Light Regulation Pipelines – Financial Reporting Guideline Explanatory Statement

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Economic Regulation Authority
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1. Introduction

1.1 Overview

An objective of recent amendments to the National Gas Rules (**NGR**) by the Australian Energy Markets Commission (**AEMC**) is to provide **prospective users** of light regulation pipelines with comprehensive financial information to facilitate informed negotiation with **service providers**.[1]

Rules 36B(1)(c) and (d) of the National Gas Rules (**NGR**) require **service providers** for light regulation services to publish financial and **weighted average price information** to assist **prospective users** in assessing whether prices offered by the **service provider** are reasonable.

The Financial Reporting Guideline for light regulation services (**Guideline**) is published by the **ERA** in accordance with rule 36F of the **NGR**. The **NGR** require the **Guideline** to:

- provide for the publication of financial information about each light regulation pipeline on a pipeline by pipeline basis and in respect of the financial year of the **service provider** for the pipeline
- specify the methods, principles and inputs to be used to calculate **weighted average price information** and the form this information is to take
- specify the level of detail of information required, which must be the level of detail reasonably required to enable a prospective user or users to negotiate on an informed basis with a service provider for the provision of a pipeline service to them by the service provider
- specify the basis on which the information is to be provided
- specify the form of any statement and / or any supporting documentation required to demonstrate that the information has been arrived at on a reasonable basis and is accurate and complete to the best knowledge of the service provider.

The **Guideline** refers to **the financial reporting template** and sets out the requirements for **service providers** to complete the template. The **Guideline** is to be read in conjunction with this Explanatory Statement.

The **Guideline** prescribes:

- the form and content of financial information required to be published
- the methodology, principles and inputs used to calculate the financial information
- the form and content of the **weighted average price information** to be published
- the methodology, principles and inputs used to calculate the **weighted average price information**
- the manner in which the above information must be certified by an independent auditor.

1 https://www.aemc.gov.au/rule-changes/regulation-covered-pipelines

1.1.1 Relationship with the Non-scheme Pipelines – Financial Reporting Guideline[2]

In its final determination on the review of Parts 8-12 of the **NGR**, the **AEMC** stated that its amendments to the **NGR** apply many of the information provision obligations that already apply to non-scheme pipelines under Part 23 of the **NGR** to light regulation pipelines, and covered distribution pipelines.[3] The amendments also provide for a separate guideline to be prepared for light regulation pipelines, rather than adoption of the Financial Reporting Guideline for Non-Scheme Pipelines (2017) that the **ERA** previously made under Part 23. Nothing, however, prevents the **ERA** from publishing the financial reporting guidelines for light regulation pipelines in the same document as the financial reporting guidelines for non-scheme pipelines (rule 36F(4) of the **NGR**).

Different regulatory arrangements for light regulation pipelines and non-scheme pipelines is the primary reason for having two separate guidelines. Specifically, for light regulation pipelines:

- Where one exists, the last previously determined asset value from an access arrangement under the **NGR**, Gas Code or other Commonwealth, State or Territory legislation is to be used to determine the opening asset value, which is then to be rolled forward in accordance with the roll forward approach outlined in rule 77 of the NGR.
- For any pipeline that does not have a previously determined asset value, two asset values are to be determined:
  - (a) an asset value determined in accordance with rule 77 of the NGR.
  - (b) an asset value determined using the **construction cost** as a starting point (**RCM value**).
- Given that light regulation pipelines are covered, a regulatory **WACC** is to be used for reporting and calculating the **RAB value** and the **RCM value**.

1.2 Key elements of the Guideline

The table below summarises the key elements of the Guideline.

Table 1.1 Key elements of the Guideline

Reporting obligations	Requirements
Pipeline service and access information	Service providers are required to publish basic information about the pipeline, service provision to related parties and other parties and information on the derived rate of return for the pipeline.
Pipeline financial statements	Service providers are required to publish financial statements for individual pipelines. Pipeline financial statements consist of: - statement of pipeline revenues and expenses - statement of pipeline assets - basis of preparation – method, principles and inputs used

2 https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/non-scheme-pipeline-financial-reporting-guidelines

3 https://www.aemc.gov.au/rule-changes/regulation-covered-pipelines, page ii

Reporting obligations	Requirements
Asset valuation based on: • regulatory asset base; or • using the recovered cost method	Where a RAB value has been established the service provider is to use the regulatory asset base approach (section 4 of the Guideline). Where a RAB value has not been established the service provider is required to determine a pipeline asset value based on the recovered capital methodology (section 5 of the Guideline). The RCM asset valuation is distinct from the asset values published in the pipeline financial statements. This asset valuation must be published with a basis of preparation.
Weighted average price	Service providers are required to publish weighted average price information for individual pipeline services. Service providers are required to publish pipeline revenue disaggregated by service categories and by charging method to support the calculation of weighted average price information. The weighted average price information must be published with a basis of preparation.

All information is to be published at least annually, on the service provider's website. Pipeline service and access information is to be published monthly under rule 36B(2) of the **NGR**.

1.2.1 Process undertaken to prepare the Light Regulation Pipelines – Financial Reporting Guideline *and template*

The **AER** published a draft Light Regulation Financial Guideline and template on 19 August 2019. The draft Guideline was informed by targeted consultation with pipeline owners, shippers and industry associations. The **AER** took this approach based on industry familiarity with the Financial Reporting Guideline for Non-scheme Pipelines given the extensive consultation undertaken to finalise this Guideline. The **AER** also gave weight to the extensive consultation undertaken by the **AEMC** as part of its review of Parts 8-12 of the NGR. A period of 4 weeks was allowed for submissions and five submissions were received (Annex A).

The **ERA** has taken into account consultation by the **AER** undertaken in the development of the initial financial reporting guidelines in accordance with the Transitional Provisions of Schedule 1 rule 63(3) of the NGR.

The **ERA** has now published the Guideline having regard to the feedback provided by stakeholders to the **AER**'s consultation process, the overarching objective of the framework and the National Gas Objective (NGO).

1.3 Background

On 14 March 2019, following consultation, the AEMC made amendments to the NGR to implement a range of improvements to the regulation of covered pipelines across Australia.

The AEMC determined that the publication of timely and relevant information by service providers is critical to aid users and prospective users in negotiating with a service provider. It stated that the purpose of the rule changes is to address the information asymmetry issues identified by stakeholders during it consultations. The changes apply many of the information provision obligations that already apply to Bulletin Board pipelines and non-scheme pipelines under Part 23 of the NGR. The AEMC took the view that the rule changes will result in more relevant, timely and accessible information for users and prospective users to inform their negotiations with service providers.[4]

The rules require the AER to publish a financial reporting guideline for light regulation pipelines by 31 October 2019.[5] The information disclosure regime, as reflected in rule 36B of the NGR, requires service providers of light regulation pipelines, to publish a range of information on their website, including financial information and weighted average price information. The disclosure regime also requires any information published under Part 7 to be prepared and maintained in accordance with the access information standard in the NGR, which means the information:[6]

- is not false or misleading in a material particular
- where of a technical nature, is prepared in accordance with the practices, methods and acts that would reasonably be expected from an experienced and competent person engaged in the ownership, operation or control of a pipeline in Australia acting with all due skill, diligence, prudence and foresight
- in relation to a forecast or estimate, is supported by a statement of the basis of the forecast or estimate and:
  - is arrived at on a reasonable basis
  - represents the best forecast or estimate possible in the circumstances.

The information to be disclosed in accordance with rule 36A of the NGR is intended to provide a prospective user with adequate information to consider whether it should seek access to services on a light regulation pipeline. Prospective users can use the information to assess the reasonableness of the service provider’s standing price, as well as the terms and conditions associated with the services available.

