

# Determination: Gas Services Information Allowable Revenue and Forecast Capital Expenditure for the Independent Market Operator

1 July 2013 to 30 June 2016

1 November 2013

Economic Regulation Authority

WESTERN AUSTRALIA

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## Determination

1. In 2011, the Western Australian Government appointed the Independent Market Operator (**IMO**) to establish and operate the Gas Bulletin Board (**GBB**) and to prepare and publish the Gas Statement of Opportunities (**GSOO**) for the Western Australian natural gas sector.
2. Under clause 14 of schedule 3 of the Gas Services Information (**GSI**) Rules, the IMO was required to seek approval of its initial Allowable Revenue and Forecast Capital Expenditure for the provision of the GSI Services for the initial Review Period from the Economic Regulation Authority (**Authority**).
3. In accordance with this, the IMO submitted a proposal for the GSI Allowable Revenue and Forecast Capital Expenditure for the period 1 July 2013 to 30 June 2016 on 1 July 2013, following the commencement of the GSI rules on 29 June 2013.
4. The IMO's proposal is available on the Authority's [website](#).
5. On 14 August 2013 the Authority published a notice inviting submissions on the proposed GSI Allowable Revenue and Forecast Capital Expenditure and an Issues Paper to assist interested parties in understanding and making submissions on the IMO's proposal. No public submissions were received in response to the Issues Paper.
6. In making its determination the Authority has taken into account the requirements set out in clause 109 of the GSI Rules.
7. The Authority has determined that the IMO's GSI Allowable Revenue and Forecast Capital Expenditure for the initial Review Period should be the amounts proposed by the IMO, which are shown in Table 1 below.

**Table 1** IMO's GSI Allowable Revenue and Forecast Capital Expenditure for the Initial Review Period 1 July 2013 to 30 June 2016 (nominal \$'000).

Item	2013/14	2014/15	2015/16	Total
<b>IMO Proposal</b>				
Allowable Revenue	2,250	2,360	2,309	6,919
Forecast Capital Expenditure	88	157	216	461
<b>Authority's Determination</b>				
Allowable Revenue	2,250	2,360	2,309	6,919
Forecast Capital Expenditure	88	157	216	461

8. The reasons for this determination are set out below.

## Reasons for the Determination

### Legislative Requirements

9. The IMO was established under regulation 4(1) of the *Electricity Industry (Independent Market Operator) Regulations 2004*.
10. The IMO has functions conferred on it by the *Electricity Industry (Independent Market Operator) Regulations 2004*, the *Electricity Industry (Wholesale Electricity Market) Regulations 2004*, and the WEM Market Rules.
11. Additionally, the IMO now also has functions conferred on it under regulation 4 of the *Gas Services Information Regulations 2012* and the GSI Rules.
12. Clause 107 of the GSI Rules outlines the GSI Services required of the IMO, which are:
  - to establish, operate and maintain the GBB;
  - to register or deregister Registered Participants and Registered Facilities and to grant Exemptions;
  - to prepare and publish the GSOO;
  - to make Amending Rules and Procedures, including the initial Rules made by the Minister under regulation 6 of the GSI Regulations;
  - to facilitate the processes of the Gas Advisory Board;
  - to monitor compliance and investigate breaches or possible breaches of the Rules or the Procedures;
  - to take enforcement action under the GSI Regulations;
  - to manage information gathering and disclosure functions under the GSI Regulations and the Rules; and
  - services deriving from the exercise of any other functions conferred on the IMO under the GSI Act, the GSI Regulations or the Rules.
13. Under clause 14(1) of schedule 3 of the GSI Rules, the IMO is required to submit its initial Allowable Revenue and Forecast Capital Expenditure proposal to the Authority by 30 April 2013 or the first Business Day following the day that the GSI Rules commence, whichever is later. The IMO submitted this proposal to the Authority on 1 July 2013, following the commencement of the GSI Rules on 29 June 2013.
14. In determining the Allowable Revenue and Forecast Capital Expenditure for the IMO, under clause 108(3) of the GSI Rules, the Authority is required to undertake a public consultation process, which includes publishing an Issues Paper and issuing an invitation for public submissions.
15. The matters for consideration by the Authority in determining the GSI Allowable Revenue and Forecast Capital Expenditure are set out in clause 109 of the GSI Rules:

