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REVIEW OF WATER REGULATORY ACCOUNTING CODE AND TEMPLATES

FINAL CODE AND TEMPLATE AMENDMENTS PAPER

OCTOBER 2009

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1 INTRODUCTION

1.1 Background

The Essential Services Commission is responsible for the regulation of prices, service standards and conditions of supply for services provided by Victoria's 19 water businesses. In December 2005, the Commission released a Regulatory Accounting Code for the Victorian Water Industry (the Code) requiring businesses to maintain and report specified accounting records.

The purpose of the Code is to enable the Commission to collect regulatory accounting information on the actual expenditure incurred and revenue received by water businesses. This information collected under the Code allows the Commission to monitor the financial performance of the businesses and provides a basis for assessing expenditure and revenue forecasts. The forecasts are used in approving prices for water, sewerage and related services in future price reviews.

The first issue of the Code was released in December 2005 subsequent to the 2005 Urban Water Price Review. At the time of the release of the Code, the Commission had not completed reviewing the pricing proposals of the rural water businesses. The Code therefore initially applied to metropolitan and regional urban water businesses and these businesses submitted the first set of regulatory accounts in 2006.

In November 2006, the Commission released an amended Code to account for the information requirements relating to the rural water businesses. Further minor amendments were made to the Code in October 2007 to reflect issues that had arisen in the review of the 2005-06 regulatory accounts submitted by the urban businesses. Following the amendments all water businesses submitted 2006-07 regulatory accounts to the Commission for review.

After a review of the 2006-07 regulatory accounts, the Commission decided that it was timely to undertake an extensive review of the Code. This was prompted by a number of issues that were identified during the review process and scope for improving the timeliness of the review process itself. Amongst other things, clear differences in the business' regulatory accounts have been identified, which have translated into difficulties with using the data in price reviews.

In undertaking this review, the Commission has taken into account its inquiry into the development of a third party access regime and its recommendations in relation to the ring fencing of major segments of the water and waste water supply chain.

In October 2008, the Commission released a Consultation Paper as the first step in the review process. This paper detailed the role of the regulatory accounts, general

particulars behind the regulatory accounts, and specific information requirements of the regulatory accounts.

Following the release of this paper the Commission consulted with businesses and proposed a number of revisions to the template based on its proposals in the consultation paper and the subsequent consultation with businesses. The Commission also held a workshop with businesses to work through the proposed revisions to the template.

Based on this consultation process the Commission released a draft amendments paper which recommended a number of amendments to the regulatory accounting code and templates and further guidance on the requirements of each template.

In response to this paper, a number of businesses made submissions and began trialling the revised template. This paper aims to respond to issues raised by businesses and finalise the Commission's amendments to the Code and templates for this review.

1.2 Regulatory framework

The Commission's functions in respect of the Victorian water industry are established by the legislative framework as set out in *The Essential Services Commission Act 2001*, *Water Industry Act 1994*, and the Water Industry Regulatory Order 2003 (the WIRO). The Commission has the power to regulate prices for services which are prescribed services under the WIRO.

The Commission has the authority under section 4F(2)(e) of the *Water Industry Act 1994* to issue a code that requires the businesses to maintain specified accounting records and prepare accounts according to specified principles. The Commission also has general powers under *The Essential Services Commission Act 2001* and the *Water Industry Act 1994* to obtain information from the businesses.

The WIRO provides the Commission with a general power to conduct audits in relation to the reliability and quality of information reported by businesses and conformity with specifications issued by the Commission.

1.3 Timeline and purpose of this paper

The timeline of this review process is shown in Table 1.1. As noted in the draft amendments paper, given the current review of the Code and templates the Commission is extending the timeline to allow businesses to formally submit the regulatory accounting statements and supporting information for 2007-08 and 2008-09 to 30 November 2009.

Table 1.1 Timetable for Review

<i>Milestone</i>	<i>Completion date</i>
Release consultation/issues paper	October 2008
Visit businesses to discuss issues	November 2008 - January 2009
Responses to consultation paper due	January 2009
Review responses to consultation paper	February 2009 to March 2009
Release revised template with draft amendments	May 2009
Consultation with businesses and workshop. Businesses to provide feedback.	July 2009
Release draft decision and code - invite businesses to trial template with 2007-08 accounts	August 2009
Responses to draft decision due	September 2009
Release final decision and code	October 2009
Businesses to formally submit regulatory accounting statements for 2007-08 and 2008-09	30 November 2009

The purpose of this final amendments paper is to:

- summarise the process to date and the draft amendments to the Code and templates proposed by the Commission
- outline issues raised by businesses during the consultation process and the Commission's response to those issues
- outline the Commission's final Code and template amendments.

2 | ROLE OF REGULATORY ACCOUNTS

2.1 Introduction

The Code sets out the nature of information to be prepared and submitted by businesses on actual financial performance. Firstly, clause 1.2.2 of the Code states that the information provided is intended to enable the Commission to:

- (a) exercise its powers under the WIRO to approve prices which a water business may charge for prescribed services or the manner in which such prices are to be calculated or otherwise determined or to specify the prices or manner in which they are to be determined in respect of a subsequent regulatory period which will require:
 - (1) a comparison of actual expenditure and revenue of the water business during the current regulatory period against forecast expenditure and revenue; and
 - (2) information to enable the forecast of prudent and efficient expenditure during the subsequent regulatory period.
- (b) monitor and assess compliance with all arrangements relating to the regulation of the regulated water industry which are in place from time to time;
- (c) otherwise give effect to the objectives of the Commission as stated in the *Essential Services Commission Act 2001*, Part 1A of the *Water Industry Act* and the WIRO.

The Code also requires the businesses to complete and provide the Commission with a series of templates referred to as regulatory accounting statements (RAS). The information provided in the RAS is reviewed by the Commission for consistency with the requirements of the Code.