4 AEMC, *Review in scope of economic regulation of covered pipelines*, Final Report, 3 July 2018, p. 9.

5 NGR r. 63(1). See Appendix B.

6 NGR, r. 36A

1.4 Asset Valuation

The Guideline includes two approaches to asset valuation and roll forward:

- the regulatory asset base approach (RAB value)
- the recovered capital method (RCM).

The RAB value is set out in section 4 of the Guideline and discussed in section 4 of this paper. The RAB value uses the approach that covered pipeline service providers are already familiar with for rolling forward the asset base. The RAB value is to be rolled forward using the RFM Material – which is incorporated by reference.

The RCM asset valuation method is set out in section 5 of the Guideline. It calculates the depreciated cost of constructing the pipeline, with the depreciation component reflecting the return of capital generated since the pipeline was constructed (i.e. revenue less operating expenditure less the return on capital less net tax liabilities). It is intended to provide service providers and prospective users with greater understanding of the residual value of the asset by showing the capital that has been recovered from users since the pipeline was constructed.

1.5 Legal Framework

Western Australia is a participating jurisdiction in the national gas regulatory scheme to the extent set out in the *National Gas Access (WA) Act 2009.*

The National Gas Access (Western Australia) Law is a modified version of the National Gas Law, as amended by adoption amendments orders issued by the Western Australian Minister for Energy, or the **AEMC** in accordance with its rule making power under section 74 of the *National Gas Access (WA) Act 2009*.

The *National Gas (Pipelines Access – Arbitration) Amendment Rule 2017* has been adopted under the *National Gas Access (WA) Adoption of Amendments Order 2017*, and the *National Gas Amendment (Regulation of covered pipelines) Rule 2019 No. 1*, issued by the **AEMC** under section 313 of the *National Gas Access (WA) Act 2009*, also applies in Western Australia.

On 14 March 2019, the AEMC amended the NGR to implement improvements to the regulation of covered pipelines. The revised rules require the ERA to publish a financial reporting guideline for light regulation pipelines no later than 31 October 2019.[7]

The Guideline should be read in conjunction with:

- the NGL as applied in Western Australia
- the NGR as applied in Western Australia, in particular Part 7, Division 2
- the ERA's Non-scheme Pipeline Arbitration Guide.[8]
- The Gas Pipeline Information Disclosure and Arbitration Framework.[9]

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7 NGR, Schedule 1 Transitional Provisions, 63(1).

8 When published by the ERA.

9 Gas Market Reform Group, Gas Pipeline Information Disclosure and Arbitration Framework Initial Gas Rules Explanatory Note, 2 August 2017.

Rule 36D(2) of the NGR states that a dispute resolution body is not bound by the financial information published or by any methods, principles or inputs that have been used to calculate financial information published due to the financial reporting guidelines.

1.6 Assessment of the costs and benefits of the information disclosure

The AEMC consulted widely and fully on the proposal to increase information disclosure requirements on light regulation pipelines and have them mirror Part 23 (this was to minimise differences between light regulation and Part 23, and hence regulatory costs). The AEMC Final Rule Determination sets out the expectation that the light regulation guideline will be similar to that for Part 23 pipelines.[10] Due to the lengthy and extensive consultation undertaken by the AEMC the ERA has not undertaken a further cost benefit analysis.

1.7 Status of the Guideline in the event of a dispute

A dispute resolution body is not bound by the financial information published or by any methods, principles or inputs that have been used to calculate financial information published due to the financial reporting guidelines (rule 36D).

1.8 RIS review examining the forms of gas regulation

On 10 August 2018, the Council of Australian Governments' (COAG) Energy Council asked its Senior Committee of Officials (SCO) to prepare a Regulation Impact Statement (RIS) to examine options to improve gas pipeline regulation. This request was made in response to concerns about whether the existing regulatory framework is fit for purpose and provides a coherent and proportional response to the problems it seeks to address.

The RIS is to identify and evaluate options to deliver a more efficient, effective and well-integrated regulatory framework for gas pipelines. The RIS process also incorporates a review of the information disclosure and arbitration framework set out in chapter 6A of the National Gas Law (NGL) and Part 23 of the National Gas Rules (NGR).[11]

The broader context means there is potential for significant change to the way gas regulation is conducted. However, the NGR, as currently in force, require the ERA to publish the Guideline by 31 October 2019.

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10 AEMC, *National Gas Amendment (Regulation of Covered Pipelines) Rule 2019: Rule Determination*, 14 March 2019, pp. 108-110, https://www.aemc.gov.au/sites/default/files/2019-03/Final%20Determination_0.pdf

11 SCO, Terms of Reference - Regulation Impact Statement on Gas Pipeline Regulation Reform, 19 December 2018.

2. About the Guideline

2.1 Application

The information disclosure framework, as articulated in Part 7 of the NGR, applies to light-regulation transmission and distribution pipelines. The term 'light regulation pipeline' is applied to a gas pipeline which is covered by the National Gas Rules (NGR).[12] Covered pipelines can be subject to full or light regulation. Full regulation pipelines are required to submit an access arrangement for assessment by the ERA. In contrast to a full regulation pipeline, a light regulation pipeline is not required to have an access arrangement.

2.2 Reporting requirements

In accordance with rule 36B of the NGR, the financial information and weighted average price information must be published annually within four months of the end of the service provider's reporting period. The table below sets out the first reporting dates for pipelines that were **light regulation pipelines** on the commencement date.

Table 2.1: First reporting dates for the financial information and average weighted prices

Reporting year end	Reporting Dates
30 June 2020	By 31 October 2020
31 December 2020	By 30 April 2021

2.3 Process for revisions

The ERA may amend or replace the Guideline from time to time, in accordance with rule 36F(3) and the standard consultative procedure in rule 8 of the NGR. A date of issue will identify each version of the Guideline.

2.4 Terminology/definitions

The terms and definitions used in this Explanatory Statement are as specified in Section 1.4 of the Guideline, unless indicated otherwise.

2.5 Structure of this paper

The remainder of this explanatory statement is structured as follows:

- Section 3 outlines the reporting obligations for pipeline financial statements;
- Section 4 sets out asset valuation using the regulatory asset base approach;

12 Australian Energy Market Commission, *Regulatory classification of gas pipelines*, downloaded from https://www.aemc.gov.au/regulation/energy-rules/national-gas-rules/regulatory-classification-gas-pipelines on 3 May, 2019.

- Section 5 sets out asset valuation using the recovered capital method;
- Section 6 sets out how the weighted average cost of capital is to be calculated;
- Section 7 outlines the reporting obligations for the weighted average price information;
- Section 8 focuses on the assurance requirements; and
- Section 9 outlines the compliance and enforcement arrangements.

3. Pipeline financial statements

Rule 36F(2)(a) of the NGR requires the Guideline to provide for the publication of annual financial information about each light regulation pipeline on a pipeline by pipeline basis, which may include:

- financial statements
- information on the methods, principles and inputs used to calculate asset values, depreciation allowances and for cost allocation purposes
- financial performance metrics.

The asset valuation in Section 4 of the Guideline (statement of pipeline assets) differs from the RCM valuation in Section 5 of the Guideline.

Basis of preparation

Service providers are required to provide a basis of preparation separate to the financial reporting template. This must be published on the service provider's website with the financial reporting template.[13] The pipeline financial statements section of the basis of preparation document requires details of the sources of information used in the preparation of the financial reporting template, any amendments to the data from previous years, identification of shared assets and the method for allocating these from the entity to the individual pipeline. The basis of preparation will:

- Enable an understanding of how the amounts reported in the pipeline financial statements are determined or calculated.
- Assist with interpretation of information reported in the pipeline financial statements.
- Assist with comparison of information provided in the pipeline financial statements to the service provider as a whole.
- Provide an understanding of how shared amounts are allocated.

The Guideline requires the service provider to publish financial statements for the pipeline that include:

- A statement of pipeline revenues and costs
- A statement of pipeline assets
- Pipeline information

Each of these requirements is discussed separately in the remainder of this chapter.