- The Allowable Revenue must be sufficient to cover the forward looking costs of providing the GSI Services in accordance with the following principles:
    - a. recurring expenditure requirements and payments are recovered in the year of the expenditure;
    - b. capital expenditures are to be recovered through the depreciation and amortisation of the assets acquired by the capital expenditures in a manner that is consistent with generally accepted accounting principles; and
    - c. despite sub rules (a) and (b), expenditure incurred, and depreciation and amortisation charged, in relation to any GSI Project are to be recovered over the period determined for that GSI Project.
  - The Allowable Revenue and Forecast Capital Expenditure must include only costs which would be incurred by a prudent provider of the GSI Services, acting efficiently, seeking to achieve the lowest practicably sustainable cost of delivering those services in accordance with the Rules, while effectively promoting the GSI Objectives.
  - Where possible, the ERA should benchmark the Allowable Revenue and Forecast Capital Expenditure against the costs of providing similar services in other jurisdictions.
16. Under clause 14(2) of schedule 3 of the GSI Rules, the Authority must determine the Allowable Revenue and Forecast Capital Expenditure for the initial Review Period within four calendar months of receipt of the IMO's proposal, i.e. by 1 November 2013.
17. Pursuant to clauses 15(2) and 15(3) of schedule 3 of the GSI Rules, the IMO must submit an initial GSI Budget Proposal to the Minister for Energy for approval for the 2013/14 financial year at the same time as its submission to the Authority. The GSI Budget Proposal must be consistent with the proposed Allowable Revenue and Forecast Capital Expenditure. The budget approved by the Minister (**Approved Annual Revenue**), will be used to calculate the GSI Fees for the 2013/14 financial year.
18. Under clause 16 of schedule 3, in the event that there is any difference between the Approved Annual Revenue for 2013/14 and the Allowable Revenue and Forecast Capital Expenditure approved by the ERA in this decision, the IMO must make any necessary adjustments to address the difference in the GSI Budget Proposal for the 2014/15 financial year.

## Proposed Allowable Revenue and Forecast Capital Expenditure

19. With the appointment of the IMO to provide the GBB and GSOO, the IMO now has two key functions:
- the IMO's existing electricity functions set out in the WEM Rules; and
  - the IMO's new GSI services function set out in the GSI Rules.

20. The IMO has integrated its functions under the GSI Rules into its existing operations. The IMO's resources (including staff, administrative support, office accommodation, and other corporate and management support) are shared across both functions.
21. Accordingly, the IMO, in conjunction with consultants Ernst & Young, has developed a Gas Overhead Allocation Methodology to allocate these shared (indirect) costs across its electricity and gas market functions. The IMO's proposed Allowable Revenue and Forecast Capital Expenditure for its WEM activities, for the third Review Period (2013/14 to 2015/16), adopted this cost allocation methodology.<sup>1</sup>
22. In its submission to the Authority, the IMO presented its proposed GSI Allowable Revenue and Forecast Capital Expenditure as a sum of cost line items, as set out in Tables 2 and 3, below (respectively).

**Table 2 IMO's Proposed GSI Allowable Revenue for the Initial Review Period 1 July 2013 to 30 June 2016 (nominal \$'000).**

Item	2013/14	2014/15	2015/16	Total
Employee Benefits Expense	798	761	793	2,352
Accommodation	103	99	103	304
Supplies and Services	629	727	628	1,985
<b>Total before borrowing and depreciation</b>	<b>1,530</b>	<b>1,587</b>	<b>1,524</b>	<b>4,641</b>
Borrowing Costs	150	127	103	379
Depreciation	571	646	683	1,899
<b>Total Expenditure</b>	<b>2,250</b>	<b>2,360</b>	<b>2,309</b>	<b>6,919</b>
<b>Allowable Revenue</b>	<b>2,250</b>	<b>2,360</b>	<b>2,309</b>	<b>6,919</b>

**Table 3 IMO's Proposed Forecast Capital Expenditure for the Initial Review Period 1 July 2013 to 30 June 2016 (nominal \$'000).**

Item	2013/14	2014/15	2015/16	Total
Extensions	-	70	71	141
Development of Rule Changes	69	70	71	210
IT Hardware/Software Replacement (3 yr cycle)	-	-	50	50
Corporate Support - Gas	19	17	23	59
<b>Forecast Capital Expenditure</b>	<b>88</b>	<b>157</b>	<b>216</b>	<b>461</b>

<sup>1</sup> This determination is available on the Authority's website:

