Cost Allocation Methodology

APPROVED

CONTACT

This document is the responsibility of the Asset Strategy & Planning Group, Transend Networks Pty Ltd, ABN 57 082 586 892.

Please contact Transend's Manager Asset Strategy & Planning Group with any queries or suggestions.

REVIEW DATE

This document is due for review not later than Not Applicable

RESPONSIBILITIES

Implementation

All Transend staff and contractors.

Audit

Periodic audits to establish conformance with this document will be conducted by Transend's Asset Strategy & Planning Group.

Compliance

All Group Managers

Document Management

Asset Strategy & Planning Group
Revenue Reset team

MINIMUM REQUIREMENTS

The requirements set out in Transend's documents are minimum requirements that must be complied with by Transend staff and contractors, including designers and other consultants. The user is expected to implement any practices which may not be stated but which can reasonably be regarded as good practices relevant to the objective of this document without non-compliance with the specific requirement of this document. Transend expects the users to improve upon these minimum requirements where possible and to integrate these improvements into their procedures and quality assurance plans.

TRANSEND NETWORKS PTY LTD

Cost Allocation Methodology

Version History

Version No	Date of Revision	Authorised By	Details of Amendment
1.0	April 2008	M. Hunnibell	Version 1.0

Amendments to each version of this document will be tracked through Transend's document management system.

TRANSEND

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1 OVERVIEW

1.1 PURPOSE

The purpose of this document is to establish a methodology for attributing or allocating costs to, or within prescribed, negotiated and non-regulated transmission services and other non–regulated activities undertaken by Transend Networks Pty Ltd (Transend).

This Overview outlines:

- the objectives of this Cost Allocation Methodology document; and
- key responsibilities and general requirements to ensure that Transend implements and maintains this methodology in accordance with good financial management practice and the requirements of the Australian Energy Regulator (AER's) Cost Allocation Guidelines.

The attached Appendix provides the detailed cost attribution principles and policies referred to including a Directors' Statement regarding Transend's Cost Allocation Methodology that is required by the AER.

1.2 PRINCIPLES

Transend has specific obligations to ensure that costs are allocated and recorded in the financial systems in an appropriate manner. These obligations are imposed by:

- statutory requirements in accordance with legislation;
- regulatory requirements in accordance with Chapter 6A of the National Electricity Rules (NER); and
- operational and management requirements to meet business needs.

It is an imperative that the above obligations are met as the board and management specifically sign-off that the above obligations are met when submitting:

- the Transend Annual report to its shareholders and to the Australian Securities and Investments Commission (ASIC);
- revenue Submissions and Regulatory Accounting Statements to the Australian Energy Regulator (AER). Transend is committed to allocating costs between and within categories of transmission services consistent with the AER's Transmission Ring-Fencing Guidelines; and
- tax returns to the Australian Taxation Office.

This document provides policies and principles that guide the cost allocations associated with these obligations.