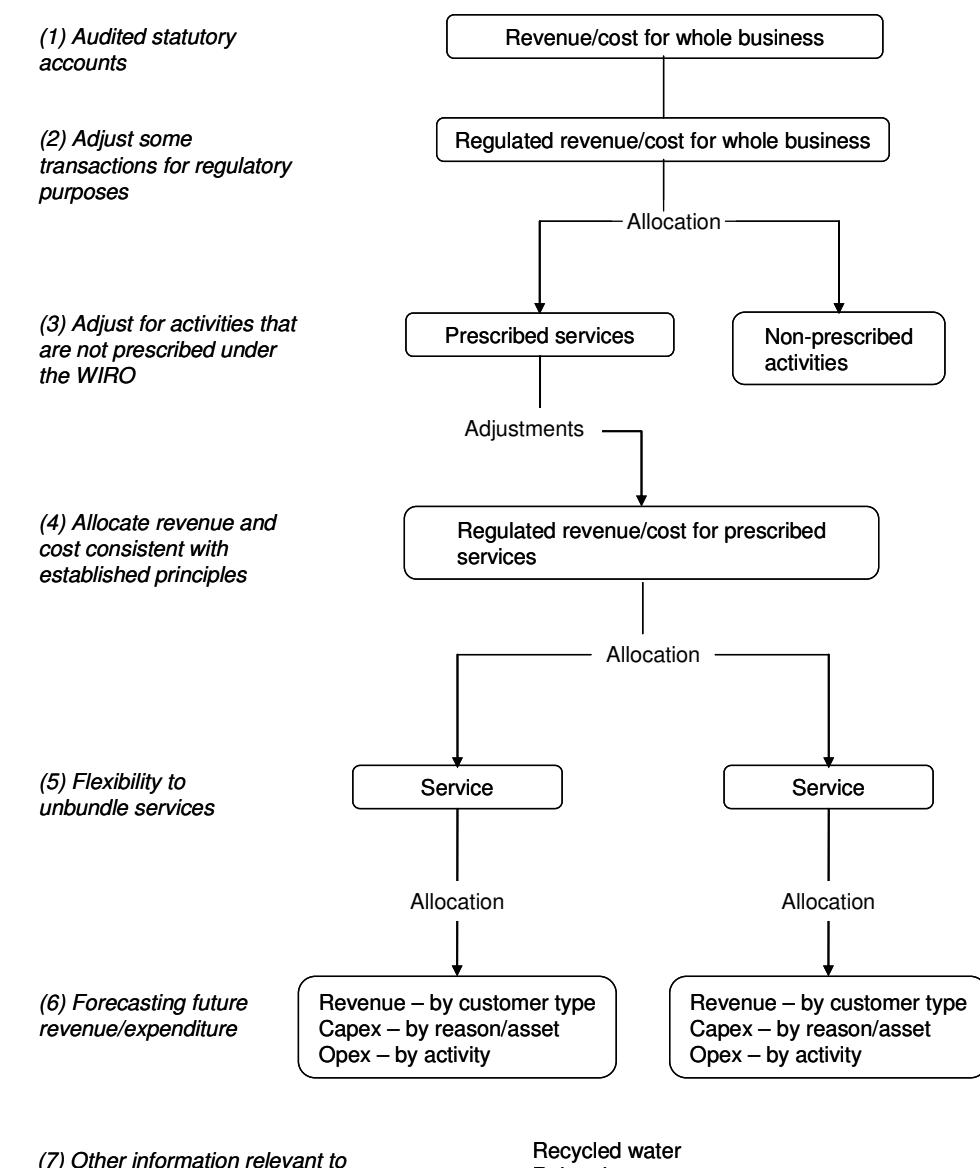
In practise the Commission uses the information collected through the Code to:

- monitor financial performance overtime
- identify issues regarding the treatment of transactions for the purposes of approving prices
- update the regulatory asset base for the purposes of approving prices
- provide a basis for assessing forecasts used to approve prices in future price reviews.

2.2 Overview of the information collected by the Commission

Figure 2.1 outlines the information collected by the Commission through the Code.

Figure 2.1 Information collected through the Regulatory Accounts process



Water businesses' audited statutory accounts provide the starting point for information provided through the RAS. The statutory accounts then need to be adjusted to provide the Commission with the information it requires for regulatory purposes. Some transactions may be treated differently for financial accounting

purposes than for regulatory purposes should the Commission decide that a different regulatory treatment is more consistent with the WIRO or another regulatory or legislative instrument.

The statutory accounts cover all of a business' activities, including those that are not regulated by the Commission. Adjustments need to be made to account for the revenue and expenditure associated with those activities that are not prescribed under the WIRO.

The regulated revenue and expenditure arrived at after steps 2 and 3 includes information on aggregate operating and capital expenditure incurred by a business in delivering prescribed services, as well as information on customer and government contributions and assets disposals. The regulatory asset base is updated for actual expenditure, contributions and disposals at the commencement of each subsequent regulatory period for the purpose of approving prices. Actual operating expenditure also provides information relevant to the starting point for assessing the efficiency of forecasts going forward.

Steps 5 and 6 involve disaggregating financial information by service and activity/reason/asset. Not all categories are relevant to each business. Obtaining disaggregated information at a service level is useful because it can identify trends at a service level, and is important for unbundling. Disaggregated information by activity/reason/asset also enables the Commission to identify trends in expenditure for specific activity areas. This information can be used by Commission to assess expenditure benchmarks when approving prices.

The RAS also require the provision of other information (step 7) that the Commission considered may inform its general functions and/or future price reviews (third party and related party transactions).

3 | GENERAL ARRANGEMENTS

3.1 Review and sign-off of regulatory accounting information

Clause 4 of the Code sets out the requirements for the review of the RAS and subsequent adjustments required by the Commission. The Commission has followed a similar approach in both reviews of the 2005-06 and 2006-07 accounts.

As part of the review process businesses are required to make adjustments that the Commission considers are necessary to bring the RAS into line with the requirements of the Code.

Businesses are sent the adjusted RAS and are required to resubmit the RAS with a Director's responsibility statement. The purpose of the statement is to attest that the regulatory accounts have been prepared in accordance with the Code and that the regulatory accounting statements accurately represent the financial performance of the business.

The Commission noted in practice that although businesses are not required to submit a Director's responsibility statement with the initial submission of the RAS some businesses seek Board approval before making the initial submission. The business is then required to go back to its Board several months later following the completion of the review to obtain the Director's statement. Our understanding is that this causes issues for some businesses, as Boards are confused about their role/responsibilities.

The Commission considered in the draft amendments paper that the timeliness of the sign-off process would be improved if when businesses submit their regulatory accounting statements to the Commission, they were signed-off by Director, Managing Director and/or a Chief Financial Officer. The Commission could then undertake its review of the accounts to ensure they are consistent with the Code. Once this review has been completed the Commission would approve the accounts as being consistent with the Code. Businesses would therefore no longer need to obtain a further director sign-off once the review process has been complete.