3.1 Statement of pipeline revenues and costs

The statement of pipeline revenues and expenses provides an overview of the revenue generated from pipeline operations and the costs associated with earning this revenue. Providing a statement of revenue and expenses for the pipeline provides prospective users with an understanding of the returns generated and profitability of each pipeline, which will assist them to assess the reasonableness of the standing prices and services offered by service providers.

[13] See section 7 of the ERA's *Non-scheme pipelines - Financial Reporting Guideline*, 23 May 2018.

3.1.1 Reporting requirements

The pipeline financial statements, including the statement of revenues and expenses must be based on principles contained in Australian Accounting Standards.[14] Unlike a standard income statement, however, service providers are not required to report interest and tax expenses in the statement of revenues and expenses. Interest and tax are typically reported at the entity level, so there is a risk that allocating these to the pipeline level would be misleading.

The Guideline specifies the revenue and expense categories to be reported.[15] Revenue is classified as either direct revenue or indirect revenue. Further disaggregation of direct revenue is required for specific services. Service providers must also publish details of contributions made by customers or governments that are included in the reported revenues. Indirect revenues may be allocated to the pipeline.[16] Details on sources of indirect revenues are also required. Where an allocation of indirect revenues is made, the basis of the allocation must be disclosed, and the methodology included in the basis of preparation. Related party transactions impacting both direct and indirect revenues must also be disclosed by the service provider.[17]

Expense categories are classified as either direct costs or shared costs. Shared costs may be allocated to the pipeline, but costs relating to interest and taxes are not required to be reported. Details on sources of shared costs are also required. Where an allocation of shared costs is made, the basis of the allocation must be disclosed, and the methodology included in the basis of preparation. Related party transactions impacting both direct and shared costs must also be disclosed by the service provider.

The Guideline includes a principle that shared costs paid to related parties cannot include any component of profit to the related party.

Service providers are required to provide a basis of preparation separate to the financial reporting template. This is to be published on the service provider's website with the financial reporting template.[18] The statement of pipeline revenues and expenses section of the basis of preparation requires:

- details of the sources of information used in the preparation of the financial reporting template
- any amendments to the data from previous years
- identification of shared revenues and expenses and the method for allocating these from the entity to the pipeline.

3.1.2 Deliberation in setting the reporting requirements

In preparing the light regulation financial reporting guideline, the ERA has relied on the equivalent guideline for non-scheme pipelines as our foundation. In their joint report on east coast gas market transparency, the ACCC and GMRG recommended that scheme pipelines should be required to comply with the same price and financial reporting obligations as non-

14 See section 3.1 of the ERA's *Non-scheme Pipelines – Financial Reporting Guideline*, 23 May 2018.

15 See section 3.1.1.1 of the ERA's *Non-scheme Pipelines – Financial Reporting Guideline*, 23 May 2018.

16 This is required in worksheet 2.3 of the financial reporting template.

17 See section 3.1.1.1 of the ERA's *Non-scheme Pipelines – Financial Reporting*, 23 May 2018.

18 See section 7 of the ERA's *Non-scheme Pipelines – Financial Reporting Guideline*, 23 May 2018.

scheme pipelines.[19] Further, the report states that 'if light regulation is to be retained, we support extending the financial and price reporting obligations that currently apply under Part 23 of the NGR to these pipelines.'[20] Coupled with the fact that during the AER's early consultation sessions, stakeholders did not raise concerns with using the non-scheme financial reporting guideline as the foundation, this is taken as providing additional support for the ERA's proposed approach.

3.2 Statement of pipeline assets

The 'statement of pipeline assets' provides prospective users with an overview of the assets used in the pipeline's operations and/or attributable to a pipeline (worksheet 3). The statement of pipeline assets provides shippers with an understanding of the asset base, for use when considering the financial performance of a pipeline.

Pipelines that have previously had a regulatory asset base established as a result of the pipeline being covered and subject to a full access arrangement, must use the asset value determined in the last access arrangement (section 4 of the Guideline and further elaboration is provided in section 4 of this paper).

Pipelines that have no prior regulatory asset base are to use rule 77(1) of NGR, as well as an asset value using the recovered capital method (section 5 of the Guideline and further elaboration is provided in section 5 of this paper).

3.2.1 Reporting requirements

Asset values are to be reported in accordance with the instructions set out in the Guideline. The statement of pipeline assets is to be prepared in accordance with Australian Accounting Standards, except where specific treatments are specified in the Guideline.[21] This allows the asset values to be reported based on acquisition (in specific circumstances) or construction cost plus capitalised expenditure (noting that upward revaluations are not allowed), less depreciation and impairment. The Guideline provides further detail regarding the determination of an asset's opening value, capitalised expenditure, depreciation and impairment.[22]

Unlike a balance sheet, service providers are not required to report debt and liabilities in the statement of pipeline assets. Debt and liabilities are typically managed at the entity level, so there is a risk that allocating these to the pipeline level would be misleading.

The Guideline requires assets disclosed in the statement of pipeline assets sheet of the financial reporting template (worksheet 3) to be valued as:

- construction or acquisition cost (where the asset was acquired prior to the commencement of the Guideline);
- plus certain expenditure which meets the requirements to be capitalised since asset acquisition or construction;

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19 ACCC/GMRG, *Measures to improve the transparency of the gas market*, 21 December 2018, http://gmrg.coagenergycouncil.gov.au/sites/prod.gmrg/files/publications/documents/accc-gmrg-measures-improve-transparency-gas-market.pdf, Section 5.3.1, p.32.

20 ACCC/GMRG, *Measures to improve the transparency of the gas market*, 21 December 2018, http://gmrg.coagenergycouncil.gov.au/sites/prod.gmrg/files/publications/documents/accc-gmrg-measures-improve-transparency-gas-market.pdf, Section 5.3.1, p. 33.

21 See section 3.2.1 of the ERA's *Non-scheme Pipelines – Financial Reporting Guideline*, 23 May 2018.

22 See section 3.2 of the ERA's *Non-scheme Pipelines – Financial Reporting Guideline*, 23 May 2018.

- less accumulated depreciation;
- less disposals;
- less any impairment charges.

Pipeline assets are likely to be impairment tested regularly as part of the service provider's group audit procedures. Asset impairments are able to be included in the statement of pipeline assets, but the reasons and amounts must be disclosed in the basis of preparation. Similarly, impairments can be reversed, but the reasons and amounts must be disclosed in the basis of preparation.

The Guideline does not provide for the indexation of pipeline assets under the RCM. This approach is consistent with Australian Accounting Standards, which do not allow asset values to be indexed for inflation.

Some service providers have complex corporate structures that result in transactions with related parties (for example, one entity may own the pipeline assets and lease this asset to the entity that operates the pipeline or have an outsourcing arrangement with a related party).

The Guideline requires related party transactions in the reporting period to be separately disclosed.[23] This information is required to be reported because, as noted above, there is the potential for related party transactions to not reflect arm's length market rates. The related party transactions do not need to be adjusted to reflect an "arms length" value, as the process required to confirm an arm's length market rate may significantly increase the costs of auditing the financial reporting template.

The Guideline specifies that the following methods, principles and inputs are to be used in determining the statement of pipeline assets.[24]

Capitalisation principles

Assets are to be capitalised at either construction cost or acquisition cost in accordance with the Guideline. The conditions for an amount to be capitalised are specified in the Guideline and are broadly consistent with the approach adopted in the Australian Accounting Standards.

Capitalisation principles are to be applied consistently across the RAB value and the RCM value.

Asset life principles

A range of useful lives for various classes of assets is included in Appendix A of the Guideline. Where an asset's useful life does not fall within this range, the service provider is required to explain why this is the case in the basis of preparation. The explanation is intended to provide shippers with an understanding of why the asset life is longer or shorter than those for similar types of assets (for example, a pipeline with a longer potential operational life may be depreciated over a shorter estimated useful life when there is an expectation that gas will no longer be required due to changing customer needs).

