Submission to the Australian Energy Regulator

Re: Regulatory Accounting Methodologies Position Paper

UNITED ENERGY Distribution

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TABLE OF CONTENTS

1 Introduction

This submission is in response to the position paper published by the Australian Energy Regulator (AER) titled Regulatory Accounting Methodologies Position Paper dated September 2005.

Whilst UED does not currently own any transmission electricity assets, and therefore not subject to the requirements of the proposed methodology, to the extent that there is consistency between transmission and distribution guidelines our preferred approach is documented below.

The AER's Position Paper proposes to prescribe the "as-incurred" approach to recognising capital expenditure rather than the "as-commissioned" approach. This submission sets out UED position on the high level approach that should be adopted by regulators when assessing capital expenditure and sets out UED response to each of the issues raised in the position paper.

2 Approach to Capital Expenditure

UED supports an approach to capital expenditure that provides the company with the incentives to invest and ensure the long-term future of service reliability. Such an approach would establish benchmarks for the forthcoming regulatory period that provides incentives to the business to minimise actual costs. This approach provides the companies with appropriate incentives and the regulator with sufficient certainty to ensure that an ex-post examination of costs is not required and minimises the regulatory burden of all parties.

This approach is similar to the one described in the position paper where efficient capital benchmarks are assessed up front as part of the revenue review and actual capital expenditure is rolled into the asset base at the end of the period. Companies are either rewarded or penalised for any differences between actual and forecast capital expenditure and only actual expenditure, as it is incurred, is rolled into the asset base.

3 Specific Issues

3.1 Issue 1

The AER's preliminary view is that the "as-commissioned" approach is not consistent with the ex-ante incentive regime established in the AER's SRP. Specifically, it requires a project specific assessment and will require complex adjustment to ensure that the present value of the revenue stream over the life of the asset would be the same as under the "as-incurred" approach.

UED agrees that the "as-commissioned" approach could be complex to administer and not necessarily consistent with the ex-ante incentive regime established in the AER as Statement of Regulatory Principles (SRP).

Capital expenditure should be recognised/forecast on a cash/accrual basis as the asset is being constructed. This is consistent with international accounting principles and policies. This will ensure that any differences between the company's statutory accounts and regulatory accounts are easily identifiable and not subject to timing differences across different accounting periods.

Accordingly return of assets should be calculated on this basis and depreciation can be calculated when the asset is commissioned.

3.2 Issue 2

The AER's preliminary view is that under the "as-commissioned" approach an ex-post assessment would need to be undertaken. The assessment would need to consider the prudency of expenditure undertaken during the previous regulatory period on projects that are commissioned in the current regulatory period.

For the reasons provided above UED does not favour an approach that relies on an ex-post assessment of capital expenditure. UED makes no comment as to whether an ex-post requirement is necessary under an "as-commissioned" approach. To the extent that the AER considers that this is a necessary requirement of the "as-commissioned" approach, as ex-post assessment is not part of a regulatory regime that UED considers to be best practice.

3.3 Issue 3

The AER's preliminary view is that under the "as-commissioned" approach would involve additional administrative complexity. This would affect TNSPs as well as the AER. TNSPs would be required to implement new arrangements and provide supporting ongoing reporting.

UED agrees that there is the potential for additional administrative complexity to an "as-commissioned" approach to capital recognition. The complexity associated with this approach would appear to come for no net benefit. UED does not support regulatory policies where costs outweigh any benefits.

3.4 Issue 4

The presentation of regulatory accounts differs from financial accounts. This applies whether or not the "as incurred" or "as commissioned" approach is applied.

The AER's preliminary view is that the different reporting and reconciliation requirements do not favour one approach over the other. However, the AER recognises that TNSPs may incur one-off costs in the transition from one approach to another and that TNSPs should be compensated for any additional costs.

UED agrees with the AER's assessment that there can be differences between financial and regulatory accounts when applying either the "as-incurred" or the "as-commissioned" approach. Any differences between financial and regulatory accounts should be limited to genuine differences of expenditure rather than timing differences. Genuine differences could be described as expenditure incurred by the company in areas other than transmission or differences in accounting policies applied between the regulatory and financial accounts.

These differences are easily identifiable, easily presented and easily explained. In other words capital expenditure recognised in the financial accounts is either allocated to the transmission business or not allocated at all. Differences attributable to timing simply confuse the recognition of capital expenditure and potentially mislead the reader due to the "lumpy" nature of large capital projects.

3.5 Issue 5

The AER's preliminary view is that consistency between accounting approaches across TNSPs would assist in comparing performance between TNSPs and over time.

UED agrees that consistency between accounting approaches will assist in comparing performance over time. However it is not always possible to maintain consistency due to company specific requirements. Differences should be minimised without major disruption or cost to individual companies. Any inconsistencies should be addressed on a case by case basis.

3.6 Issue 6

The AER's preliminary view is any price shocks associated with transitioning from the "as-commissioned" to the "as-incurred" approach is not likely to be significant.

UED makes no comment on this issue.

3.7 Issue 7

The AER's preliminary view is that any price shocks associated with implementing either approach is not likely to be significant.

UED makes no comment on this issue.