The Commission also proposed amending the Code so that it would approve a business' regulatory accounting statement if it was satisfied the accounts are consistent with the Code requirements. Clause 4.1.5 was also included in the Code to allow the Commission to amend the values of the approved regulatory accounting statements should information arise at a later date.

Melbourne Water noted that the requirement to submit the initial Regulatory Accounting Statements at the same time as an extract from the Board's minutes will shorten the timeframe available for the actual preparation of the statements. This is because of the lead times associated with the circulation of Board papers.

Melbourne Water proposed that the process from previous years be retained whereby the signed Directors responsibility statement and the extract of board minutes are submitted after the Commission's formal review of the statements. This would allow enough time for the accounts to be prepared, and ensure that the directors and board are approving the final set of numbers without further changes being made by the Commission.

Gippsland Water considered that it is not immediately obvious what value a second 'true and fair statement' adds, as this is already done for the Auditor-General. To seek a further statement by directors can only be done after the Commission has provided comments on the initial submission. It also noted that this will add significant time to the process of submitting the RAS.

The Commission acknowledges that the proposed amendments would put extra time pressure on the initial submission of accounts and it may be preferable for some businesses that directors sign-off on the final version of the regulatory accounts. Given these responses to the proposed amendments, the Commission has decided to retain the current process whereby businesses will be required to submit a director's responsibility statement at the end of the process, once they have been approved by the Commission.

The Commission has amended clause 2.3.2 removing the requirement for businesses to submit a director's responsibility statement and extract of board minutes with the initial set of accounts. An additional clause 4.1.6 has been included to reflect that businesses will be required to submit a director's responsibility statement and extract of board minutes once the accounts have been approved by the Commission.

The timeliness of the sign-off process will be reviewed once the 2007-08 and 2008-09 regulatory accounts review has been completed and the Commission will determine whether this process requires refinement.

3.2 Timing and content of submissions

Currently businesses are required to submit regulatory accounts for each financial year by 31 October. This is four months after the end of the financial year to which the regulatory accounts relate. The Commission noted in the consultation paper that it considers this is still an appropriate timeframe because it allows businesses time to prepare the regulatory accounts and provide sufficient time for the Commission to undertake its review. The Commission will allow an additional month for businesses to submit their 2007-08 and 2008-09 accounts, to reflect the current review and changes to the Code and templates.

The Commission noted in the consultation paper that there have been some issues regarding the time to complete RAS reviews. However, the Commission's expectation from this review is that by making a number of changes to the Code and establishing better guidance to the businesses, it should help to improve the timeliness of future reviews of the RAS.

As noted in the consultation paper and draft amendments paper, to improve the timelines required to complete the RAS review, the Commission plans to make site

visits to each business where necessary as a more efficient way of addressing issues. As outlined in the draft amendments paper the Commission has made a number of amendments to the templates, which aim to improve the information that is collected in the RAS and the timeliness of the review process.

Gippsland Water noted that the Commission has not confirmed when it would complete its review. It also argued that the timeframe appears far too long, where a submission date of 30 September would allow the corporation to complete the statutory accounts and lodge printed accounts with Parliament. The Commission should endeavour to complete its reviews by mid November with the corporation providing amendments by 30 November. Final clearance from the Commission would allow formal sign off by Corporation's board by 24 December.

The Commission acknowledges Gippsland Water's concerns over the timeliness of the Commission's review process. The Commission will aim to undertake its review process during November; however the timeline for completion will depend on the number of issues that need to be addressed by each business.

At this stage the Commission will also retain the deadline for submission of accounts as 30 October, given most other businesses have agreed to retain this date. However businesses can submit accounts prior to this date and the Commission would begin its review of the accounts when they are received.

3.3 Level of prescription and guidance in the Code

The Code is a high level document setting out obligations on businesses to submit certain information, prepare regulatory accounting statements, the principles for preparing regulatory accounts and obligations regarding the review and adjustment of accounts. In developing the Code the Commission noted a preference for being less prescriptive.

Clause 3.4 of the Code sets out the allocation principles to be used by businesses in allocating amounts/transactions by service and activity/reason/asset. The Code requires amounts that are directly attributable to a business segment, activity area or revenue source to be allocated to that business segment, activity area or revenue source.

Where amounts cannot be allocated on a directly attributable basis the Code requires them to be attributed on a causation basis. If a causal relationship cannot be reasonably established, amounts can be allocated on a non-causal basis provided that:

- there is a strong positive correlation between the non-causal basis and the actual cause
- cost to derive causal allocation outweighs the benefits
- aggregate of amounts allocated on non-causal basis are not material.

Different businesses have taken different approaches to the basis for allocating amounts between services and activities. For example, some businesses have allocated amounts based on customer numbers or on revenues shares. It is important that businesses are consistent with the way they allocate year on year

and that the Commission understands how businesses have allocated to ensure that it is reasonable and consistent with the Code.

As outlined in the draft amendments paper, the Commission has consolidated and expanded the guidance on the requirements of each template into one guidance appendix that addresses each template. The guidance in Appendix B aims to provide a guide on how to fill out each template and describes the requirements for each category.

The Commission also amended clause 2.2.1 of the Code to require businesses to comply with the specific requirements in Appendix B.

3.4 Treatment of activities that are not prescribed under the WIRO

In the consultation paper the Commission noted there had been some concerns with the definition of prescribed and non-prescribed activity and whether some activities that were incidental to prescribed services should be considered as part of prescribed revenue. The Commission's main concern with this classification is that while it has no role in regulating prices for non-prescribed activities, it needs to be satisfied that non-prescribed activities are correctly classified and that their costs are excluded from the regulated cost base.

To improve the clarity of the allocation between prescribed and non-prescribed revenue the Commission has also made a number of amendments to the revenue template, to separate prescribed revenue from revenue that is received from other sources. Refer to section 4.5 for further discussion of these amendments.

South East Water in its submission considered that the Commission would use this review of the Regulatory Accounting Code as an opportunity to agree with businesses some key criteria for determining which new products should be priced in accordance with pricing principles. South East Water stated that it provides its customers with a range of products and services some of which are non-prescribed. It considers that there should be a consistent set of criteria that determines whether a service is non-prescribed, such as, whether the product or services is provided in the water retailer's licensed area only or whether it can only be obtained from the water retailer.