<http://www.erawa.com.au/markets/electricity-markets/determination-of-the-imo-and-system-management-allowable-revenue/>

## Approach to Assessment

23. The Authority's determination must ensure that the proposed GSI Allowable Revenue and Forecast Capital Expenditure includes only those costs that would be incurred by a prudent provider of the GSI Services, acting efficiently, seeking to achieve the lowest practicably sustainable cost of delivering those services in accordance with the Rules, while effectively promoting the GSI Objectives.
24. The time period for the GSI Allowable Revenue coincides with the third Allowable Revenue period for the IMO's WEM functions which was approved by the Authority in March 2013. As part of its review of the WEM Allowable Revenue proposal, the Authority engaged Geoff Brown and Associates (GBA) to provide technical advice and assistance to the Authority in its assessment.<sup>2</sup> As the GSI forecasts were prepared at the same time and in conjunction with the forecasts for the WEM Allowable Revenue using the same processes, the Authority has taken account of the findings of the GBA review in relation to the IMO's governance and budgeting processes in its assessment of the GSI Allowable Revenue proposal.
25. In its determination of GSI Allowable Revenue for the IMO, the Authority has ensured that the shared costs included in the current proposal are consistent with those incorporated in the IMO's proposal for Allowable Revenue and Forecast Capital Expenditure for its WEM functions, approved by the Authority in March 2013.
26. In relation to direct expenditure on gas activities, the Authority assessed the proposed costs against the costs incurred by the IMO for performing similar functions in the Electricity Market. Consideration was also given to the items of capital expenditure that underlie amounts of depreciation and amortisation in Allowable Revenue.
27. In approving the Forecast Capital Expenditure for the IMO, the Authority ensured there was sufficient evidence to demonstrate that the expenditure was consistent with costs that would be incurred by a prudent provider of services, acting efficiently and seeking to achieve the lowest practicably sustainable cost of delivering these services.

## Benchmarking of GSI Services

28. Clause 109 of the GSI Rules requires, among other things, that where possible, the ERA should benchmark the Allowable Revenue and Forecast Capital Expenditure against the costs of providing similar services in other jurisdictions.
29. Though the gas market on the east coast of Australia currently supports a greater demand, it is, in a number of respects, comparable to that of the west coast. For example, both markets are zoned, with the east coast market based on 16 National Electricity Market (NEM) modelling zones, and the west coast comprising ten zones. Both markets also comprise a similar number of participants and share many of the same participants.

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<sup>2</sup> Geoff Brown and Associates Ltd, Technical Review of Allowable Revenue for Independent Market Operator for 1 July 2013 to 30 June 2016, 26 March 2013. This review is available on the Authority's website:

<http://www.erawa.com.au/markets/electricity-markets/determination-of-the-imo-and-system-management-allowable-revenue/>

30. At a national level, the Australian Energy Market Operator (AEMO) provides a broadly similar service to the IMO. However, the AEMO is not directly comparable to the IMO, as it does not perform all of the same functions. For example, AEMO does not have rule making or rule enforcement functions. A comparison of the functions of the IMO and AEMO is set out in Appendix 1, which also notes that AEMO's operational and administrative costs are funded separately from the national GBB and GSOO i.e., they are covered by revenue obtained from fees charged to participants in each of the state markets.
31. In contrast to the national GBB, the GBB on the west coast provides extra information, representing supply as well as demand.
32. In addition, the gas services provided by the IMO have just commenced, so the Allowable Revenue proposal includes recovery of set up costs. The AEMO established the national GBB in 2008, funded by the Commonwealth, and published the first national GSOO in 2009, with set up costs having already been fully recovered.
33. The Authority recognises these factors need to be taken into account when comparing costs between the IMO and AEMO.
34. The 'AEMO Final Budget and Fees 2013-14' report indicates that the GSOO expenditure in 2013-14 is \$1.5 million. The AEMO 'Gas Bulletin Board Final Budget 2013-14' report indicates a total expenditure of \$239,000 in 2013-14.
35. Thus, the total expenditure for AEMO's GBB and GSOO in 2013-14 is \$1.74 million, which is approximately \$500,000 less than the IMO's budget for 2013-14 for the new GSI Services. The Authority notes that the IMO's forecast expenditure includes approximately \$500,000 per annum in relation to depreciation of the initial development costs for the gas information services. If this is excluded, the IMO's annual costs are similar to those incurred by the AEMO.
36. Taking account of the similarities between jurisdictions, the added tasks that the IMO is required to undertake that are not covered by AEMO, and the set up costs, the Authority considers that the similarity between IMO's costs and those incurred by AEMO is not unreasonable.
37. The Authority recognises that the market needs to be established first to allow for proper benchmarking and a more robust comparison. This will be considered further in the next review.