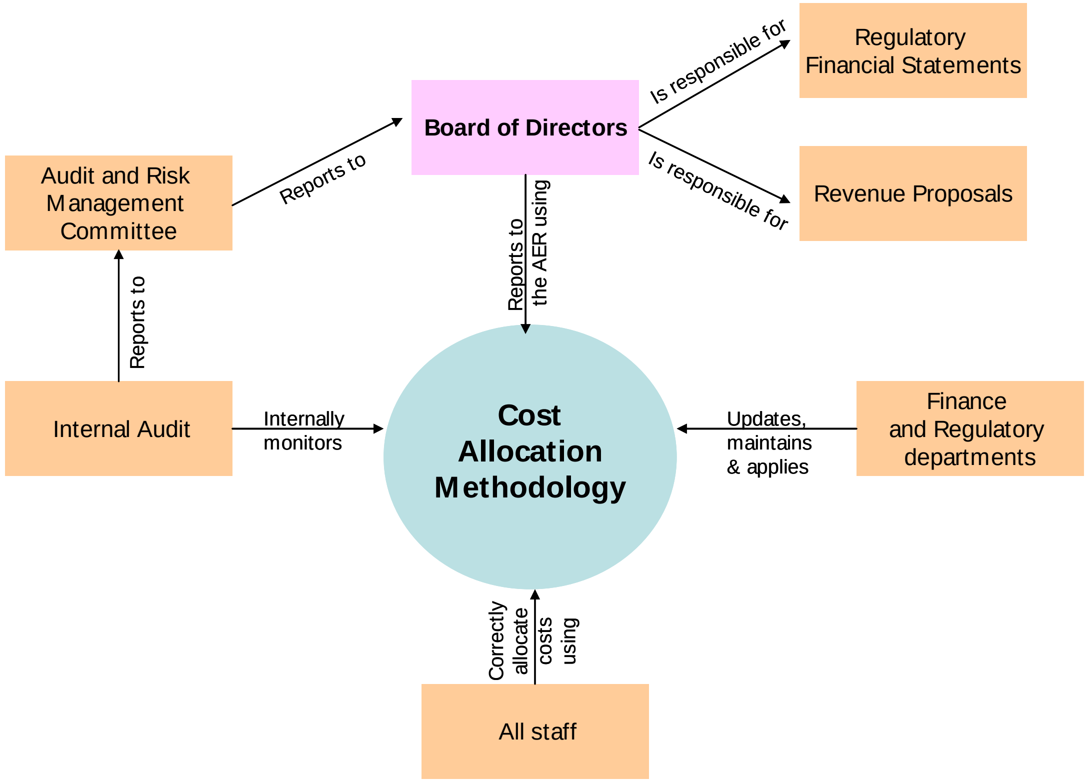
1.2.1 National Electricity Rules obligations

This document also comprises Transend's "Cost Allocation Methodology" prepared in accordance with clause 6A.19.4 of the National Electricity Rules (NER) and the requirements of the Cost Allocation Guidelines dated September 2007 issued by the Australian Energy Regulator (AER). Accordingly the content of this document also complies with the requirements of clause 3.2 of the Cost Allocation Guidelines.

1.3 ACCOUNTABILITIES AND RESPONSIBILITIES

The schematic below represents the governance and responsibility structure Transend employs to maintain and implement this methodology:

Figure 1 - Accountabilities and responsibilities



Board of Directors

The board is responsible for Transend's regulatory financial statements and revenue submissions to the AER, and other financial statements and documents which are prepared in accordance with this Cost Allocation Methodology. Appendix A includes a Directors' responsibility statement for submission to the AER in this regard.

Finance and Regulatory departments

The Finance and Regulatory departments are responsible for:

- approving and the mandatory application of this policy;
- regularly maintaining and updating this policy and supporting documents;
- monitoring the correctness and reasonableness of direct attribution of costs via labour timesheets and invoice processing to transmission service categories;
- determination of appropriate causal cost drivers for the allocation of overhead costs;
- determination of appropriate causal cost drivers for the allocation of specific costs; and
- preparation of regulatory reports.

Internal Audit

Internal Audit is responsible for the internal monitoring and reporting on the application of the Cost Allocation Methodology. In accordance with good corporate governance practice, Transend's internal audit function:

- sets the scope of and undertakes its work independently of the managers responsible for the subject of internal audit; and
- reports to the Audit and Risk Committee independently of Transend's management personnel.

All staff

All staff are responsible for following the requirements of Transend's general accounting and administrative procedures to ensure that all costs are completely and properly recorded.

1.4 MAINTENANCE OF AN AUDIT TRAIL AND RECORD RETENTION

1.4.1 Accounting records

Transend records its costs in accounting records which are maintained in accordance with Corporations Act statutory requirements. Transend requires its accounting records to be maintained in a way that enables its directors to explain and verify costs and other entries recorded in Transend's accounting records and how they have been derived from source data.

1.4.2 Working papers

When preparing reports for submission to the AER, Transend shall prepare supporting work papers and documentation that may be required by the Information Guidelines, Submission Guidelines or any other relevant guidelines published by the AER, in accordance with these principles and policies. These work papers and documents should be in sufficient detail to allow:

- the AER or an auditor to replicate the cost and asset allocation outcomes reported to the AER; and
- Transend to demonstrate that it has complied with the requirements of this Cost Allocation Methodology, prepared in accordance with the AER's Cost Allocation Guidelines.

In particular, assets are recorded at regulatory values in a regulatory asset register which allows the regulatory asset base balance to be calculated at any given balance date and for movements in balances to be explained and reconciled.