The Commission notes that determining whether services are prescribed or non-prescribed is based on the definition of prescribed services in the WIRO¹. If a new product falls within the prescribed services under the WIRO, then the service should be charged based on the pricing principle included in schedule of a businesses' determination. In the regulatory accounts its revenue should be allocated to revenue from non-scheduled services – schedule 4. If the product or service does not fall within the definition of a prescribed service under the WIRO

¹ Part 6 of the WIRO outlines the prescribed and declared services supplied by or within the regulated water industry in which the Commission has the power to regulate standards and conditions of service and supply.

then revenue and expenditure from this service should be classified as non-prescribed.

4 | SPECIFIC INFORMATION REQUIREMENTS

This chapter outlines the final amendments to each regulatory accounting statement template, the consequential amendments to the Code and where further guidance has been provided.

4.1 Profit and loss statement, balance sheet and cash flow statement templates

Templates 1 to 3 (profit and loss statement, balance sheet and cash flow statement) should accurately reflect the financial information contained in the statutory accounts. The amounts for each category should also reflect the amounts in the statutory accounts. For example, the amounts for depreciation, bad debts, and borrowing costs should reflect the amounts contained in the Statutory Accounts.

The revised profit and loss template includes a schedule to reconcile revenue recorded in the statutory accounts and that in the regulatory accounts by means of identifying balancing items between the two sets of accounts. This is to give the Commission a better understanding of the items that create a variation between revenue in statutory and regulatory accounts. This should include items that are not considered revenue for regulatory purposes, such as realisation of bad debts, asset revaluation gains and defined superannuation gains.

The Commission has also included a separate column where businesses can provide any relevant notes in the annual report which may assist the Commission in its review of the accounts.

The Commission has provided further guidance in Appendix B.1, B.2 and B.3 of the revised Code on the basic requirements of these templates. Refer to the revised Code for further details of this guidance.

The Commission received no comments in relation to these templates.

4.2 Capital expenditure templates

The Code requires businesses to allocate capital expenditure to each business segment and the following activity areas:

- cost drivers — growth, renewal of existing infrastructure, improvements and compliance
- asset categories — headworks, pipelines, channels, treatment, and corporate.

The Commission proposed in the draft report to largely retain the information that is collected in the capital expenditure templates as it is consistent with the information

collected for price review purposes. It also proposed creating a separate asset class category for the purchase of any permanent water entitlements. Guidance on the requirement for businesses to complete this category is included in Appendix B.5 of the Code.

Appendix A of this report contains all amendments to templates 4 and 5 relating to capital expenditure.

In response to the draft amendments, Gippsland Water commented that the Code needed further clarification from the Commission regarding the circumstances when audit approved impairments and asset revaluations would be agreed by the Commission. The Commission notes that generally it will not allow impairments or asset revaluations in the regulatory accounts. The Commission would have to consider the specific circumstances if a case for doing so was presented.

4.3 Operating expenditure template

Currently, the Code requires businesses to allocate operating expenditure to each business segment and the following activity areas:

- operations, maintenance, bulk charges, treatment, renewals annuity, customer services and billing, GSL payments, licence fees, corporate and other.

The Commission in the draft amendments paper proposed a number of template changes to the operating expenditure template. These included:

- an additional water business segment (column) for recycled water – this is consistent with the collection of operating expenditure for price reviews
- schedule for licence fees expenditure – to require businesses to separate out licence fees for the ESC, the EPA and Department of Human Services
- an additional line for the environmental contribution was created
- a comparative data column from the previous year was included which the Commission will pre-fill
- non-prescribed expenditure – the aggregated total of non-prescribed operating expenditure is linked from the non-prescribed services template
- an additional line has been created for businesses to separate out their purchases of temporary water entitlements.

The Commission also included further guidance in Appendix B.6 in relation to the additional requirements of this template, including the requirements for the schedule for licence fees, separating out the environmental contribution and the purchase of temporary water entitlements.

Based on comments from Gippsland Water in relation to the revised operating expenditure allocation template (see section 4.4), the Commission has also included water conservation as a separate activity area in the operating expenditure template. Appendix B.6 of the Code has been amended to provide guidance to businesses on the allocation of expenditure to the water conservation category.

Lower Murray Water commented that there is no guidance on the allocation of rural water trading and water ordering operating expenditure. Lower Murray Water has included costs incurred for water trading and water ordering in billing and customer service though there is no mention of these services within the Code. The Commission agrees with Lower Murray Water's approach and has provided further guidance in the Code so that the allocation of water trading and ordering costs should be included in customer service and billing.

South East Water retained the view that there is little value in isolating some license fees and not others and that additional room be allowed in the template for other license fees to be separated out.

Water businesses are required to pay licence fees as a contribution to the costs incurred by DHS, EPA and the ESC that regulate aspects of the water businesses' activities.² For price review purposes, water businesses include estimates of these licence fees over the regulatory period in their operating expenditure forecasts. Actual licence fees are set on an annual basis and will vary from year to year. The regulatory accounts separately identify licence fees in order to ascertain the actual amounts incurred each financial year. This information can then be used to confirm the adjustment of prices at the end of the regulatory period to reflect any difference between estimated and actual licence fees levied by the EPA, DHS and the Commission.

Wherever possible, the regulatory account information collected should reflect that collected for price review purposes. The separation of the three licence fees is consistent with this approach. No other licence fees are separately identified for price review and hence regulatory account purposes. If businesses wish to separately note other licence fees incurred they may do so in the explanatory notes section of the operating costs template.

4.4 Operating costs allocation – new template

The Commission, in its aim to improve the level of information collected in the regulatory accounts process, proposed in the draft amendments paper a new template in which water businesses are required to provide a breakdown of major costs that comprise operating expenditure under each activity area. The purpose of this template is to provide further detail for the basis of the allocation of operating expenditure from businesses' trial balances to the regulatory accounts. These expenditure allocation categories will also provide an accurate base line for these

² Licence fees are payable as set by:

- the Minister for Health under s.51 of the *Safe Drinking Water Act 2003*, for costs incurred by the Department of Human Services in administering the Safe Drinking Water Regulations
- the Minister for the Environment under s.24 of the *Environment Protection Act 1970*, for costs incurred by the EPA in administering discharge licences and works approvals
- the Minister for Finance in consultation with the Minister for Water under s.4H(2) of the *Water Industry Act 1994*, for costs incurred by the Essential Services Commission in administering the economic regulatory framework.

key operating expenditure categories when reviewed by the Commission as part of future price reviews.

In the draft amendments paper, the Commission outlined that this reconciliation schedule will require businesses to provide further detail of the major operating expenditure items across the following categories:

- Labour costs
- Plant and materials
- Contractors
- Electricity
- Chemical costs
- Water conservation
- Greenhouse gas offsets
- Vehicle Fleet running costs
- IT
- Other trial balance accounts.