The inclusion of a range of useful lives is intended to reduce the burden on service providers, because if their asset lives fall within the range, they will not be required to provide an explanation for the basis for the asset's useful life. If a range of asset lives were not

23 See section 3.2.6 of the ERA's *Non-scheme Pipelines – Financial Reporting Guideline*, 23 May 2018.

24 See sections 3.2.2, 3.2.3, 3.2.4 and 3.2.5 of the ERA's *Non-scheme Pipelines – Financial Reporting Guideline for Non-Scheme Pipelines*,23 May 2018.

prescribed, service providers would be required to explain the basis of the useful life for each asset (or class of assets) disclosed.

Where a pipeline has previously had a RAB established, it is expected that unless there is a clear reason not to, the service provider would continue to use the economic lives set at the time the pipeline was last regulated. If asset lives does change throughout a pipeline lifetime, **Service providers** must maintain NPV neutrality to ensure that asset is depreciated only once as required by rule 89(1)(d) of the NGR.

Asset life principles are to be applied consistently across the RAB value and the RCM value (even if it is only for asset life tracking purposes).

Allocation principles

Service providers are given some flexibility to develop their own policies to allocate revenue, expenses and assets to a pipeline, provided that their methodology is consistent with the broad principles set out in the Guideline.

The basis used to allocate assets must be provided in the basis of preparation document.

Allocation principles are to be applied consistently across the RAB value and the RCM value.

Depreciation principles

Deprecation is to be determined in accordance with methods provided in the Australian Accounting Standards unless otherwise stated in section 5 of the Guideline on RCM.

The Guideline also does not provide for land or easements to be depreciated.

For the RAB value, depreciation principles are to be applied in accordance with section 4 of the Guideline.

For RCM value, depreciation principles are to be applied in accordance to straight line depreciation consistent with the Australian Accounting Standards in association with section 5 of the Guideline.

3.2.2 Deliberation in setting the reporting requirements

Our rationale for requiring asset valuation using the RAB value approach is set out in detail in section 4 of this explanatory statement.

3.3 Pipeline and financial performance information

The pipeline information required to be published is basic information on the size and location of the pipeline, and the services offered to related parties and other users.[25] The pipeline performance measure is a measure of profitability of the pipeline derived from the financial information reported in accordance with the Guideline.[26] The profitability measure is the return on assets, derived as EBIT as a proportion of total pipeline assets.

The pipeline performance information is included in the Guideline to provide clarity about the pipeline and its services to all users of the published information. The ERA notes that

25 See worksheet 1 of the financial reporting template.

26 See worksheet 1.1 of the financial reporting template.

prospective users may calculate other performance measures using information provided in the financial reporting template.

The ERA has kept all asset related material in Section 3 of the Guideline. The ERA has clarified where the guidance relates to the regulatory asset base approach (section 4) and where it relates to the recovered capital method (section 5).

4. Asset valuation using the regulatory asset base approach

All light regulation service providers are to report asset values based on the RAB value.

Service providers with pipelines that have a previously established regulatory asset base are to roll forward the asset base from the last access arrangement.

Service providers with no established regulatory asset base are to apply NGR (rule 77(1)) in determining the opening value.

4.1 Roll forward of the RAB value

The RAB value will increase or decrease from the previous RAB value:

- from one regulatory control period to the next regulatory control period
- from one regulatory year to the next regulatory year in the same regulatory control period.

The closing RAB value for a regulatory control period becomes the opening RAB to be used for the purposes of making a building block determination for the next regulatory control period.

The RAB values from this process are inputs into the regulatory financial models, where they are rolled forward from one regulatory year to the next regulatory year on a forecast indicative basis. They are used in the regulatory financial models as part of the calculation of the annual revenue requirements.

The roll forward process deals with many aspects of RAB estimation, including:

- establishment of the opening RAB for a regulatory control period
- adjustments for prudent and efficient capital expenditure (capex)
- the depreciation approach based on forecast or actual capex
- how the (forecast) roll forward occurs within the regulatory control period.

The roll forward of the RAB from year-to-year will reflect:

- additions for actual capex, net of customer contributions
- reductions for the disposal value of assets
- reductions for depreciation
- indexation for actual inflation
- adjustment for the difference between estimated and actual capex for a previous regulatory control period
- other adjustments for removal or addition of assets.

4.2 Issues considered in requiring asset valuation based on the regulatory asset base

The ERA notes that the AER has developed what it refers to as Roll Forward Model Material (RFM Material) because the covered pipelines it regulates are already familiar with the AER's RFM Material developed for electricity, and have adapted the electricity models for gas regulatory purposes.

The NGR requires the ERA to complete the *Light Regulation Pipeline Services – Financial Reporting Guideline* by October 2019, and first reporting will be October 2020.

The ERA notes the familiarity and support for the RFM that was provided by both pipeline owners and shippers in submissions to the AER consultation process.[27]

The ERA considers that a more general roll forward approach such as prescribed in rule 77 of the NGR is appropriate for the purpose of this first financial reporting guideline. ERA has consulted with the owner of the single light regulation pipeline in the ERA's jurisdiction who agreed the rule 77 provisions were adequate. If it becomes apparent in future that a more prescriptive approach is required then the ERA would seek to amend the guideline in accordance with rule 36F(3) of the NGR.

[27] APGA submission to AER draft Guideline, 16 September 2019, p.1.
EUAA submission to AER draft Guideline, 11 September 2019, p.1.
AGN submission to AER draft Guideline, 17 September 2019, p.1-2.

5. Asset valuation using the recovered capital method

The Guideline requires a service provider who does not have an established RAB through an access arrangement, to determine a pipeline asset value using the recovered capital methodology (RCM value). The methodology and rationale for the RCM value has already been set out in the ERA's Non-scheme Pipelines – Financial Reporting Guideline.

The RCM value has been included as part of the reporting requirements only for pipelines without any previous asset value because it is consistent with the intent of the framework. This is to make as much useful information available to shippers as practical in order to assist negotiations, and provide an asset valuation range which better allows operators and shippers to come to a commercial agreement.

In addition, availability of this information may be useful to the dispute resolution body in the event of a dispute involving pricing.

5.1 Requirement to report the recovered capital value

Service providers and shippers are already familiar with the RCM Value. RCM is the default asset valuation method that complies with the objective of Part 23 of the NGR.

The ERA in its non-scheme guideline noted the benefits of publishing this information and it believe these benefits are relevant to light regulation pipelines where an asset value has not been determined for regulatory purposes.[28] These benefits include:

- The publication of this information will reduce the degree of information asymmetry between service provers and prospective users. It will facilitate more timely and effective negotiations and encourage the resolution of disputes without the need to resort to arbitration.
- Prescribing the approach that service providers are to use when calculating the RCM asset value in the Guideline will provide prospective users with greater clarity about what the asset value represents and how it has been calculated. It will also reduce the risk of service providers employing different methods when calculating the RCM and/or providing different estimates of the recovered capital value to different shippers. The publication of this information will ensure that all prospective users, regardless of their size and bargaining power, will have access to the same information about the RCM asset value to assess the reasonableness of the offer.
- The RCM asset value, in conjunction with other information from the pipeline statements and the weighted average prices, will enable prospective users to assess whether the price offered is consistent with what would be expected in a workably competitive market. The absence of this information may result in either:
- prospective users paying more for services than would be expected to prevail in a workably competitive market, or
- more protracted negotiations between prospective users and service providers and a greater number of arbitrations.

[28] ERA, Non-Scheme Pipeline – Financial Reporting Guideline – Explanatory Statement, 23 May 2018, p. 16.