## Public Submissions

38. In accordance with clause 108(3) of the GSI Rules, on 14 August 2013 the Authority undertook a public consultation process, which included publishing an Issues Paper and issuing an invitation for public submissions. Public submissions were due on 11 September 2013.
39. No public submissions were received in response to the Issues Paper.

## Costs for the Review Period

### Governance

40. When approving the allowable revenue for electricity services the Authority commissioned GBA to undertake a review of the IMO's governance framework.
41. In its review of the IMO's governance framework, GBA reviewed the policies that the IMO uses to:
  - set expenditure budgets and develop annual operating plans;
  - formulate new projects and programs and approve them for implementation;
  - control the actual cost of approved projects and programs; and
  - forecast its capital and operating expenditure requirements for the third Allowable Revenue and Forecast Capital Expenditure Review Period.
42. Additionally, GBA examined key projects and programs, which had been implemented and those proposed for implementation to evaluate how well governance principles had been applied in practice. In particular GBA considered:
  - the alignment of the policies, procedures and processes for the management of expenditure with the IMO's overall business objectives;
  - the extent to which the IMO's policies and procedures are consistent with good practice; and
  - the extent to which the IMO's policies and procedures are implemented in practice.
43. The review by GBA also took account of the requirements set out in the Market Rules, and Regulations in relation to expenditure approvals, budget processes and reporting requirements. GBA reviewed the following internal documents:
  - Internal procedure: Determination of IMO Budget (August 2007);
  - Board Manual;
  - Internal Procedure on Fees (March 2012); and
  - Accounting Policies and Procedures Manual.
44. GBA noted that the IMO's annual financial statements are required to be audited by the State Auditor General. They must also be submitted to the Minister who tables the reports in the State Parliament. In addition, the IMO is subject to market audits that cover compliance by the IMO with the Market Rules. The IMO is also required to attend budget estimate hearings arranged by the State Parliament that scrutinise prior year financial performance and proposed budgets for the coming years.

45. Based on its review of processes and procedures, and sample reports provided by the IMO, GBA concluded that the IMO Regulations, the Market Rules and the IMO's internal procedures combine to provide a strong governance framework in respect of the IMO's budgetary formulation and that it has sound procedures, processes and practices in place to manage its budget expenditure.

#### IT Roadmap

46. The IT Roadmap covering the period 2013-16 was submitted by the IMO as part of its proposal and summarises the capital expenditure, depreciation and written down value of the Gas Information Services Project assets.
47. GBA reviewed the IMO's IT Roadmap, and noted that it is the IMO's primary strategic planning tool used to ensure that the planning, delivery, management and use of the IT systems optimally support the IMO's business. GBA found that the IT Roadmap is well formulated and that the approaches and capital expenditure items incorporated within it were reasonable from both a strategic and tactical perspective.
48. The document was submitted to the Minister for Energy for endorsement in October 2012, for consideration as part of the State Capital Budget for 2013/14 onwards.

#### Recurrent Costs

49. As noted above, the IMO has integrated its functions under the GSI Rules into its existing operations. The IMO's resources (including staff, administrative support, office accommodation, and other corporate and management support) are shared across both functions.
50. Accordingly, the IMO, in conjunction with consultants Ernst & Young, has developed a Gas Overhead Allocation Methodology to allocate these shared (indirect) costs across its electricity and gas market functions. The IMO's proposed Allowable Revenue and Forecast Capital Expenditure for its WEM activities, for the third Review Period (2013/14 to 2015/16), adopted this cost allocation methodology.<sup>3</sup>
51. For comparison purposes, the annual costs proposed by the IMO for its WEM and Gas Market functions for the period 1 July 2013 to 30 June 2016 are set out in Table 4 below.