Businesses are required to provide high level account numbers from their chart of accounts which identify how expenditure recorded in the trial balance has been represented in the operating expenditure allocation template.

Guidance on the requirements of this template as outlined above was included in Appendix B.7 of the revised Code. The Commission considered this should provide businesses with a reasonable level of guidance on the requirements to complete this template.

Gippsland Water noted in response to the draft template amendments that the classification of ‘water conservation’ as an element of expenditure, rather than an activity appears odd. As the Commission’s paper notes, water conservation will include labour and contractor costs. Gippsland Water also noted that it may have some difficulty with collating this information retrospectively.

The Commission agrees that water conservation is more of an activity rather than an element of expenditure. It has therefore amended the operating expenditure allocation template to include water conservation as an activity, consistent with the changes made to the operating expenditure template.

Gippsland Water also noted that the provision of a high level trial balance with numbers from the chart of accounts is getting back to the mapping exercise. It remains doubtful that this will assist the Commission to perform meaningful comparisons between years. The Commission notes that the provision of this trial balance information is to assist the Commission’s assessment of the information as part of the annual review process, rather than for year on year comparisons.

South East Water noted that its financial systems do not provide for activity based costing. Therefore it is difficult to populate the regulatory accounts template with a detailed breakdown of expenditure type for each category. In some cases the template will only be able to be populated on the basis of high level allocations and

assumptions. Given the level of accuracy able to be achieved, South East Water questioned whether this degree of cost breakdown adds value.

The Commission retains the view that this information is necessary as part of the regulatory accounts information collection and for the assessment of operating expenditure elements as part of price reviews. Where allocations are made by businesses they should be based on reasonable assumptions, consistent with the allocation principles in clause 3.4 of the Code.

Goulburn Valley Water noted that the Code does not specify whether the labour category should include overtime. The Commission has included additional guidance in the Code to specify that overtime is included under labour.

Goulburn Valley Water also noted there appears to be no provision in the template to identify any significant or one-off expenditure items as further explanation to the disclosure. For example, Goulburn Valley Water has incurred significant water trucking costs in 2007-08, but this cannot be disclosed in the template. An explanatory notes section would help this. The Commission agrees and has included an explanatory notes section in the template for businesses to explain any significant transactions and expenditure incurred that may not be clear in the template. Businesses should also use this explanatory notes to explain the basis of any allocations in this template that are not clear. This would greatly assist the Commission in its assessment of the accounts. An additional column has also been included for businesses to list trial balance accounts for the other trial balance items.

Goulburn Valley Water commented that the template heading does not agree with the Code guidance of plant and materials. The Commission has amended the title in the template to 'plant and materials', consistent with the Code.

GWMWater argued that it does not see merit in collecting information related to IT and fuel costs. The Commission however maintains that this information is reviewed as part of the Commission's price review processes and any proposed large change in expenditure needs to be compared with historical expenditure. These categories have therefore been retained in the template.

4.5 Revenue template

The Code requires that water businesses allocate revenue items between a number of business segments (such as retail water services, retail sewerage services, and bulk water services etc.) and then further allocate the revenue for each business segment between revenue sources (such as residential, non-residential, trade waste services etc.).

In the consultation paper the Commission noted that issues arose during the 2006-07 RAS review regarding the number of business segments and revenue sources provided for in template 7.

In the draft amendments paper the Commission proposed amendments to the revenue template with the aim of providing greater clarity around the allocation of revenue items. The amendments were aimed to clearly identify revenue from those services for which the Commission regulates prices and those it does not. It has

also separated out those revenue items that are not determined by regulated prices or pricing principles but do offset the business' revenue requirement and those that do not. There is also a change in terminology from 'prescribed/non-prescribed' to 'revenue from determined prices or pricing principles' and 'revenue from other sources'.

The Commission also noted in the draft report that revenue items that are included in revenue for accounting purposes, such as the realisation of bad debts, asset revaluation gains and defined superannuation gains, should not be included in this template, but rather should be recorded as an adjustment from statutory to regulatory accounts, in the revenue schedule included in the profit and loss template.

The revenue template has been amended to include schedules for miscellaneous and non-scheduled services for business to identify each revenue item, and a separate column for recycled water.

Guidance on how revenue items should be allocated has also been extended in Appendix B.8 of the Code. The Commission considers this provides a reasonable level of guidance for businesses to complete the revenue template.

Goulburn Valley Water submitted in response to the draft amendments that government and customer contributions are not included as part of determining a businesses' revenue requirement though in the template they appear as such. The Commission notes that these contributions are included in the determination of the revenue requirement as they are subtracted from gross expenditure that is included in the revenue requirement.

Goulburn Valley Water also noted that the Code makes no mention of the temporary trade of water entitlements but only refers to revenues collected from the sale of water entitlements whatever legal form those entitlements take. It considered that the Code should provide definitive guidance on what should be included in this category. The Commission has amended appendix B.8.3(i) of the Code to include examples such as revenue from either temporary or permanent water entitlements.

4.6 Provisions template

The provisions template in the RAS requires the businesses to report on the following provision categories:

- (a) employment entitlement – annual leave
- (b) employment entitlement – long service leave
- (c) insurance
- (d) other.

The Commission noted in the draft amendments paper that other employee entitlements such as sick leave and rostered time off have been included in the "other" category. In order to provide greater clarification the Commission proposed in the amendments paper to include an 'employment entitlement – other' category for other employee related provisions, reserving the "other" category solely for

provision which cannot reasonably be allocated to employee entitlements and insurance.

The Australian Accounting Standards require entities to make a current provision for bad and doubtful debts. Bad and doubtful debts older than twelve months are written off as bad debts. The Commission recommended in the draft report that the treatment of reporting of bad and doubtful debts in the RAS be aligned with Australian Accounting Standards and removed the non-current bad and doubtful debts category from the template.

The Commission also amended the Code by shifting clause 3.5.9 into the expanded guidance in Appendix B. The Commission considers that this provides businesses with adequate guidance on the requirements to complete this template.

No further comments were received in relation to this template.

4.7 Third party transactions template

Under the Code, businesses are required to report certain information on third party transactions. The Commission considers that it is important to collect information on third party transactions to ensure that it has a more complete understanding of how amounts that have been recorded as the actual cost of providing prescribed services have been determined. Where a business enters into an arrangement with another party to provide services, the contracted amount will generally be recorded as the cost. In most cases, the contracted amounts are likely to be recognised by the Commission as the efficient cost of undertaking an activity, particularly where it has been determined through a competitive process or has been market tested.