In short, greater transparency can be expected to impose more discipline on service providers when determining the price of services and discourage exercises of market power that would otherwise operate to the detriment of consumers and economic efficiency. When coupled with the other benefits outlined above, the ERA considers that the benefits of requiring the RCM to be published in the financial statements will exceed the costs and promote the NGO. The ERA is therefore satisfied that this information should be reported by service providers in their financial statements and updated on an annual basis.

5.2 Calculation of the recovered capital value

The Guideline requires service providers to disclose the value arising from the application of the RCM at worksheet 4 of the financial reporting template.

The RCM formula in the Guideline is as follows:[29]

$$Value\ of\ Capital\ Base_t = Construction\ Cost\ _0 + \sum_{i=1}^{t} Capex_i - \sum_{i=1}^{t} Return\ of\ Capital_i - \sum_{i=1}^{t} Asset\ Disposals_i$$

Where

$$\sum_{i=1}^{t} Return\ of\ Capital_i = \sum_{i=1}^{t} Revenue_i - \left[\sum_{i=1}^{t} Opex_i + \sum_{i=1}^{t} Return\ on\ Capital_i + \sum_{i=1}^{t} Net\ Tax\ Liabilities_i\right]$$

The term return of capital in this formula is used to refer to the change in the economic value of the asset and is equal to the difference between: [30]

- the revenue earned by the service provider
- the costs incurred by the service provider, where costs include operating expenditure, net tax liabilities and a return on capital.

To calculate the RCM asset value, service providers will require historic information on:

- the cost of constructing the pipeline (including shared assets)
- any capital expenditure that has occurred since the pipeline was constructed
- asset disposals that have occurred since the pipeline was constructed
- the return of capital that has occurred since the pipeline was constructed, which requires historic information on:

29 See section 4 of the ERA's *Non-scheme Pipelines – Financial Reporting Guideline for Non-Scheme Pipelines*, 23 May 2018.

30 It is worth noting in this context that under the RCM, if a service provider has not generated sufficient revenue to recover the operating expenditure, return on capital and net tax liabilities in a year, then the return of capital value will be negative, which will increase the value of the capital base. Note also that if the application of this approach produces a negative value for the capital base, the value of the capital base will be zero. This is consistent with the principle that an asset should be depreciated only once.

- revenue that has been generated since the pipeline was constructed from the provision of all pipeline services;
- the operating expenditure that has been incurred since the pipeline was constructed
- the net tax liabilities that have been incurred since the pipeline was constructed
- the return on capital required by the service provider in each year, which will require information on:
  - the closing value of the capital base in each year
  - the rate of return to be applied to the closing value of the capital base from the immediately preceding year, which should be determined for each year and based on a commercial rate of return that is commensurate with the prevailing conditions in the market for funds and reflect the risks the service provider faces in providing services.

5.3 Issues considered in requiring asset valuation based on the recovered capital method

Submissions on the draft Guideline published by the AER from pipeline owners raised concerns with the AER's decision to require light regulation pipelines with no previous regulatory determined asset value to report an RCM value. Pipeline owners also expressed general concern with the broader definition of deprecation that RCM entails.

Shippers consulted by the AER expressed support for the disclosure of an RCM value for pipelines with no previously determined asset value.[31]

Having considered the views of pipeline owners and shippers in response to the AER draft Guideline, the ERA has decided to retain the requirement to publish an RCM asset value where a pipeline does not have a previously determined regulatory asset value. As set out above in section 5.1, the ERA is satisfied that the publication of this information will assist in reducing the degree of information asymmetry between service provers and prospective users. It will facilitate more timely and effective negotiations and encourage the resolution of disputes without the need to resort to arbitration.

The rest of this section addresses the issues raised in submissions from pipeline owners.

How is depreciation to be calculated?

The rules relating to deprecation for asset base determination and asset base roll forward are different. The ERA has not introduced a new method for calculating depreciation.

The ERA has been guided by the AEMC and by the AER's consultation with shippers on its decision to retain calculation of the RCM value.

Box 5.1 below sets out the most recent considerations of the AEMC on the matter of deprecation as it relates to asset base roll forward and opening asset base determination.

RCM is currently being reported by non-scheme pipelines (reporting obligations commenced in 2018), and it is embedded in the NGR. Hence the ERA is not introducing a new definition

[31] EUAA submission 11 September 2019, p1.

of depreciation to be used in asset base determinations as the definition currently exists in the NGR.[32]

RCM was approved by the COAG Energy Council following extensive consultation on a package of measures developed by the GMRG.[33] In the absence of a regulatory asset base RCM provides further information that prospective users can consider in their negotiations with service providers.

The ERA has also taken guidance from the AEMC. The AEMC, in strengthening information reporting obligations on light regulation pipeline service providers, specifically sought to apply many of the information provision obligations that already apply to Bulletin Board pipelines and non-scheme pipelines under Part 23 of the NGR. The purpose being to provide more relevant, timely and accessible information for users and prospective users to inform their negotiations with service providers.

Box 5.1: Deprecation for opening asset base determination and asset base roll forward purposes

Extract AEMC:

There is a distinction between deprecation for opening asset base determination and asset base roll forward purposes.

Rule 77 of Part 9 of the NGR is concerned with how to determine the opening capital base of a full regulation pipeline:

- when a pipeline service provider submits the first access arrangement after a pipeline becomes covered (rule 77(1))
- when an opening capital base is required for a new access arrangement period that immediately follows a previous access arrangement period (rule 77(2))
- when an opening capital base is required for a new access arrangement period that does not immediately follow a previous period (rule 77(3)).

Depreciation is one element in determining the initial opening capital base. In the current context of rule 77(1), there is no single, universally applicable methodology for calculating depreciation. Accordingly, in this context, many depreciation profiles could be assumed for the period between commissioning and the date of setting the initial opening capital base.

In contrast, rules 77(2) and 77(3) of the NGR relate to the depreciation schedule for a full regulation pipeline that has had an initial capital base valuation. Rule 89 sets out criteria for the regulator to assess depreciation during an access arrangement period. These criteria are linked to the determination of reference tariffs. As a result, rule 89 of the NGR is relevant to determine an opening capital base at the beginning of a subsequent access arrangement period, but does not apply to the opening capital base for the initial access arrangement period. Rule 89 is concerned with the change in the value of the pipeline across access arrangement periods.

……

However, the NGR does not limit the regulator to only the roll forward methodology. The Commission considers that other methodologies could also be adopted by the regulator or dispute resolution body to determine the initial opening capital base under rule 77(1) of the NGR subject to the revenue and pricing principles and the NGO. One of these may be a recovered capital methodology such as that included in the AER guideline on financial reporting obligations under Part 23 of the NGR. The relative simplicity of the capital base roll forward model is that it does not require an ex post determination of an efficient rate of return for each year between pipeline commissioning and initial opening capital base determination. In contrast, the relative complexity of the recovered capital methodology is that it requires an ex post

32 NGR, Part 23, r.569(4)(b).

33 http://gmrg.coagenergycouncil.gov.au/sites/prod.gmrg/files/publications/documents/Final%20Explanatory%20Note%20-%202%20August.docx see introduction p. 1.

determination of the appropriate commercial rate on return over each year of the period between commissioning and initial opening capital base determination to calculate depreciation.

Given the expected outcomes under different methodologies, the Commission considers that the regulator should retain its discretion in determining the appropriate methodology for the purposes of rule 77(1). The Commission expects that in exercising this discretion, the regulator would have regard to the NGO and revenue and pricing principles in addition to a range of factors….

(emphasis added by ERA)
Source: AEMC Final Report Review into the scope of economic regulation applied to covered pipelines 3 July 2018, section 7.2.4, p147-151.

Where might RCM be used?

The ERA has been guided by feedback received by the AER from shippers who believe that the RCM will provide prospective users with greater information to aid negotiations, and its prescription in the Guideline will provide clarity about what the asset value represents and how it has been calculated.