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<sup>3</sup> This determination is available on the Authority's website:

<http://www.erawa.com.au/markets/electricity-markets/determination-of-the-imo-and-system-management-allowable-revenue/>

**Table 4 IMO's Proposed WEM Allowable Revenue for the third Review Period and GSI Allowable Revenue for the Initial Review Period i.e., 1 July 2013 to 30 June 2016 (nominal \$'000).**

Item	WEM Allowable Revenue for the third Review Period			GSI Allowable Revenue for the Initial Review Period		
	2013/14	2014/15	2015/16	2013/14	2014/15	2015/16
Employee Benefits Expense % of WEM cost	5,568	5,851	6,102	798 14.3%	761 13.0%	793 13.0%
Accommodation % of WEM cost	715	753	784	103 14.4%	99 13.1%	103 13.1%
Supplies and Services % of WEM cost	5,065	4,952	4,984	629 12.4%	727 14.6%	628 12.6%
<b>Total costs % of WEM cost</b>	<b>11,348</b>	<b>11,556</b>	<b>11,170</b>	<b>1,530 13.5%</b>	<b>1,587 13.7%</b>	<b>1,524 13.6%</b>

52. The Authority notes that the forecast expenditure of the IMO for the GSI Services is equivalent to less than 15 per cent of the expenditure of the IMO for its WEM functions in every year of the current Review Period.
53. In its proposal, the IMO notes that the submission is made on the basis that it covers the first three years of "business as usual" operation and that the IMO has had to estimate the resources required in delivering them. The IMO has informed the Authority, that it has considered line items on their own merit and drawn from the IMO's experience and technical expertise to determine a best estimate of the appropriate costs. The following points in relation to the GSI Allowable Revenue are also noted:
- There is a reduction in Employee Benefits Expense in 2014/15, which reflects a higher allocation for Corporate Legal expenses in the year of services commencement (i.e., 2013/14) than in subsequent years.
  - Accommodation costs are broadly steady over the Review Period.
  - Supplies and Services costs increase in 2014/15 as Market Administration costs include the cost of undertaking a post implementation review of the costs and benefits of the GSI Services in that year.
54. GBA gave consideration to the Gas Overhead Allocation Methodology, a summary of which was submitted as part of the working papers forming the IMO proposal. In relation to this GBA noted that it believed that the allocation methodology was soundly based and that the allocation amounts included in the allowable revenue proposal were consistent with the methodology.
55. Each of the specific expenditure lines is considered in more detail below.

**Employee Benefit Costs**

56. The Employee Benefits cost category includes salaries, superannuation, payroll tax, fringe benefits tax and other staffing costs.
57. The IMO's Proposed Employee Benefits costs for the Initial Review Period are set out in Table 5 below.

**Table 5 IMO's Proposed Employee Benefits Expenditure for the Initial Review Period 1 July 2013 to 30 June 2016 (nominal \$'000).**

Item	2013/14	2014/15	2015/16
Employee Benefits Expense	798	761	793
<i>% change</i>		(4.64)	4.20

58. The IMO's proposal does not include an allowance for any dedicated gas positions, as its functions under the GSI Regulations and Rules will be integrated into the IMO's existing operations and delivered by staff that have both electricity and gas responsibilities.
59. The IMO's proposal allows for three of five temporary positions (corresponding to 4.5 FTE) that were originally approved for 2012/13 for the GISP implementation, to transition into permanent positions from 2013/14.
60. In determining the appropriate salary levels for IMO staff for its Gas Market functions, the IMO has applied annual salary increases based on:
- escalation rates developed as a result of a specialist remuneration consultant report commissioned by the Board and provided as part of the IMO's submission; and
  - the history of recent salary increases.
61. In its report, GBA noted that the key economic forecasts included in the Western Australian State Budget 2012-13 Overview Paper incorporate Wage Price Index (WPI) increases of 4.5 per cent over each year of the Third Review Period. This was slightly lower than the weighted average salary increase proposed by the IMO, which was approximately 4.7 per cent. GBA noted that the IMO Board approved the forecast salary increases on the basis that the skill level of the IMO was likely to be on the higher end of the labour cost spectrum within an area where there are competing demands and that the turnover of staff in key positions is reflective of this.
62. In allocating indirect costs, the IMO proposed that 17 per cent of the costs for the Junior Lawyer and the Manager of Legal and Compliance be allocated to the GSI Budget in the first year, followed by a reduced allocation in the ensuing two years. As explained by the IMO, this is consistent with the potential need for a greater focus on legal compliance in the first year of operation of the GSI services.
63. The Authority notes that the gas allocation proportions included in the allowable revenue proposal for IT Employee Benefit Costs are not consistent with those

provided in the Gas Overhead Allocation Methodology (i.e., they are greater in the first year and reduced by around half thereafter).