However, there may be instances where the Commission may need to better understand the basis on which contracted amounts have been determined, particularly where the incentives to minimise the cost of the services may be absent or where the contract is with a single entity to perform a substantial share of the regulated business's activities. By collecting this information as part of the regulatory accounting statements the Commission will be in a position to identify any issues related to how these transactions are treated in advance of undertaking future price reviews.

In reassessing the current threshold for reporting of third party transactions, the Commission noted in the draft amendments paper that most businesses have not been required to report any third party transactions. The current threshold of transactions 'greater than 10 per cent of total operating and capital expenditure or \$1 000 000 for the financial year, whichever is the greater,' is therefore considered too high.

Operating expenditure is a key driver of prices charged to customers and many businesses outsource or contract significant operating costs such as maintenance, energy and IT to third party providers. With significant increases in prices proposed over the current regulatory period a picture of what operating costs are actually incurred over the period is required to assist the Commission in assessing operating expenditure trends for future pricing decisions.

The Commission considered contracts over \$1 million in aggregate to be a material reflection of water businesses' costs and will capture the major third party transactions that water businesses have engaged in. This threshold is also consistent with the regulatory accounting reporting requirements for the gas and electricity distribution businesses.

In response to the draft amendments Gippsland Water commented that the Commission has identified the key concerns with operating expenditure as the reason behind the move to a more stringent 'all contracts over \$1 million' approach. The changes to the Code however do not refer to operating expenditure and as such are more likely to collect significant information related to capital expenditure. Given this, Gippsland Water questioned whether the Code should refer to operating expenditure over \$1 million.

Melbourne Water opposed the tightening of the threshold. They claimed that given the level of expenditure over the past couple of years that the revised threshold could potentially require up to 100 lines of disclosure and therefore a very significant increase in work.

The Commission acknowledges that its arguments for a tighter threshold were more related to obtaining information related to operating expenditure third party transactions. However, it is also interested in obtaining more information related to third party capital expenditure transactions than under the current threshold, though not to the same degree as operating expenditure transactions. The Commission has therefore amended the threshold to require reporting of third party transactions greater than \$1 million in aggregate for operating expenditure, or greater than \$10 million in aggregate for capital expenditure transactions. Appendix B.11 of the Code has been amended to reflect these changes.

4.8 Unbundled segments template

This template applies to all businesses except Melbourne Water and the rural only businesses. In this template, expenditure and revenue information provided in the earlier templates are allocated to water collection and storage, water treatment, water transport, sewage treatment and sewage transport.

The Commission noted in the draft amendments paper the general agreement to retain this template. A separate process for establishing ring fencing will be undertaken in consultation with businesses, when the outcomes of the access inquiry and the government's response are released. This review process is aimed to work through a number of other regulatory accounting issues and improve the information collection process, which will assist the process of establishing ring fencing. This approach was supported in the submissions made by Gippsland Water and South East Water.

As noted in the draft amendments paper, guidance on the requirements of the unbundled segments template has been included in Appendix B.13 of the Code. This guidance outlines the basic requirements for this template and where an allocation cannot be made on a causation basis, it should be consistent with the principles in clause 3.4 of the Code.

4.9 Non-prescribed services template

This template requires businesses to identify any non-prescribed services provided to customers during the year. In its current form, it is difficult to confirm the non-prescribed revenue/expenditure associated with the services that are identified in this template. The Commission noted in the consultation paper that it would be useful if this template reflected the revenue and expenditure for each item so they can be reconciled back to the revenue and expenditure templates as well as the Trial Balance/Statutory accounts.

In the draft amendments paper the Commission proposed amending this template to require businesses to include revenue and expenditure associated with each identified non-prescribed service. To assist with the allocation of non-prescribed services, the Commission has more clearly defined non-prescribed services as part of the guidance Appendix to the Code. Additional guidance was included in Appendix B.14 of the revised Code outlining the requirements to complete the non-prescribed services template.

South East Water noted in response to the draft amendments that in the past it has found it difficult to provide this information with a reasonable degree of accuracy, as it does not have an activity based costing system in place. The only way in which South East Water can comply with this requirement is to arbitrarily allocate costs to the major categories of non-prescribed activity on the basis of a set of assumptions.

The Commission considers that where it is not possible to directly allocate costs for non-prescribed services, the allocation of costs of non-prescribed activity should be done in accordance with the allocation principles included in clause 3.4 of the Code.

Gippsland Water commented that the template does not provide for a distinction between directly allocated costs and those overheads apportioned to the non-prescribed service. The Commission is interested in this information when it undertakes its annual review process, and has included an explanatory notes box for businesses to provide detail of any allocations made to non-prescribed services.

Goulburn Valley Water requested that some generic examples be included in appendix B.14 of the Code. Non-prescribed services are defined to be any services provided by the business that do not fall within the prescribed services defined in the WIRO. While there are some common non-prescribed activities such as rental and interest income, non-prescribed activities are mostly business specific and would therefore require an extensive list to cover off the various non-prescribed service provided by water businesses.

5 | NEXT STEPS

The Commission has made a number of amendments to improve the information collected from businesses and improve the timeliness of the review process. These are the final amendments to the Code and regulatory accounting template as part of this review process.

Businesses are required to formally submit a RAS for 2007-08 and 2008-09 by 30 November 2009 using the final version of the Code and business specific RAS templates that will be provided to each business

APPENDIX A | REGULATORY ACCOUNTING CODE REVIEW – FINAL TEMPLATE AMENDMENTS

Table 1 **Regulatory Accounting Code - template amendments**

Profit and Loss template

<i>Schedule 3 - Revenue</i>	Businesses will be required to reconcile revenue recorded in the statutory accounts and that in the regulatory accounts by means of identifying any balancing items between the two sets of accounts. This is to give the Commission a better understanding of those items that create a variation between revenue in statutory and regulatory accounts.
<i>Annual report notes</i>	A separate column has been created for businesses to provide the relevant notes from their annual report for each category. This is to assist the Commission in its review of the templates when referring to supporting material.

Balance Sheet template

<i>Annual report notes</i>	A separate column has been created for businesses to provide the relevant notes (where relevant) from their annual report for each category.
<i>Explanatory Notes</i>	An explanatory notes section has been included for businesses to explain any change in accounting treatment from the previous year.