1.4.3 Record retention

Transend will maintain all source documents and records (timesheets / invoices) for a minimum period of seven years.

General ledger trial balances and transaction listings as well as cost allocation working papers will also be retained for a minimum period of seven years.

1.5 MONITORING COMPLIANCE

Transend will monitor its compliance with this Cost Allocation Methodology and the

AER's Cost Allocation Guidelines as follows:

- as part of processing timesheets and invoices, the Finance Department will review the reasonableness of coding expenditure to the categories of services provided;
- annual review of documentation by the Finance and Regulatory departments of financial year end data used to prepare Transend's regulatory statements;
- to help meet the scope of the audit of Transend's regulatory statements the general ledger and individual transactions will be reviewed by external audit as necessary;
- based on an assessment of risk, direct attributions and the allocation of overhead costs will be reviewed by Internal Audit;
- the directors of Transend will make such enquiries as may be necessary to allow them to sign responsibility statements for financial information that Transend submits to the AER; and
- where required by the AER, financial information prepared under the Cost Allocation Methodology and Cost Allocation Guidelines shall be subject to independent audit.

1.6 DATE OF COMMENCEMENT

Following approval by the AER this Cost Allocation Methodology is current at the date signed by Transend's directors and for regulatory purposes will apply to:

- Transend's regulatory revenue submission for the regulatory period effective from 1 July 2009 to 30 June 2014; and
- information provided by Transend to the AER for Transend's submission of its regulatory financial statements for the year ended 30 June 2008.

This document remains current until such time the document is re-issued.

Information provided by Transend to the AER for Transend's submission of its regulatory financial statements for earlier financial years is consistent with this methodology.

1.7 AVAILABILITY

In accordance with the requirement of clause 6A.19.4(h) of the NER, Transend will maintain a current copy of its approved cost allocation methodology on its website and this will be made available to the AER in electronic and printed form.

1.8 VERSION HISTORY AND DATE OF ISSUE

This is version 1 of Transend's Cost Allocation Methodology prepared under the AER's Cost Allocation Guidelines.