64. However, the Authority considers that this re-allocation is reasonable given the requirement to provide more IT related services at the commencement of the GSI Services, and notes that the allocation for the WEM's IT Employee Benefit Costs (previously approved by the Authority) have been adjusted accordingly.
65. The Authority notes that all other Employee Benefit costs are consistent with the Gas Overhead Allocation Methodology for allocating indirect costs between Electricity and Gas operations.
66. As noted earlier, in its report to the Authority, GBA considered that the Gas Overhead Allocation Methodology was soundly based and that the allocation amounts included in the WEM Allowable Revenue proposal were consistent with the methodology.
67. GBA also noted that the expansion of IMO activities into gas has allowed staff efficiencies to be achieved across both markets.
68. The Authority notes that the IMO's proposal for the Employee Benefits Expenditure for its Gas Market functions includes, and is consistent with, the Employee Benefits expenditure approved by the Authority in the IMO's proposal for Employee Benefits expenditure for its WEM functions.
69. The Authority has considered the information provided by the IMO and the advice provided by GBA and determined that the proposed Employee Benefits costs are reasonable.

#### Accommodation Costs

70. Accommodation costs incorporate a portion of office rental, cleaning, electricity, maintenance and car parking.
71. The IMO's Proposed Accommodation Expenditure for the Initial Review Period is set out in Table 6 below.

**Table 6** IMO's Proposed Accommodation Expenditure for the Initial Review Period 1 July 2013 to 30 June 2016 (nominal \$'000).

Item	2013/14	2014/15	2015/16
Accommodation costs	103	99	103
% change		(3.88)	4.04

72. The largest component of the Accommodation costs relate to office rental (around \$90,000 per annum).
73. The Authority notes that the allocated proportions employed in calculating the Accommodation costs for the IMO's Gas Market functions (including office rental) across the Initial Review Period are consistent with those provided in the Gas Overhead Allocation Methodology.

74. The Accommodation costs are also consistent with the values provided in the earlier proposal approved by the Authority in March 2013 for the IMO's Allowable Revenue for its WEM functions.

### Supplies and Services

75. Supplies and Services costs include IT expenditure, accounting, auditing, human resources, administrative costs, insurance, travel and training, and consultant expenditure in support of service delivery.
76. The IMO's Proposed Supplies and Services expenditure for the Initial Review Period is set out in Table 7 below.

**Table 7 IMO's Proposed Supplies and Services Expenditure for the Initial Review Period 1 July 2013 to 30 June 2016 (nominal \$'000).**

Item	2013/14	2014/15	2015/16
IT Support	210	213	222
<i>% change</i>		1.43	4.23
Corporate Support	159	148	155
<i>% change</i>		(6.92)	4.73
Legal and Compliance	90	116	97
<i>% change</i>		28.89	(16.38)
Market Administration	50	151	52
<i>% change</i>		202.00	(65.56)
System Planning	120	100	102
<i>% change</i>		(16.67)	2.00
<b>Supplies and Services Total</b>	<b>629</b>	<b>727</b>	<b>628</b>

77. IT Support includes:
- GBB system maintenance and support;
  - Data centre hosting by specialist services providers;
  - High speed fibre links between head office, production and backup data centres;
  - Specialist database support;
  - IT desktop and infrastructure support; and
  - Telecommunications and internet access costs.
78. The Authority notes that the percentage allocations employed for the IT Support Services that are shared between the Electricity and Gas Market functions are consistent with those provided in the Gas Overhead Allocation Methodology for allocating indirect costs between the two.
79. The Authority notes that the IT Support Services costs are also consistent with the values provided in the earlier proposal approved by the Authority in March 2013 for the IMO's Allowable Revenue for its WEM functions.
80. As noted in the IMO's proposal, the largest component of IT Support is GBB Maintenance and Development Support, at around \$95,000 per annum. The

Authority considers that, like the majority of the IT gas only costs, this allowance is reasonable in comparison to the allowance approved for the performance of similar IT Support functions in the WEM.