Cash flow statement template

<i>Annual report notes</i>	A separate column has been created for businesses to provide the relevant notes from their annual report for each category.
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<i>Explanatory Notes</i>	An explanatory notes section has been included for businesses to explain any change in accounting treatment from the previous year.
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Capital expenditure template

<i>Schedule of accounting adjustments</i>	The main difference with this template is the inclusion of the schedule of accounting adjustments, which requires businesses to identify each adjustment made in translating the capital additions reported in their statutory accounts to the capital expenditure reported in their regulatory accounts. This will sum to the total accounting adjustments in the first table.
<i>Comparative data</i>	A comparative total for prescribed capital expenditure from the previous year has been included. This will be prefilled by the Commission.
<i>Annual report notes</i>	A separate column has been created for businesses to provide any relevant notes from their annual report for each category.

Capital expenditure breakdown template

<i>Recycled water</i>	Businesses will be required to separately report capital expenditure for recycled water from water and sewerage. A separate column for recycled water has been created for businesses to complete. This is to be consistent with how recycled water expenditure is allocated in the price review template. Expenditure primarily related to the provision of recycled water should be included in this column.
<i>Comparative data</i>	A comparative total for prescribed capital expenditure from the previous year has been included. This will be prefilled by the Commission. Major differences between years would need to be explained by businesses in the explanatory note section.
<i>Permanent water entitlement</i>	A separate asset class category for permanent water entitlements has been created. The requirement for businesses to complete this category has been included in Appendix B.5 of the Code.

Operating expenditure template

<i>Recycled Water</i>	Businesses will be required to separately report operating expenditure for recycled water from water and sewerage. A separate column for recycled water has been created for businesses to complete. This is to be consistent with how recycled water expenditure is allocated in the price review template. Expenditure primarily related to the provision of recycled water should be included in this column.
<i>Water conservation</i>	<p>Water conservation has been included as a separate activity area in the operating expenditure template.</p> <p>Businesses are required to provide details of any expenditure related to water conservation programs that has been incurred during the year, including labour or contractor costs. Water conservation programs include programs designed to promote more efficient water use, or reduce non-revenue water, by either domestic or non-domestic customers. Specific examples of water conservation expenditure will differ from business to business, but the Commission expects water conservation to include, at a minimum, expenditure related to:</p> <ul style="list-style-type: none">• the promotion and enforcement of water restrictions• the promotion of behavioural change campaigns, such as those campaigns designed to encourage water users to remain within a water consumption ‘target’• leakage management programs that have been specifically created to improve water conservation and are additional to standard maintenance expenditure• expenditure related to promoting, distributing or installing water efficient devices such as showerheads and washing machines• contribution to Government or industry programs that target water conservation• development of water efficiency plans or water audit regimes for non-domestic customers.
<i>Environmental Contribution</i>	A separate line for the environmental contribution has been included.

<i>Licence Fees</i>	A separate schedule has been created for licence fees. Businesses will be required to fill in an amount for fees to the Essential Services Commission, Environment Protection Authority and the Department of Human Services. This will link to the licence fees row in the activity area table.
<i>Comparative data</i>	An aggregate comparative column has been created to compare operating expenditure to the previous year - this will be prefilled from the previous year by the Commission.
<i>Non-prescribed services</i>	The sum total of operating expenditure from non-prescribed services is linked to the total operating expenditure included in the non-prescribed services template.
<i>Licensing applications (Southern Rural Water)</i>	A separate category/column for licensing applications has been included.
<i>Out of balance formula</i>	The out of balance formula and alert message has been removed as it is no longer required.
<i>Purchase Temporary water rights</i>	A separate category for the purchase of temporary water rights has been created for businesses to allocate operating expenditure to where required.

Operating expenditure allocation schedule (new template)

<i>Allocation of cost categories</i>	<p><i>Labour costs</i> - This includes wages and on-costs including:</p> <ul style="list-style-type: none"> • superannuation • Work Cover • long service leave • payroll tax • training • study assistance • overtime. <p>Labour costs should include employees directly employed by the business with the exception of employees directly employed for the provision of IT</p>
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services and conservation programs. Any agency staff or labour expenses incurred on contractors should also be included in the 'Contractors' expenditure allocation category.

Plant and materials – businesses are required to provide details related to any expenditure incurred on plant and materials during the year. Examples of plant and materials expenditure include:

- the hire of equipment to undertake maintenance works
- expenditure on concrete
- expenditure on steel and other metals or alloys
- expenditure on cables and other electrical materials
- expenditure on wood or timber products
- expenditure on nuts, bolts and screws
- expenditure on any other plant or materials that can be reasonably justified by the business for inclusion in this category.

Contractors – businesses are required to provide details of all contractor (including consulting and agency staff) costs that have been incurred by the business during the year, with the exception of contractors engaged in the provision of IT maintenance and support services (these are to be included in the IT expenditure allocation category or water conservation services). A contractor is considered to be a person (or team of persons) who provides services to the business but is not directly employed by the business.

Electricity – this is to include all electricity costs that have been incurred during the year, with the exception of renewable or green electricity expenditure. Businesses are to provide a separate disclosure of these expenditure items under green house gas offset costs.

Greenhouse gas offsets – Businesses are required to provide details of all expenditure related to offsetting the business's greenhouse gas emissions that have been incurred during the year, including:

- purchasing green energy
- purchasing renewable energy certificates (RECs) as part of MRET
- creating Victorian Energy Efficiency Certificates through the VEET scheme
- any other greenhouse sequestration activities that the

business has implemented during the year.

Chemical costs – businesses are required to provide details of all chemical costs incurred in the process of treating water, sewerage or recycled water during the year.

Vehicle Fleet running costs – businesses are required to provide details of all fuels and other vehicle fleet running and maintenance costs. Fuels include petrol, diesel, liquefied petroleum gas (LPG) or any other fuel used to power motor vehicles. To the extent that any labour costs are incurred by the business in managing its fleet, these costs should be included in the ‘Labour costs’ expenditure allocation category, rather than in this expenditure allocation category.

IT - businesses are required to provide details of all IT costs that have been incurred during the year. This includes such items as software (where classified as an operating expenditure by the business), IT licence costs, IT maintenance and support arrangements and SCADA operating costs. Businesses should also allocate any direct or contracted labour expenses related to the provision of IT services to this category. These labour expenses should be included exclusively in this expenditure allocation category and not be re-presented in the ‘Labour costs’ expenditure allocation category.

