emergency supply restoration;
- Power Line Environment Committee (**PLEC**) projects, up to the legislated required annual expenditures;
- Fleet vehicle refurbishment, according to legislative requirements; and
- Carryover projects from the previous year.

Due to the nature of Mandatory expenditure, it is not subjected to a risk assessment.

Priority Projects
Risk assessments are undertaken to evaluate the risks of not undertaking a project. Projects that are assessed as extreme or high risk are categorised as *"Priority"* projects.

Discretionary Projects
Regulated projects with risk ratings lower than extreme or high are classified as *"Discretionary"*. Discretionary projects are ranked primarily according to their risk rating bands.

Risk rating bands provide for coarse ranking, ie between bands. Finer ranking requires ranking within a band.

Ranking near the Budget Cut-off

Priority and Discretionary projects do not need to be ranked within a risk band, except for Discretionary projects where the budget cut-off falls within a band.

Projects will be included in the budget, in order of their ranking, up to the level of the allowed budget totals.

4.2.2.2 Risk Assessment

Risk assessment is a primary criterion for selecting projects for inclusion in the budget. Risk, in the context of capital budgeting, can be described as the *likelihood* of adverse business *consequence(s)* if the capital project does not proceed in the budget year. This definition has the following key elements:

Likelihood

This is expressed in terms of probability ranges (%) and indicative frequencies of events, as shown in Table 2.

Table 2: Qualitative measures of likelihood

Rating	Likelihood	Perception	Probability	Frequency
5	Almost Certain	Is expected to occur	96 – 100%	At least one event per year
4	Likely	It will probably occur	81 – 95 %	One event per year on average
3	Possible	May occur	21 – 80%	One event per 2 – 10 years
2	Unlikely	Not likely to occur	6 – 20%	One event per 11 – 50 years
1	Rare	Most unlikely to occur	0 – 5%	One event per 51 – 100 years

Consequence

This is the impact or repercussion(s) from an adverse event. Consequences may be widespread in their nature and are assessed for each of seven risk domains (ie financial, safety, environmental, reputation/customer service, legislative and regulatory, organisational and reliability). Financial and qualitative measures of consequence are shown in Table 3.

Table 3: Financial and qualitative measures of consequence

Rating	Minimal 1	Minor 2	Moderate 3	Major 4	Catastrophic 5
Financial	Less than $100,000	$100,000 or more, but less than $1m	$1m or more, but less than $10m	$10m or more, but less than $100m	$100m or more
OH&S	Incident but no injury	Medical treatment only	Lost time injury	Death or Permanent Disability	Multiple Fatalities
Environment	Negligible damage that is contained on-site.	Minimal damage to the environment and small clean-up. Immediately contained on site.	Moderate damage to the environment and significant clean-up cost.	Significant environmental damage with wide spread impacts. Damage may be permanent.	Long term environmental harm. Permanent irreparable damage
Reputation / Customer Service	Localised customer complaints	Widespread customer complaints or Complaints to Ombudsman or Regulator	Intervention by the Ombudsman or Regulator	Repeated intervention by the Ombudsman or Regulator	Loss of Distribution Licence
	Adverse regional media coverage	Adverse State media coverage	Adverse media campaigns by customers, media, industry groups	Severe negative impact on both regulated and un-regulated businesses	Loss of Distribution Licence
Legislative and Regulatory	Minor breaches by employees resulting in customer complaints or publicity	Act or Code infringements resulting in minor fines	Severe Company or Officer fines for Act or Code Breaches	Prison sentences for Directors or Officers	Loss of Distribution Licence
	ACCC require apology and / or corrective advertising	ACCC require special offer be made to all customers / suppliers	ACCC minimum level penalties	ACCC moderate level penalties	ACCC maximum level penalties
	Directors / Officers given minimum fines	Directors / Officers given moderate fines	Directors / Officers given severe fines	Directors / Officers given prison sentences	Loss of Distribution Licence
Organisational	Absorbed without additional management activity	Absorbed with minimal management activity	Significant event which requires specific management	Critical event which can be endured with targeted input	Disaster which can cause collapse of the business
Reliability	2000 customers without supply for a min. of 12 hours (ie. a medium size urban feeder)	10,000 customers without supply for a min. of 24 hours (ie. a major storm related outage or a major substation outage)	Up to 40,000 customers without supply for a min. of 48 hours (ie. major multiple zone substation coincident outages)	Over 40,000 customers without supply for longer than 48 hours (ie. major geographical areas off supply)	Adelaide CBD without supply for longer than 24 hours