81. The Authority notes that the IMO has escalated gas only IT Support forecast costs in accordance with the indexation factor provided by State Treasury for non-salary costs i.e., at 1.75 per cent per annum, except in one instance in which a contract specific escalation was employed. In this particular case, a very small budget of less than two per cent of the budget provided for the same service in the WEM was provided.
82. The Authority notes that the Corporate Support costs are consistent with the Gas Overhead Allocation Methodology and that the values provided correspond to the values provided in the earlier proposal approved by the Authority for the IMO's Allowable Revenue for its WEM functions.
83. Legal and Compliance costs include the costs associated with the Annual Compliance Audit that is required by the GSI Rules, compliance investigations and dispute resolution.
84. The Authority notes that in 2014/15, the IMO have allowed for an initial full audit of the IMO's compliance with the GSI Rules and associated market procedures, followed by an incremental audit in 2015/16 in its Legal and Compliance costs.
85. The Authority considers that the budget allowed for this audit is reasonable in comparison to the budget approved by the Authority for a similar audit of both the IMO and System Management for the IMO's WEM's Allowable Revenue and Forecast Capital Expenditure, as it is less than ten per cent of the cost.
86. The Authority notes that for all other Legal and Compliance costs, the IMO has escalated the forecast costs at 1.75 per cent per annum, in accordance with the indexation factor provided by State Treasury for non-salary costs.
87. Market Administration costs include the external costs of supporting Rule Changes determined by the Gas Advisory Board. The Authority notes that the budget of \$50,000 in 2013/14 is based on the IMO's experience of progressing changes to the IMO's WEM Rules. The Authority considers that the budget is reasonable in comparison to the budget approved for the same function performed by the IMO in the WEM.
88. The Authority notes that in the remaining two years, the Market Administration costs for Rule Changes are escalated in accordance with the indexation factor provided by State Treasury for non-salary costs i.e., at 1.75 per cent per annum.
89. Market Administration costs also include the cost of undertaking a post-implementation review of the costs and benefits of the GBB and the GSOO (\$100,000) in 2014/15 that the IMO noted was requested by Gas Market Participants.
90. The Authority notes that the Supplies and Services Total cost is greatest in 2014/15 and that this is largely attributable to the cost of undertaking this post implementation review.
91. However, the Authority considers that a post implementation review of costs and benefits is in keeping with the Authority's March 2013 Determination of the IMO's

Allowable Revenue and Forecast Capital Expenditure for the IMO's WEM functions. In this Determination, the Authority considered that a full, post implementation, project review of the MEP should be carried out together with a cost benefit analysis in order to give Market Participants confidence that the expected benefits were realised in developments to date. Additionally, the Authority considered that post implementation reviews should be incorporated as part the standard IT project implementation process. The Authority takes a similar view in the context of the GISP.

92. At the request of the Authority, the IMO also provided further documentation to support the cost of the post implementation review for the GSI Services. This included a quote for the original cost benefit analysis undertaken by the IMO during the development of the GBB and GSOO,<sup>4</sup> which ascertained benefits in a theoretical way. The costs of the post implementation review reflected the costs for the original analysis, whilst also allowing for costs to provide for a more detailed, quantitative analysis.
93. System Planning costs relate to specialist forecasting services for the annual GSOO. It is expected that these costs will be highest in 2013/14 (\$120,000), and reduce in the following two years.
94. The Authority notes that the 2013/14 System Planning cost was based on the IMO's experience in developing the WEM Statement of Opportunities, as well as the cost of having a portion of the forecasts undertaken for the initial GSOO.
95. The Authority has reviewed the detailed information provided by the IMO and considers that the proposed Supplies and Services costs are reasonable.

#### Depreciation Allowances

96. A key component of the IMO's proposal was the recovery of the costs of the implementation of the GSI Services. A budget estimate of \$2.965 million was developed in early 2012 and was initially funded by borrowings from the Western Australian Treasury Corporation (**WATC**) in July 2013. The Allowable Revenue proposal is based on this expenditure being capitalised on 31 July 2013 (i.e. when the IT systems were completed) and depreciating the expenditure over the first five years of operation of the GSI Services.
97. Depreciation costs over the Review Period are presented in Table 8 below.