In addition, a published RCM and its associated information means that in the event of a dispute the dispute resolution body has access to additional information to assist its determination. Noting that the dispute resolution body has discretion when determining the opening asset value and is not bound:

- to use Parts 8-12 of the NGR.[34]
- by the Guideline.[35]

Should the** ERA **defer consideration of RCM given pipeline owner concerns** and **given the RIS review examining the future of light regulation?[36]

The ERA has noted (section 1.8) that a broad ranging RIS review of gas regulation has commenced.

The ERA accepts the RIS review creates uncertainty regarding the future design of the regulatory regime for both shippers and service providers. However, the outcomes and timing of implementation of the RIS is uncertain and does not present sufficient justification for the AER to change or delay the Guideline. The NGR requires the ERA to publish a guideline by 31 October 2019, with first reporting due 31 October 2020 – assisting prospective shippers. It is unlikely the process kicked off by the RIS will have been completed by then.

Does the** ERA's **requirement to report RCM for pipelines with no regulatory asset base increase uncertainty and risk for asset owners?

On the east coast there is only one light regulation pipeline that does not have a regulatory asset base – the Carpentaria pipeline owned by APA. The AEMC considered this matter and in its final report concluded that the benefits of developing an initial capital base for Carpentaria pipelines (increased certainty and potentially a faster outcome in the event of a dispute) outweigh the costs. The AEMC recommended that the NGR should be amended to require the regulator to determine an initial opening capital base for light regulation pipelines without

[34] Neither the NGL nor the NGR lay out an overarching reference framework for the dispute resolution body that would apply in cases where there is no applicable access arrangement. https://www.aemc.gov.au/markets-reviews-advice/review-into-the-scope-of-economic-regulation-appli See chapter 9.

[35] https://www.aemc.gov.au/sites/default/files/2018-07/Final%20Report.PDF, p. 147-149.

[36] Jemena submission to AER draft Guideline, 16th September 2019, p. 3.
APA submission to AER draft Guideline, 16th September 2019, p. 2 and p. 10.

an initial capital base determination. The COAG Energy Council indicated that it agreed in principle with the AEMC's recommendation. However, it is anticipated the issue will be considered in the context of further work by the Senior Committee of Officials (SCO) on light regulation, Part 23 and the coverage test – RIS Review.[37]

While this matter is being considered, on balance the ERA's view is there are benefits from increased information disclosure and transparency and hence an RCM value should be reported.

[37] https://www.aemc.gov.au/sites/default/files/2019-03/Final%20Determination_0.pdf p. 7.

6. WACC

Light regulation pipelines are covered pipelines. The ERA has considers that the Weighted Average Cost of Capital (WACC) for a given year should be an estimate of the WACC that would have been set by the ERA at that time had the pipeline been subject to full regulation.

The estimated WACC for a given year must follow the hierarchy set out in Box 6.1. The calculation of a WACC is relevant for the Asset Valuation based on the regulatory asset base approach (section 4 of this paper and the Guideline) and the RCM value (section 5 of this paper and the Guideline).

Box 6.1 WACC hierarchy

The estimated WACC for a given year must follow the following option hierarchy, using the lowest numbered option applicable.

1. Where the light regulation pipeline was under full regulation in part of a given year for which an estimated WACC is required, the WACC from the pipeline's ERA final decision applicable to that given year is to be used.

The relevant WACC (for the given year) is to apply to the full pipeline even where only part of the pipeline was under full regulation for that year, or where the WACC applied only for part of the year.

In the event two regulatory determinations applied in a given year for which an estimated WACC is required, the estimated WACC is to be a weighted average of the two determination WACCs based on the number of business days each regulatory WACC applied during the given year.

2. Where there was an ERA WACC instrument, guideline, or statement of regulatory intent ("WACC Instrument") in place that would have been applied at the time (i.e. in force at the start of a given year for which an estimated WACC is required) this WACC Instrument is to be applied, to the extent possible, as it would have been applied at the time.[38]

3. The estimated WACC is to be taken from the most recent previous ERA final decision that covers the same year and the same type of gas pipeline (i.e. transmission or distribution).

4. The estimated WACC is to be taken from the most recent previous ERA final decision that covers the same year and different type of gas pipeline.

5. The estimated WACC is to be based on the first available ERA final gas transmission of distribution decision from a later year.

In addition, as the form of WACC calculated have changed through time (e.g. from pre-tax to post corporate 'Vanilla'), financial market conditions change over time, and financial market data availability for historical periods has changed (relative to what was available for setting the WACC in the past), the relevant WACC for a given year should be calculated/adjusted as set out in the Financial Reporting Guideline for Light Regulation Pipelines (section 6).

The information and calculations used to determine the value of the WACC is to be documented in the basis of preparation.

38 Note a trailing average return on debt is not to be used for estimating the WACC.

6.1 Issues considered in developing a WACC methodology

Should the regulatory WACC apply to light regulation pipelines?

Submissions to the AER from pipeline service providers raised questions over what is the appropriate WACC for light regulation pipelines.[39] In considering this issue the ERA notes that:

- Light regulation pipelines are covered pipelines underpinned by the ability of shippers and service providers to negotiate and arbitrate services.
- Light regulation compared to full regulation avoids the upfront cost of developing a full access arrangement – particularly determining reference services and reference tariffs.

Light regulation pipelines are expected to publish information to assist prospective shippers in their negotiations with pipeline owners and are not required to submit a full access arrangement. In the event of an arbitration, the dispute resolution body would have regard to the revenue and pricing principles in section 24 of the NGL (one of which is that the reference tariff should allow for a return commensurate with the regulatory and commercial risks involved in providing the service). Hence in the event of a dispute, the pipeline service provider has the opportunity to make its case on the risks and returns unique to that pipeline.

Fundamentally, light regulation pipelines are covered pipelines, and the ERA is satisfied that its approach to use a regulated WACC is justified.

Why the ERA is not proposing to use a trailing average for estimating the debt risk premium or the cost of debt?

The Guideline requires use of the ‘on the day’ rate instead of the trailing average because the on the day rate reflects the cost of debt capital in the economy at that point in time whereas a trailing average (of historical rates) does not.

The ERA considers that an on the day rate best reflects the prevailing cost of capital in the market. This reflects the opportunity cost of regulated capital at that point in time and is an appropriate measure of the compensation required to owners of regulated infrastructure in that year. The on the day rate best reflects the required point in time (prevailing) required compensation on debt capital.

Light regulation pipelines are not price regulated and do not currently have a regulated WACC (and building block allowance) set for them. However, if a light regulation pipeline was to become fully regulated in the future (i.e. be declared) the 2018 rate of return instrument would apply to the pipeline’s access undertaking. Under this scenario, an on-the-day risk free rate and a 10-year trailing average debt risk premium would be used to calculate the cost of debt. However, for the purposes of calculating the WACC for light regulation pipelines an on-the-day risk free rate and on-the-day debt risk premium will be used.

The ERA does not consider that the WACC calculation hierarchy set out in the Guideline is particularly complicated. However, the ERA can assist the light regulation pipelines with these calculations if required.

[39] APA submission to AER draft Guideline, 16th September 2019, p.18
Jemena submission to AER draft Guideline, 16th September 2019, p.4.

The ERA remains of the view that the calculation of the WACC without the use of a trailing average is appropriate.

In light regulation WACC is used to either determine efficient prices at a given time, or to be used to allow negotiating parties to work out what is a reasonable access price. This is representative of a point in time and for simplicity the ERA proposes to not use a trailing average.

Hypothetical example of an annual WACC calculation

The ERA undertook to provide a worked example of the application of the WACC hierarchy and this is provided in Box 6.2. The purpose of this worked example is to assist service providers understand and apply the WACC hierarchy.