Appendix A - Detailed Cost Attribution Principles and Policies

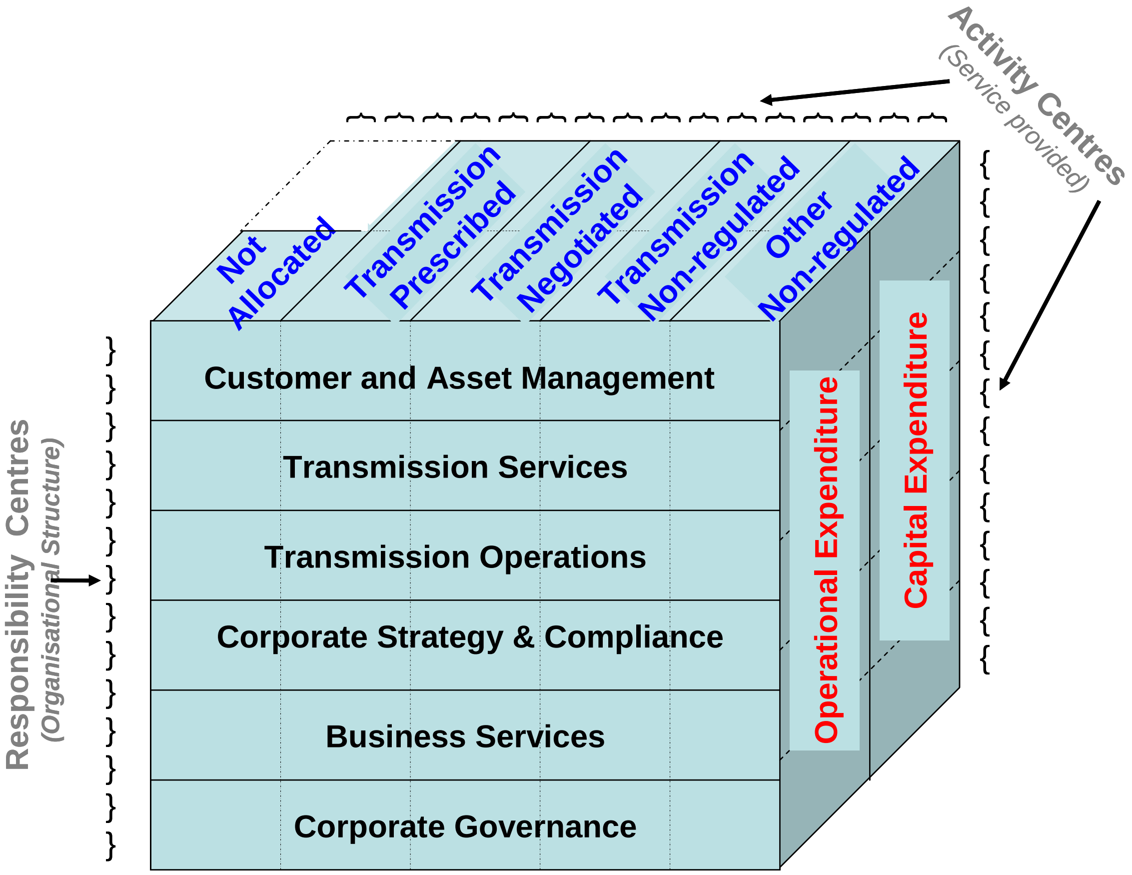
A.1 - General overview

Transend uses a "cube" concept to report costs within the 3 dimensions of a cost allocation matrix within the chart of accounts maintained within the general ledger. That is to say costs normally need to be attributed according to:

- Responsibility Centre - defined as the area in the business that is responsible for the work performed;
- Activity Centre - defined as the nature of the work being performed and is also used to identify between capital and operating expenditure; and
- Cost Element - defined as the nature of the costs incurred such as labour or contracted services.

A single Activity Centre may appear across a number of different Responsibility Centres. All costs are assigned to both a Responsibility Centre and an Activity Centre. This is illustrated by the diagram below.

Figure 2 - Cost Allocation Matrix



The concept of Responsibility Centre / Activity Centre (RCAC) is the primary concept used to populate the cost allocation matrix. All costs are allocated to a Responsibility Centre / Activity Centre at the time the expenditure is authorised. In addition, the general ledger chart of accounts is structured to enable costs to be further segregated by:

- organisational structure (refer A.1.1);
- category of service provided (refer A.1.2);
- regulatory reporting categories (refer A.1.3);
- shared (overhead) and directly attributable costs (refer A.1.4); and
- other information needs as required by management.

This allows for costs to be further segregated allowing for more detailed reporting and to meet both statutory and regulatory reporting requirements. Reports can be produced from the general ledger at any time to replicate outcomes reported to the AER or its consultants.

A1.1 - Organisational Structure – Responsibility Centres

As at February 2008 Transend is structured as six major groups:

- Customer and Asset Management;
- Transmission Services;
- Transmission Operations;
- Corporate Strategy and Compliance;
- Business Services; and
- Corporate Governance.

A1.2 - Regulatory “Business Segments”

For regulatory purposes Transend is required to report costs according to the following Regulatory Business Segments which align with the principal activities outlined in the cost matrix described in Figure 2 above:

- prescribed transmission services;
- negotiated transmission services;
- non-regulated (contestable) transmission services;
- other non-regulated (non-transmission) services; and
- not allocated costs.

These Regulatory Business Segments are briefly outlined below.

A1.2.1 - Categories of transmission services

Both capital and operating expenditure are allocated to Activity Centres that are aligned with the following principal categories of transmission services:

- prescribed transmission services provided to generators, high voltage customers and distribution networks;

- negotiated transmission services. For the sake of brevity the NER service definitions are not repeated here, but to aid explanation, Transend's negotiated services broadly comprise:
  - connection services including entry and exit connection services and connection to Basslink;
  - use of system services supplied by the shared transmission network that exceed or are below the network's legislated specified standard;
  - services where customers require a different standard of service such as increased security of supply, reduced harmonic distortions to meet special electrical equipment needs; and
  - use of system services relating to augmentation for transmission network loads or generators - this might arise where a new load requires augmentation of existing assets that also provide prescribed services to existing customers
  - non-regulated (contestable) transmission services such as Transend operating and maintaining a transmission line on behalf of an external party.

where these services are defined in accordance with *Chapter 10* of the *NER*.

A1.2.2 - Other non-regulated services

In addition to the various categories of transmission services summarised above, Transend may incur costs related to non-regulated – non-transmission services such as the lease of building space to external parties. These costs are accounted for separately within Transend's general ledger.