Budget year

By its nature, risk will change over time and a risk assessment will be based on the likelihood and consequences of the project not proceeding in the budget year.

Level of risk matrix

The risk assessment evaluates scores for likelihood and consequence against the risk matrix, for each of the seven risk domains to establish a level of risk, as shown in Table 4.

Table 4: Level of risk matrix

Risk Matrix	Consequence				
Likelihood	Minimal 1	Minor 2	Moderate 3	Major 4	Catastrophic 5
Almost Certain 5	Medium 6	High 7	High 8	Extreme 9	Extreme 10
Likely 4	Low 5	Medium 6	High 7	High 8	Extreme 9
Possible 3	Low 4	Low 5	Medium 6	High 7	High 8
Unlikely 2	Negligible 3	Low 4	Low 5	Medium 6	High 7
Rare 1	Negligible 2	Negligible 3	Low 4	Low 5	Medium 6

The domain with the highest risk score becomes the final score for the project. Projects are ranked within the risk colour bands, from extreme (red) to negligible (green), according to their project score.

Projects with a risk rating of extreme (red) or high (orange) will be treated as "Priority". Projects with multiple medium (yellow) ratings across several risk domains might be treated as Priority, depending upon the circumstances.

4.2.2.3 Network Risk Assessment

The Network Management Department has further developed its risk ranking system for non-Mandatory projects, based on the corporate methodology, to quantify the financial consequence of each project and allocate risk scores based on the corporate risk system's financial consequence values.

Each project's risk is assessed both pre and post proposed implementation to arrive at a risk score based on a "do nothing" scenario, as well as assessing the residual risk on completion of the project. This also provides a method for measuring the overall level of risk reduction due to the proposed implementation.

In order to remove as much subjectivity as possible from the risk assessment process, likelihood and consequence scores are automatically assigned based on responses to a series of questions posed to responsible Network Management personnel. This also ensures consistency across different assessors.

System administrators can manually override the assigned likelihood value. This will normally only be performed where the history of a specific asset model is known to be more unreliable than the general asset population or where specific asset condition monitoring has indicated a higher likelihood of failure. Where this is the case, this will be noted against the project's risk assessment.

Only network projects with an overall risk ranking of 6 or more (ie medium or greater risk level) are considered in the budget process.

The methodology employed by the Network Management Department considers risks attributable across three categories, namely:

- safety;
- environment; and
- reliability.

Assessors submit risk assessments for all three categories, with the final risk scores being the highest value of all three categories unless the assessor provides appropriate justification.

4.2.3 Unit Cost Methodology

Costs assigned to each project for budget consideration are determined using a set of standard component or "unit" costs expressed in a nominal dollars terms. Project costs are derived using a standard estimating tool and standard construction components. Project estimates are based on high level scopes for budget consideration and are further refined for detailed scopes at the project approval stage.

Unit costs are reviewed and updated periodically, based on historic project information, current activity, material and service rates, and/or quotes received from suppliers or service providers. They represent all possible costs likely to be incurred in undertaking a specific project, including non-field based activities such as design and third party services.

Options assessments are undertaken for augmentation projects to determine the lowest cost feasible solution using present value analysis. Projects greater than $5 million are subject to the Regulatory Investment Test – Distribution (**RIT-D**), to identify the credible option that satisfies the test and maximises benefits to customers.

4.2.4 FERC Capital Budget Assessment and Endorsement

FERC assesses the ranking of projects across the business and evaluates the retained level of risk against target expenditure.

Non-regulated projects are considered separately for inclusion based on their assessed level of risk, related return and available financing.