Other trial balance accounts – businesses should report all other operating expenditure accounts not already included in the previous expenditure allocation categories. The Commission anticipates that this category would include a number of smaller expenditure accounts (to the extent that they are considered to be incurred in the provision of prescribed services), including, but in no way limited to:

- membership fees
- advertising
- subscriptions and publications fees
- sponsorships
- entertainment
- meal expenses
- travel and accommodation.

High level account/ledger codes

Businesses are required to provide high level account numbers from their chart of accounts which identify how expenditure recorded in the trial balance has been

represented in the operating expenditure allocation template. For instance, a business may structure its chart of accounts so that account numbers (or parts of account numbers) related to staff costs all begin with '34-10'. As an example, '34-1010' may be salaries, '34-1011' may be superannuation, '34-1020' may be long service leave, etc. In addition, the business may not internally classify training costs as labour expenses, but rather include it as 'other expenditure', and allocate an account code of '34-3150'.

In this example, a business can report that the expenditure included under the Commission's 'Labour cost' expenditure allocation category includes all trial balance accounts commencing with '34-10' plus '34-3150'. The purpose of this explicit allocation of the trial balance accounts to expenditure allocation categories is to assist the Commission with reconciling the two information sources and reduce ambiguity between businesses' submissions and when comparing regulatory accounts year on year.

<i>Explanatory notes</i>	An explanatory notes table has been included for businesses to include explanation of significant one-off expenditure items and the basis for allocations made in the template where necessary.
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Revenue template

<i>Separation of prescribed revenue and revenue from other sources</i>	In revising this template the Commission is aiming to make a clear distinction between prescribed and non-prescribed revenue. Although businesses are used to treating most items as prescribed, for regulatory accounts going forward there is a change in terminology. Prescribed revenue in the regulatory accounts is derived from the delivery of services contained in the schedules of each business' price determination, which are approved by the Commission.
<i>Revenue from other sources</i>	Revenue from other sources, for which the Commission does not prescribe either the price or pricing principles, has been disaggregated between revenue that will impact/offset the revenue requirement and revenue that will not. Other Revenue items which impact/offset the revenue requirement include; government contributions, proceeds from assets sales (assets for the provision of prescribed services) and sales of water entitlements, because these revenues would usually be deducted from the RAB. Revenue that will not impact the revenue

	<p>requirement would include proceeds from the sale of assets which are not related to the provision of prescribed services, and revenue from non-prescribed services, such as rent and interest on investments.</p>
<i>Non-scheduled services</i>	<p>The Commission has amended the title of non-scheduled services to refer to schedule 4 of businesses price determination. This is to make clear that this category is to only include revenue from services where prices are determined by the pricing principles in schedule 4.</p> <p>A schedule for non-scheduled services has been included. Businesses will be required to separately list revenue for each non-scheduled service. Please note that this category is to only include revenue from non-scheduled services priced in accordance with schedule 4 of businesses' determinations, and will link to the prescribed revenue table.</p>
<i>Miscellaneous services</i>	<p>The Commission has amended the title of miscellaneous services to refer to 'schedule 2'. This is to highlight that this category is to only include revenue from the core miscellaneous services which have prescribed prices set out in schedule 2.</p> <p>A schedule for miscellaneous services has been included. Businesses will be required to list revenue for each miscellaneous service provided. Please note that this category is to only include revenue from those core miscellaneous services included in schedule 2 of businesses' determinations, and will link to the prescribed revenue table.</p>
<i>Proceeds from the sale of assets</i>	<p>The terminology of this category has changed from proceeds from the sales of assets 'prescribed' to 'be deducted from the RAB', and for proceeds from the sales of assets 'non-prescribed' to 'with no impact on the RAB'. The definition of these categories is however the same.</p>
<i>Recycled Water</i>	<p>A separate column for recycled water revenue has been created. Businesses are required to separate recycled water revenue for each category.</p>
<i>Comparative data</i>	<p>A comparative column from the previous year has been included, and will be prefilled by the Commission.</p>

<i>Non-prescribed services</i>	The sum total for revenue received from non-prescribed services is linked to the total revenue that is included in the non-prescribed services template.
<i>High level account/ledger codes</i>	Businesses are required to provide high level account numbers from their chart of accounts which identify how revenue recorded in the trial balance has been represented in the revenue template.
<i>Diversions, drainage and waterways services - Melbourne Water</i>	The Commission has changed the wording of the guidance in Appendix B in relation to the allocation of revenue for drainage and waterways. Revenue from drainage and waterways services should be allocated between residential and non-residential customers. Guidance in the Code has also been changed to require Melbourne Water to allocate diversion services to miscellaneous services.

Contributions template

<i>Gifted Assets</i>	Gifted assets can now be selected as a type of contribution in column E.
<i>Prescribed/non-prescribed</i>	The terminology used in column F has changed to contributions that will offset prices and contributions that will not offset prices consistent with the change in terminology used in the revenue template.
<i>Revenue contributions - check with other templates</i>	A check box with the values for revenue contributions in the revenue and profit and loss templates has been included to ensure that businesses have equal values across the three templates.

Provisions template

<i>Employee entitlement - other</i>	A category 'employment entitlement – other' has been created for other employee related provisions.
<i>Non-current bad and doubtful debts</i>	Under the Australian Accounting Standards bad and doubtful debts older than twelve months are written off as bad debts. This category has been removed from the templates.
<i>Comparative Data</i>	Previous years data to be prefilled by the Commission.

Third party transactions template

No change to template – note the threshold change to third party transactions greater than \$1 million in aggregate for operating expenditure and \$10 million in aggregate for capital expenditure transactions.

Related party transactions template

No change.

Recycled Water, new obligations, new miscellaneous services template

Templates have been removed.

Unbundled segments template

Recycled Water A column for recycled water has been included.

Non-prescribed services template

Revenue and expenditure columns Separate columns for revenue, operating and capital expenditure have been added to this template. Businesses will be required to include the details for each non-prescribed service, noting that this information when completed will remain confidential.

Explanatory Notes An explanatory notes section has been included for businesses to provide any details of cost allocations that have been made to non-prescribed services.

High level account/ledger codes An additional column has been created for businesses to provide high level account numbers from their chart of accounts which identify how non-prescribed recorded in the trial balance has been represented in the non-prescribed services template.

Roll forward of the RAB template

Current period data Additional columns for the current regulatory period have been added. Data in this template will be pre-filled by the Commission.