A1.3 - Regulatory Reporting Categories

The principles and policies set out in this information must be applied to information submitted to the AER whenever Transend is required to prepare forecast and / or historical financial information for Revenue Proposals and regulatory financial statements.

The regulatory reporting categories used by Transend in the AER Pro Forma templates as per the AER Submission Guidelines are as follows:

- Field operations and maintenance;
- Transmission services;
- Transmission operations;
- Asset management;
- Corporate; and
- Other operating expenditure.

Regulatory Account Codes are stored in the general ledger against each Responsibility Centre / Activity Centre and these codes are the basis of extracting costs for the above categories, and corresponding sub categories, directly from the general ledger. These reports can be produced at any time to replicate information provided to the AER.

A1.4 - Shared (Overhead) and Directly Attributable Costs

Codes are stored in the general ledger against each Responsibility Centre / Activity Centre which distinguishes between shared (overhead) and directly attributable costs. These codes are the basis of extracting costs for the above directly from the general ledger. These reports can be produced at any time to replicate information provided to the AER.

A2 - Cost attribution and allocation

A2.1 - Scope

A2.1.1 - Reports

The principles and policies set out in this Methodology must be applied to information submitted to the AER whenever Transend is required to prepare:

- forecast operating expenditure to be submitted to the AER in accordance with clause 6A.6.6 of the *National Electricity Rules;*
- forecast capital expenditure to be submitted to the AER in accordance with clause 6A.6.7 of the *National Electricity Rules;*
- prices for a negotiated transmission service determined in accordance with clause 6A.9.1 of the *National Electricity Rules;*
- a certified annual statement in accordance with clause 6A.17.1(a) of the *National Electricity Rules;* and
- actual or estimated capital expenditure for the purposes of increasing the value of its regulatory asset base under clause 6A.2.1(f)(4) of the *National Electricity Rules*.

This will include:

- annual regulatory financial statements required by the AER's Information Guidelines (Transend personnel preparing this information should refer to clause 2.3 of the Information Guidelines in particular); and
- forecast financial information and Revenue Proposals required by the AER's Submission Guidelines (Transend personnel preparing forecast financial information should refer to clause 2.3 of the Submission Guidelines).

All allocations are to be supported by calculations and relevant working papers.

A2.1.2 - Costs

The principles and policies described below shall apply to all costs attributable to Transend's transmission services, regardless of the entity in which they arise. For the avoidance of doubt these would include any costs associated with related party transactions that might be identified and accounted for in accordance with Corporations Law and applicable Accounting Standards.

A2.2 - General outcome principles – substance over form

In implementing the cost attribution and allocation principles set out in this document Transend shall be guided by the following principles:

- costs shall be directly attributed to, or allocated between or within, categories of transmission services based on the substance of the underlying transaction or event;

- where the substance and legal form differ, the substance rather than the legal form of a transaction or event shall be used as the basis of cost allocation;
- in determining the substance of a transaction or event, all of its aspects and implications shall be considered, including the expectations of and motivations for, the transaction or event; and
- for the purposes of determining the substance of a transaction or event, a group or series of transactions or events that achieves, or is designed to achieve, an overall commercial effect shall be viewed collectively.

A2.3 - Specific principles for the attribution of historic costs

For any given accounting period, the total of the costs attributed to RCAC's shall equal or be capable of reconciliation to, Transend's total costs incurred.

All costs shall be classified as either a directly attributable or a shared cost only. (No single cost item can be at the same time both a direct and a shared cost). Where possible costs will be directly allocated to a Regulatory Business Segment. If direct allocation is not possible then a causal method of allocation will be determined.

No costs shall be double counted or omitted.

The principles that characterise directly attributable and shared costs are set out below.

A2.3.1 - Directly attributable costs

Directly attributable costs are those costs that are wholly and exclusively associated with a relevant Regulatory Business Segment.

General ledger account headings and account numbers are used to identify and allocate directly attributable costs to the RCAC they relate to.

Directly attributable costs shall be separately disclosed according to their account headings on work paper DISAGG Opex of Transend's annual regulatory financial statements, so as to allow:

- the AER or any other reader of the regulatory financial statements to identify the amount, nature and category of transmission services to which the costs have been directly attributed to and between Transmission Services; and
- an independent person to audit or otherwise verify the amount and nature of the directly attributed costs.