The preliminary lists of projects, accepted by the FERC for the budget, are distributed back to General Managers, who have the opportunity to review the list and request amendments.

The FERC reviews any requested amendments and prepares a final capital budget and project list for submission to the EMG for endorsement and then to the Board for approval.

4.2.5 Capital Budget Approval

The Board approves the capital budget as part of the annual budget process.

4.3 Capital Evaluation and Approval Procedures

Capital projects over $20,000 must be documented and approved with a Project Authority (**PA**), prior to expenditure being committed.

PAs are approved according to the Board-approved levels of financial delegation.

Capital projects below $20,000 do not require a PA, but are recorded individually in SAP and require approval by officers with the appropriate expenditure authority.

For each project over $100,000, the minimum required documentation includes:

- a PA (including appropriate approval);
- where the project is in the approved budget, a copy of the risk assessment and whether it has been updated from the budget;

- where the project is not in the approved budget, a copy of the risk assessment and financial evaluation;
- a business case with an analysis of options demonstrating that the project is the least cost technically acceptable option available;
- full financial evaluation if there are competing options to satisfy the project's objective;
- full documentation of cost and revenue assumptions to support the financial calculations; and
- financial risk assessment for regulated projects over $500,000.

4.4 Capital Monitoring and Completion

4.4.1 Capital Expenditure Monitoring

Projects are tracked and reported monthly as a minimum for:

- approved budget;
- actual expenditure to date; and
- forecast to completion.

Project revisions are required to be prepared and approved (by officers with appropriate expenditure authority) as soon as any actual and/or forecast expenditure above or below the revision threshold is identified.

Each month, a performance report is prepared that includes a high level summary of the year to date capital expenditure against budget, commentary in regard to variances and updated forecasts as necessary. Performance reports are provided to the Board.

Also monthly reports are provided to each General Manager to enable their review in detail of the projects for which they are responsible, including a specific report identifying projects above or below expenditure thresholds.

4.4.2 Capital Expenditure Completion

All projects are required to be closed out in a timely manner in accordance with departmental close-out procedures. A monthly WIP ageing report is prepared to identify projects that have remained in WIP for a period beyond what would be expected.

Post Implementation Reviews (**PIRs**) are undertaken for completed capital projects, according to the PIR threshold. PIRs are raised for all projects that exceed $500,000. PIRs are required at the direction of the relevant General Manager for projects less than $500,000, or if the project has significantly varied from budget, either in terms of time or cost.

The objective of conducting PIRs is to collect and utilise knowledge learned throughout a project in order to optimise the delivery and outputs of future projects.

5. OPERATING EXPENDITURE GOVERNANCE

5.1 Operating Budget Process

Operating expenditure is governed by setting expenditure targets through the annual business planning and budget process (refer section 3), and the monitoring and reporting of expenditures against targets throughout the year.

Operating expenditure work plans are prepared annually (eg line inspection, vegetation management, maintenance programs, etc) to determine the work required to ensure that SA Power Networks meets its contractual and legal obligations, the work required to meet the performance levels in the SA Electricity Distribution Code and the risk profile assumed in the budget process.

The work plan provides the framework for budgeting, and is essential to ensure that sufficient resource to complete the work is available during the year.

Annual operating budgets are presented to and endorsed by FERC, prior to submission to the EMG for endorsement and subsequently to the Board for approval.

5.2 Operating Monitoring

Monthly reporting against agreed key performance indicators is undertaken within each department and at a consolidated level to ensure that work plans and financial targets are achieved.

Material variations to targets require formal explanation and forecasting of outcomes is undertaken periodically against annual budgets and targets. Adjustment to work plans will be required where necessary to meet the overall strategic objectives of the organisation.

Consolidated reports are provided to the EMG and Board, including explanation of significant budget variations and forecast revisions.

Whilst expenditure approval is established through the budget process, compliance with SA Power Networks' Policies and Directives (eg Financial Management Policy/Directive, Procurement Directive) is monitored and reported to certify that governance standards are being met.