

Submission to the Essential Services Commission

Re: Electricity Distribution Price Review 2006 – 2010 Draft Decision

Regulatory Asset Base



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Distribution**

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1 Background

Over the course of this price review, the Essential Services Commission (the Commission) has requested a significant amount of information from United Energy Distribution (UED) regarding historical cost information contained in the company's annual Regulatory Accounting Statements. Information relating to historic capital expenditure was sought by the Commission and provided by UED prior to UED lodging its Price Service Offering (PSO) in October 2004.

UED has previously acknowledged that the structure of the regulatory accounting statements means that it could be interpreted that the data contained in UED's historic Regulatory Accounting Statements was not consistent. This is because the structure of Commission templates do not require all capital expenditure shown in the Accounting Statements to be supported by backup worksheets. Following discussions with the Commission prior to October 2004, UED was of the view that these apparent inconsistencies had been explained to the Commission, and that the Commission had accepted that the historic capital expenditure information reported in the audited Regulatory Accounting Statements reflected the substance of that expenditure. On this basis, UED's PSO contained historic capital expenditure information that had been actually incurred and externally audited.



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2 Commission's Draft Decision

The Commission's Draft Decision (published on 22 June 2005) made adjustments to the historical data contained in UED's PSO. In relation to capital expenditure the Commission has made three different types of adjustments. These being:

1. changes agreed to by UED, generally in relation to the presentation of net and gross capital expenditure (ie the presentation of customer contributions);
2. an adjustment to the forecast 2004 expenditure contained in UED's PSO (lodged in October of 2004) to align it with the actual reported expenditure contained in the annual Regulatory Accounting Statements lodged by UED in April 2005; and
3. adjustments - to externally audited accounts specifically in relation to the 2000 calendar year; which UED has not agreed to.

UED understands and accepts the reasons for the capital related adjustments described in items 1 and 2 above. This submission deals specifically with item 3, which relates to the Commission's adjustment of the reported 2000 capital expenditure by approximately \$19 million. The Commission explains this adjustment in footnote 39 of its Draft Decision as follows:

"The Commission has based its analysis on the capital expenditure reported in work paper FAAR (Fixed Assets at Cost – Additions by reason) of the Regulatory Accounting Statements. The capital expenditure reported by United Energy in additions on page 14 of its 2001 regulatory accounts, but is not consistent with the capital expenditure reported in workpaper CA (Fixed Assets at Cost – additions) of the 2000 regulatory accounting statements (which included capital expenditure for excluded services). In its price-service proposals, United Energy has included an additional \$19 million of capital expenditure as reported in the 2000 workpaper CA."

UED interprets this footnote and subsequent correspondence as stating that capital additions for any one year can only be included in the regulatory asset base if they are included in a specific work sheet of the Regulatory Accounting Statements rather than in the audited Regulatory Accounting Statements themselves.

Based on further correspondence received from the Commission, UED understands that the adjustment amount is made up of two separate components:

\$17,470,000	Capital expenditure not considered
\$2,430,000	Basis for adjustment not known



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3 UED's Response to the Draft Decision

3.1 Capital Expenditure not Considered

The accepted method of "rolling forward" the asset base value (at cost) from one year to the next is as follows:

Opening value + Capital Expenditure – Disposals – Customer Contributions.

In the preparation of UED's 2000 Regulatory Accounting Statements a standard Commission template has been lodged with these details included. Information contained in these accounts and subsequent correspondence provided to the Commission dated 15 July 2005 clearly itemises the actual audited capital expenditure for 2000.

UED strongly objects to the narrow interpretation the Commission has adopted in its Draft Decision, in which the Commission apparently considers that the information contained in a single supporting work sheet, rather than the other information contained in the audited Regulatory Accounting Statements, as determinative of whether the expenditure was in fact incurred. The capital expenditure information for 2000 was drawn from more than a single work sheet.

UED again states as a matter of fact that the actual capital expenditure for the 2000 year is \$94.981m (in money of the day). This amount has been externally verified by auditors. This amount is also consistent with information contained in both the Regulatory Accounts asset roll forward sheet in that year and in correspondence previously provided.

The Commission cannot simply determine that a capital addition has not occurred unless the relevant information is in a particular section of a report as opposed to another area of the same report. The Commission must reasonably consider the substance rather than the form when considering this matter.

In order to assist the Commission's understanding of the data contained in UED's 2000 Regulatory Accounting Statements, the company engaged Ernst and Young to review the audit work papers¹. Attached to, and forming part of this submission is a report by Ernst and Young which externally verifies that the capital expenditure incurred by UED in 2000 was \$94.981m. It is incumbent on the Commission to give due consideration not only to the explanations previously provided to it, but also to have proper regard to the evidence now contained in the attached report prepared by Ernst and Young.

3.2 Unknown Adjustment

The company has sought explanations from the Commission on 15 July 2005. In response, the Commission has provided information that itemises the adjustment amounts in further

¹ By way of explanation, the 2000 Regulatory Accounting Statements were externally audited by Arthur Andersen. Arthur Andersen no longer operates in Australia and all work files relating to UED's Regulatory Accounting Statements have been transferred to Ernst & Young.



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detail. However the Commission has not provided any substantiation for the adjustment. As of 18 August 2005 UED has received a letter from the Commission in respect to these matters. At this late stage that letter has not been taken into consideration for the purposes of this submission.

On the basis of the accompanying report prepared by Ernst & Young, UED considers that the Commission has made an error of fact in applying this adjustment. To avoid an error of fact in the Final Determination this adjustment should not be applied.



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4 Conclusion

UED believes the Commission has made an error of fact in adjusting UED's audited reported 2000 capital expenditure. The Commission must consider this submission, previous correspondence and the evidence provided in the accompanying report prepared by Ernst & Young, and include the \$94.981m as capital expenditure for the 2000 calendar year in making its Final Decision.