A2.3.2 - Shared costs

Shared costs are costs that may need to be allocated to more than one Regulatory Business Segment.

The application of the cost allocation framework will result in different allocation percentages each year depending upon changes to inputs to the allocation base. The outcome of applying the cost allocation framework will be described in working papers supporting annual regulatory information reporting.

The following principles shall apply:

- each shared cost can only be classified under one basis of allocation;
- a basis of allocation may be either *causal* or *non-causal* (the principles governing the application of these bases are set out below);
- Transend will not allocate shared costs using an avoided cost approach unless approved by the AER;
- all recorded shared costs included in Transend's regulatory financial statements shall be disclosed on schedules DISAGG Aloc of those statements in accordance with the AER's requirements and provide a description of:
  - the nature of each cost item;
  - the categories of transmission services and other Regulatory Business Segments each cost item has been allocated to;
  - the nature of each allocator and how it meets the selection criteria set out in this Cost Allocation Methodology; and
  - to meet the requirements of clause 2.2.1(b)(2)E(ii) of the AER's Cost Allocation Guidelines, an explanation of how the numeric quantity or percentage of each allocator has been calculated for each cost item, including where the data for determining the numeric quantity or percentage have been sourced and whether this has changed over or throughout the regulatory control period.
- by definition costs cannot be allocated or shared between the 'Not allocated' segment and other segments.

A2.3.3 - Causal bases of allocation of shared costs

In accordance with clause 6A.19.2(3)(ii) of the NER, each category of shared cost is to be allocated on a causal basis unless:

- the shared costs are immaterial; and
- a causal relationship cannot be established without undue cost and effort.

A causal basis of allocation is one where the basis of allocation is a trigger of the consumption or utilisation of the resources or services represented by the amounts subject to allocation.

Costs are immaterial where the omission, misstatement or non-disclosure does not have the potential to prejudice the understanding of the financial position of Transend gained by an assessment of the financial information relating to Transend.

Transend allocates the following costs on a causal basis:

- overhead and business costs;
- insurance costs; and
- asset related costs.

Overhead and business costs are allocated to Regulatory Business Segments almost entirely on the basis of direct labour hours. The use of direct labour hours is generally the most appropriate allocator to allocate these costs as:

- it is the appropriate indicator given the nature of costs involved. On the basis of previous analysis, allocating shared costs using labour hours is simple yet reflective of allocating costs on other alternative basis. For example; using direct labour hours as the basis applies overhead costs in a similar ratio to floor space, number of IT users etc;
- historically is the basis used by Transend. This basis has and continues to meet requirement of Accounting Standards and audit reviews;
- is practical, transparent and easy to forecast and apply.

Whilst other allocators are available it is Transend's view that using direct labour hours as the preferred allocator is the most appropriate and equitable. As the forecast amount of overhead and business costs and direct labour hours will vary from year to year the dollar overhead rate per direct labour hour may change from year to year.

Insurance costs are allocated on the basis of:

- insured replacement cost of the asset (for property related policies); or
- revenue earned (for liability related policies).

The reason for selecting the above allocators is because of the relevance of those items to Transend's insurance underwriters when they calculate the premium for those policies. As the forecast amount of insured asset replacement costs, revenue earned and premium costs will vary from year to year the amount allocated to each Regulatory Business Segment will change from year to year.

Asset related costs can relate to assets attributable to different Regulatory Business Segments. Asset related costs are allocated depending upon the nature of the assets involved. Costs are allocated on a pro-rata basis using the number, type or capacity of the assets as appropriate. The basis chosen best reflects the appropriate allocation of costs between each of the Regulatory Business Segments. The amount allocated may vary from year to year as the basis of the allocation changes.

A2.3.4 - Non-causal bases of allocation of shared costs

At the time of submitting this policy, Transend does not anticipate utilising non-causal bases of allocation. In the event that any costs cannot be allocated on a causal basis in accordance with the criteria described in A.2.3.3 above, a non-causal basis of allocation would:

- be selected such that it is likely to reflect a strong positive correlation between the basis of allocation and the actual cause or trigger of consumption or utilisation of the services or resources that the shared costs represent; and
- be disclosed in a working paper (refer to DISAGG Aloc in AER Information Guidelines for example) accompanying any financial information or statements provided to the AER that include costs allocated on a non-causal basis, which sets out:
    - the shared costs subject to each basis of allocation;
    - the reason for choosing the basis of allocation; and

- a demonstration that the shared cost is immaterial.