Box 6.2: Hypothetical example of an annual WACC calculation

- Transmission pipeline X has a full regulatory determination (with WACC) made on 31 Oct 2002 for an access period that was to run from 1 Jan 2003 to 31 Dec 2007. It was not regulated before 1 Jan 2003 and had coverage revoked on 31 Jan 2007. Assuming financial year WACCs, the WACC from 1 July 2002 to 30 June 2020 will be calculated for each financial year as follows (using the financial market data in accordance with the rules set out above):
- 1 July 2002 to 30 June 2003 (the ERA will use the 31 Oct 2002 determination WACC) NOTE: In accordance with hierarchy Option 1, the 31 Oct 2002 WACC determination applies to this whole year as it was in force for part of the financial year from 1 Jan 2003 to 30 June 2003
- 1 July 2003 to 30 June 2004 (the ERA will use the 31 Oct 2002 determination WACC)
- 1 July 2004 to 30 June 2005 (the ERA will use the 31 Oct 2002 determination WACC)
- 1 July 2005 to 30 June 2006 (the ERA will use the 31 Oct 2002 determination WACC)
- 1 July 2006 to 30 June 2007 (the ERA will use the 31 Oct 2002 determination WACC) NOTE: In accordance with hierarchy Option 1, the 31 Oct 2002 WACC determination applies to this whole year as it was in force for part of the financial year from 1 July 2006 to 31 Jan 2007
- 1 July 2007 to 30 Jun 2008 (the ERA will use the most recently completed ERA gas transmission final decision as at 1 July 2007 using the last 20 business days' financial market data ending on 30 June 2007)
  NOTE: Hierarchy Option 1 does not apply here as the 31 Oct 2002 WACC determination was revoked on 31 Jan 2007 prior to the commencement of the 2007/08 financial year.
- 1 July 2008 to 30 June 2009 (the ERA will use the most recently completed ERA gas transmission final decision as at 1 July 2008 using the last 20 business days' financial market data ending on 30 June 2008)
- 1 July 2009 to 30 June 2010 (the ERA will use the most recently completed ERA gas transmission final decision as at 1 July 2009 using the last 20 business days' financial market data ending on 30 June 2009)
- 1 July 2010 to 30 June 2011 (the ERA will use the most recently completed ERA gas transmission final decision as at 1 July 2010 using the last 20 business days' financial market data ending on 30 June 2010)
- 1 July 2011 to 30 June 2012 (the ERA will use the most recently completed ERA gas transmission final decision as at 1 July 2011 using the last 20 business days' financial market data ending on 30 June 2011)
- 1 July 2012 to 30 June 2013 (the ERA will use the most recently completed ERA gas transmission final decision as at 1 July 2012 using the last 20 business days' financial market data ending on 30 June 2012)
- 1 July 2013 to 30 June 2014 (the ERA will use the most recently completed ERA transmission final decision as at 1 July 2013 using the last 20 business days' financial

market data ending on 30 June 2013)
NOTE: the 2013 ERA Rate of Return Guideline is not applied here because it was not in force on 1 July 2013 at the commencement of the 2013/14 financial year.

- 1 July 2014 to 30 June 2015 (the ERA will use the 2013 ERA Rate of Return Guideline using the last 20 business days' financial market data ending 30 June 2014)
- 1 July 2015 to 30 June 2016 (the ERA will use the 2013 ERA Rate of Return Guideline using the last 20 business days' financial market data ending 30 June 2015)
- 1 July 2016 to 30 June 2017 (the ERA will use the 2013 ERA Rate of Return Guideline using the last 20 business days' financial market data ending 30 June 2016)
- 1 July 2017 to 30 June 2018 (the ERA will use the 2013 ERA Rate of Return Guideline using the last 20 business days' financial market data ending 30 June 2017)
- 1 July 2018 to 30 June 2019 (the ERA will use the 2013 ERA Rate of Return Guideline using the last 20 business days' financial market data ending 30 June 2018)
  NOTE: the 2013 Guideline applies here because it was still in force at the commencement of the 2018/19 financial year
- 1 July 2019 to 30 June 2020 (the ERA will use the 2018 ERA Rate of Return Instrument using the last 20 business days' financial market data ending 30 June 2019)

7. Weighted average price

Weighted average price information provides a measure of the amount that users are charged, on average, for a particular service. This information is intended to enable prospective users to determine whether the price they are being charged or offered is higher or lower than the average price paid by existing pipeline users in the most recent financial year.

Rule 36E requires a service provider for a light regulation pipeline to prepare and publish on its website weighted average price information for each of its light regulation pipelines. Weighted average price information must:[40]

- be determined using a methodology set out in the Guideline;
- be in the form and contain the information specified in the Guideline; and
- be certified in the manner provided for in the Guideline.

The Guideline is to specify the methods, principles and inputs used to calculate the weighted average price information and the form this information is to take (rule 36F(b)).

7.1 Reporting requirements

The Guideline requires service providers to publish weighted average prices for each service type and charging method. Service providers are required to publish this information for the most recent financial year.[41]

The Guideline requires service providers to classify pipeline revenue for the most recent financial year into the following service categories in order to calculate separate weighted average price information for each service:[42]

- Transportation services:
  - Firm forward haul transportation services (includes bi-directional services, if a pipeline operates in a bi-directional manner).
  - Interruptible or as available transportation service.
  - Backhaul services.
- Stand-alone firm compression services.
- Firm storage (combined park, and park and loan) services.

To enable weighted average prices to be compared in a meaningful manner with the prices shippers are paying or are being offered, the weighted average prices charged to customers for transportation services must be further classified based on the charging method, either distance, zonal or postage stamp.

Some estimates may be required to prepare weighted average price information. For example:

- where a customer is charged for the use of more than one service type under an agreement, an estimate of the proportion of revenue that is attributable to a particular service may be required; or

40 NGR, rule 36E(2).

41 See section 7 of the ERA's *Light Regulation Pipelines – Financial Reporting Guideline*, 31 October 2019.

42 See section 7 of the ERA's Light Regulation Pipelines – *Financial Reporting Guideline*, 31 October 2019.

- where agreements do not separate revenue under a pipeline or service type, disclosure of the basis of allocation between pipelines and service types is required in the weighted average price section of the basis of preparation.

A service provider can seek an exemption from publishing weighted average prices for a pipeline service for a financial year if:

- the service was provided, directly or indirectly, to no more than two users of the non-scheme pipeline; and
- the service provider gives a notice to the AER at least 20 business days before the date required for publication certifying this.[43]

This exemption is designed to protect the confidentiality of prices paid by individual shippers for particular services.

When such a notice is given, the AER has the discretion, by notice to the service provider, to require services to be combined for the purpose of calculating the weighted average price.

7.2 Deliberation on the weighted average prices reporting requirements

Submissions questioned the current Weighted Average Prices (WAPs) reporting requirements and its usefulness to shippers.[44] They note that a single number is unlikely to distinguish between short and long term contracts or contracts with significant variance in terms and conditions. Submissions are also aware that a process has been suggested requiring further consultation to determine a methodology that better meets the objectives of WAP, and that process may take some time.[45]

Service providers should be mindful that an exemption application can be made in accordance with rule 36E(3) of the NGR which should address to some extent the confidentiality concerns raised. The Guideline does not prescribe the methodology that should be used to allocate revenue to different categories, but the basis of allocation must be made clear in a basis of preparation.

When finalising its guideline, the ERA was aware that reviews have found that WAPs published by pipeline operators (under Part 23) may not be achieving the stated objective of this disclosure requirement, because they do not provide a good representation of the prices actually paid by shippers and in some cases are not directly comparable to the pipeline operators' standing prices. Shippers may not therefore be able to rely on this information to assess the reasonableness of an offer by reference to what other shippers are paying.[46]

Following the completion of the processes that have commenced, the ERA will look at all the recommendations relating to this guideline and the *Non-scheme pipelines – Financial Reporting Guideline* (May 2018) and amend them as it considers necessary.

Amendments and changes to this and any other ERA guideline will be undertaken according to the consultation requirements set out in the national gas rules.