A2.3.5 - AER approval of non-causal basis of allocation

Any non-causal basis of allocation should be submitted to the AER for approval as soon as the requirement for it has been determined.

Transend shall maintain a record of all AER approvals of non-causal bases of allocation.

A2.4 - Principles for the attribution of forecast costs

Forecast costs differ from historic costs because they are necessarily founded on assumptions not accounting records. Nonetheless the assumptions that underlie a forecast attribution of cost shall be consistent with the framework for recorded historic costs set out in principle A.2.3 above.

The overriding consideration should be the fairness of presentation of the forecast costs. In all cases there should be a clearly documented and properly calculated trail of underlying reasonable assumptions that provide robust support for the forecasts.

A2.5 - Consistency and principles governing any changes to bases of allocation

A2.5.1 - Review of cost allocation

Whether a recorded cost is directly attributable or shared is a matter of fact that may not always be able to be determined and verified in advance of the time at which the cost is recorded.

Therefore whenever historical financial information is prepared for submission to the AER, all classifications of costs as direct or shared shall be reviewed for:

- consistency with prior periods; and
- fairness of presentation with particular reference to the substance over form principle A.2.2 above.

A2.5.2 - Consistency between reporting periods

Subject to an overriding requirement to produce accounting information that provides a true and fair view of costs, consistent bases of allocation must be maintained whenever possible between reporting periods to assist the AER to compare the regulatory financial reports of Transend over time to identify trends in its financial position and performance.

However it is not generally possible to warrant whether and when an allocator may need to be changed in the future. In assessing a requirement to change a basis of allocation for the future the overriding considerations should be the:

- fairness;
- relevance;
- reliability; and

- requirements for comparability set out in the Australian Government Accounting Standards Board (AASB) 'Framework for the Preparation and Presentation of Financial Statements', consistent with the overriding principles set out at A.2.2.

The AASB sets out the concepts that underlie the preparation and presentation of financial reports for external users. In particular paragraph 41 states:

> *"The need for comparability should not be confused with more uniformity and should not be allowed to become an impediment to the introduction of improved accounting standards. It is not appropriate for an entity to continue accounting in the same manner for a transaction or other event if the policy adopted is not in keeping with the qualitative characteristics of relevance and reliability. It is also inappropriate for an entity to leave its accounting policies unchanged when more relevant and reliable alternatives exist."*

Practically, these considerations would need to be considered when for example:

- undertaking the reviews referred to in A2.5.1 above; or
- improved information or changes in materiality suggest that a non-causal basis of allocation should be superseded by a causal basis of allocation; or
- the continuation of a basis of allocation may prove impractical because of data constraints.

Where a requirement for a change in allocation may be identified, the approval procedures set out in the AER's Cost Allocation Guidelines would be consulted prior to implementing any change.

A3 - Directors' statement

On behalf of the board of Transend Networks Pty Ltd, we confirm that:

- this document "Transend Networks Pty Ltd Cost Allocation Methodology" dated April 2008 sets out Transend's Cost Allocation Methodology which Transend is required to prepare and submit to the AER for approval in accordance with Clause 6A.19.4 of the NER; and
- Transend intends to comply with this Cost Allocation Methodology.

We also note that clause 3.2 (10) of the AER's Cost Allocation Guidelines dated September 2007 requires two directors of Transend to confirm that the information contained in this Cost Allocation Methodology is accurate. Transend's board notes that it is not in general terms feasible to give an opinion on whether a methodology is accurate in isolation from and in advance of the application of that methodology to future submissions. However, Transend confirms its intention to provide appropriate directors' responsibility statements that may be required by Guidelines issued by the AER, regarding the preparation of information and submissions that the AER requires to be prepared using this Cost Allocation Methodology.

For and on behalf of the board of Transend Networks Pty Ltd

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Director JOHN LORD

1st MAY 2008
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Date

....
Director RICHARD BEVAN

1 - MAY 2008
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Date