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43 See section 7.3 of the ERA's *Light Regulation Pipelines – Financial Reporting Guideline*, 31 October 2019.

44 APA submission to AER draft Guideline, 16th September 2019, p. 20.

45 EUAA submission to AER draft Guideline , 16th September 2019, p. 2.

46 https://www.accc.gov.au/system/files/Gas%20inquiry%20July%202019%20interim%20report.pdf page 128.

8. Assurance requirements

Rule 36D(1) states that the financial information must:

(a) be in the form and contain the information specified in the financial reporting guidelines; and

(b) be certified in the manner provided for in the financial reporting guidelines.

The weighted average price (section 7) must also be certified in the manner provided for in the financial reporting guidelines (rule 36E(c)).

Providing assurance over information disclosed provides prospective users with greater confidence that they can rely on the information presented to inform negotiations on standing offer prices and services. Audit processes will increase the cost of compliance with the Guideline, as they impose a greater discipline on the service providers who must compile the information, as well as the direct cost of paying for an audit or review to be undertaken.

There is a need to balance the cost of assurance against the value of obtaining information that can be relied upon by prospective users and having a robust reporting process that minimises the opportunity to manipulate information.

The Guideline provides for two levels of audit assurance:

- Reasonable assurance - requiring the audit to comply with Auditing Standard *ASA 805 Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement and ASA 800 Special Considerations – Audits of Financial Reports Prepared in Accordance with Special Purpose Frameworks, Accounts or Items of a Financial Statement*. The audit report must include an opinion as to whether the financial information provided has been prepared in all material respects in accordance with the Guideline.
- Limited assurance - involving a review in accordance with *ASRE 2405 Review of Historical Financial Information Other than a Financial Report*. This provides a limited assurance review report expressing a conclusion whether, on the basis of the review, anything has come to the assurance practitioner's attention that causes the assurance practitioner to believe that the historical financial information, other than a financial report, is not prepared, or presented fairly, in all material respects, in accordance with the applicable criteria but no opinion is provided regarding whether the information is true and fair.

8.1 Reporting requirements

The following assurance is required under the Guideline:

- Pipeline financial statements - reasonable assurance
- Pipeline information (worksheets 1 and 1.1) - no assurance required
- Regulatory asset base asset valuation – reasonable assurance
- Recovered capital method asset valuation - limited assurance
- Weighted average price information - limited assurance

8.2 Deliberation in setting the assurance requirements

The audit requirements seek to achieve a balance between obtaining a level of assurance that enhances the information prospective users will rely on and acknowledging that in some situations estimates and judgements will be required to produce the information.

Submission on the AER's draft Guideline indicated that there are a range of views about the assurance requirements. Concerns were raised around an auditor's ability to report against both the basis of preparation document and the financial guidelines, and the associated high cost that would be required to undertake this task.[47] However, support for the assurance requirements was also received, in particular for the AER to appoint an independent auditor at the cost of the pipeline operator.[48]

In the 2017-2020 Gas Inquiry July Interim Report, the ACCC highlighted concerns about the auditing practices of non-scheme pipeline operators under the Part 23 Financial reporting guidelines, with examination showing auditors were not being directed to consider both basis of preparation documents and the Guidelines. The ERA's position balances the need to have the most reliable information being provided by service providers against the practical issues of providing assurance against estimated data and guidance provided by auditors that agreed upon procedures is not suitable for reliance by third parties.

Based on the ERA's review of the audits conducted on Part 23 financial information, the ERA is of the view that auditors are reasonably able to report against both the basis of preparation document and the financial Guidelines. The Guidelines and the basis of preparation should do not present different frameworks to audit against, rather the basis of preparation should provide additional explanation, where necessary, in respect of how the financial information that has been prepared is in accordance with the Guidelines.

The ERA acknowledges that there are costs involved with service providers adhering to the assurance requirements. The ERA sought to understand the approximate level of these costs by reviewing the impact the Part 23 requirements had on the total assurance costs of providers. The ERA's assessment is that the audit costs are not likely to be excessive when considered in the context of the annual revenue generated by the pipelines and the value to shippers of the financial information being audited.

Reasonable assurance is required for pipeline financial statements (statement of pipeline revenues and expenses, and statement of pipeline assets).[49] Some of this information is collected and reported at an entity level and allocation methods may need to be applied to determine this financial information at a pipeline level. In the future, it is expected that services providers will collect and/or develop systems to record this information at a pipeline level where possible. Similarly, auditors may need to adapt their procedures in the initial period and first full year of reporting to assess and provide assurance at a pipeline level, but once the new systems are established, they can be rolled forward in future years. The ERA notes that the cost of assurance is likely to be lower after the first full year of reporting.

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47 APA submission 16th September 2019, p. 22.

48 EUAA submission 16th September 2019, p. 3.

49 Reasonable assurance standard: *ASA 805 Special Considerations—Audits of Single Financial Statements and Specific Elements* and *ASA 800 Special Considerations—Audits of Financial Reports Prepared in Accordance with Special Purpose Frameworks*, *Accounts or Items of a Financial Statement.*

Limited assurance is required for the RCM asset value.[50] The limited assurance standard required to be complied with can be used in circumstances where source documentation is not available, if the framework under which the assurance is provided includes a requirement for service providers to document the process carried out when information is not available. The Guideline includes such a process by requiring a basis of preparation to be developed and specifying the material to be presented in the basis of preparation.[51] The auditor can provide limited assurance over the basis of preparation process documented being in accordance with the Guideline where actual information is unavailable.

The ERA considers limited assurance is appropriate for weighted average price information, in accordance with the accompanying basis of preparation and guideline, in recognition that many access agreements bundle services, so an allocation method will need to be applied to disaggregate data for the individual services. It is also noted that the revenue component of the weighted average price calculation is sourced from the financial statement, which has reasonable assurance.

In all cases, the person undertaking the audit assurance or review must meet the requirements set out in section 9.3 of the Guideline, including a requirement to be independent from the service provider and all of its related bodies corporate.

[50] Limited assurance standard: *ASRE 2405 Review of Historical Financial Information Other than a Financial Report*.

[51] See section 7 of the ERA's Non-scheme Pipelines – *Financial Reporting Guideline*, 23 May 2018.

9. Compliance and enforcement

Section 27 of the NGL requires the ERA to monitor, investigate and enforce compliance with the NGL and NGR. The ERA has these roles in relation to the information disclosure requirements in Part 7, including with regard to the financial information reporting in accordance with the Guideline.

Under the NGL, if a service provider fails to comply with the Guideline, the ERA can:

- seek an administrative resolution, which may include a voluntary commitment by the service provider to rectify non-compliance; or
- institute civil proceedings in the Western Australian Supreme Court and seek an injunction or an order that the service provider cease or remedy the conduct.

The ERA will exercise its functions and powers to monitor, investigate and enforce compliance with the financial reporting guideline.

The ERA aims to see businesses achieve high levels of compliance with the NGL. ERA will seek to demonstrate proportionality and procedural fairness (where required) in its enforcement actions.

Annexure A: Overview of AER's consultation approach

The following approach to consultations was undertaken:

Date	Description of consultation
May 2019	Initial consultation with service providers and shippers by the AER: • Australian Gas Networks (AGN) • APA • Australian Pipelines and Gas Association (APGA) • Energy Australia • Energy Users Association of Australia (EUAA) • Major Energy Users (MEU)
19th August 2019	Publication of draft material by the AER: • Financial Reporting Guideline for Light Regulation Pipeline Services • Financial Reporting Template Submission sought on draft material.
16th September 2019	Close of submissions on draft material. Submissions were received by the AER from: • AGN • APA • APGA • EUAA • Jemena
31 October 2019	Publication of final material by the ERA: • Light Regulation Pipelines – Financial Reporting Guideline • Financial Reporting Template • Light Regulation Pipelines – Financial Reporting Guideline Explanatory Statement