**Table 8** IMO's Proposed Depreciation for the Initial Review Period 1 July 2013 to 30 June 2016 (nominal \$'000).

Item	2013/14	2014/15	2015/16
Computer Software	554	630	668
Furniture and Fittings	1	1	1
Office Fit-out	15	14	14
<b>Total Depreciation</b>	<b>571</b>	<b>646</b>	<b>683</b>

<sup>4</sup>The quote is commercial in confidence but the scope of work for the original analysis is available on the IMO's website <http://www.imowa.com.au/n6072.html>

98. As noted in the Determination of Allowable Revenue and Forecast Capital Expenditure for the IMO's electricity market functions, the IMO has adopted an asset life of five years in relation to IT, resulting in lower annual depreciation costs than would occur over the previously employed three-year asset life.
99. In relation to this, in its report, GBA considered that the proposed extension of the IT asset lives to five years is sound and aligned with the strategic objectives set out in the IT roadmap for the core market systems IT assets.
100. The Authority has reviewed the IMO's proposed depreciation costs and ensured that the asset lives are consistent with those approved for the WEM assets.
101. Taking account of the actual expenditure incurred and the depreciation rates that were employed, the Authority is satisfied that the proposed depreciation forecasts are reasonable.

### Borrowing Costs

102. All capital requirements over the Review Period are funded by way of loan funding provided by the WATC.
103. Projected borrowing costs across the Initial Review Period were calculated based on existing funding facilities and projected capital expenditure, based on funding rates provided by the WATC.
104. Projected Borrowing costs for the Initial Review Period are set out in Table 9 below.

**Table 9** IMO's Proposed Borrowing Costs for the Initial Review Period 1 July 2013 to 30 June 2016 (nominal \$'000).

Item	2013/14	2014/15	2015/16
Borrowing Costs	150	127	103

105. An interest rate of 5.25 per cent (which includes a Government Guarantee Fee of 0.75 per cent) and a loan life of 60 months are employed for new loans over the Initial Review Period. Interest rates on existing loans vary between 3.45 per cent and 5.05 per cent.
106. The Authority notes the GSI rules require that, for the purposes of determining allowable revenue, recurring expenditure requirements and payments are recovered in the year of expenditure and capital expenditures are to be recovered through the depreciation and amortisation of the assets acquired in a manner that is consistent with good accounting principles.
107. Consequently, the only forecast expenditure that is not funded when incurred relates to any undepreciated amounts of capital expenditure. As described above, the borrowing costs proposed by the IMO assume 100 per cent of capital expenditure is financed by borrowing and that the loans are repaid over five years. This is not precisely the same as calculating borrowing costs in relation to undepreciated capital expenditure. However, given that the loan repayment period of 5 years, is similar to the average rate of depreciation, it is likely to produce a similar answer.

108. To test the reasonableness of the IMO's forecast borrowing costs, the Authority has calculated the implied interest rate based on the undepreciated value of capital expenditure at the beginning of each year. The results are set out in Table 10 below.

**Table 10 IMO's Proposed Borrowing Costs for the Initial Review Period 1 July 2013 to 30 June 2016 (nominal \$'000).**

Item	2013/14	2014/15	2015/16
Borrowing Costs	150	127	103
Undepreciated Capital Expenditure at Beginning of Year	2,965	2,463	1,957
Implied Interest Rate (%)	<b>5.04</b>	<b>5.16</b>	<b>5.26</b>

109. Taking account of the implied interest rate values and their comparability to the rates advised by WATC, the Authority considers that the IMO's proposed borrowing costs and interest income are reasonable.

### *Forecast Capital Expenditure*

110. The Forecast Capital Expenditure for the Initial Review Period is set out in Table 11 below.

**Table 11 IMO's Proposed Forecast Capital Expenditure for the Initial Review Period 1 July 2013 to 30 June 2016 (nominal \$'000).**

Item	2013/14 \$'000	2014/15 \$'000	2015/16 \$'000	Total \$'000
Extensions	-	70	71	141
Development of Rule Changes	69	70	71	210
IT Hardware/Software Replacement (3 yr cycle)	-	-	50	50
Corporate Support - Gas	19	17	23	59
<b>Forecast Capital Expenditure</b>	<b>88</b>	<b>157</b>	<b>216</b>	<b>461</b>

111. Extensions expenditure allows for enhancements post GISP, which may include further integration with more established parts of the IMO's IT systems or implementation of appropriate market suggested enhancements that fall outside a Rule Change process.

112. Forecast expenditure has been included to allow for the technical implementation of Rule Changes, as required. This allowance is consistent across each year of the Review Period. The Authority notes this expenditure is not based on known rule change proposals but considers the amount estimated to be reasonable on the basis that the GIS has only just commenced and it is likely required modifications will be identified as the GIS becomes established.

113. The IT Hardware/Software Replacement expenditure allows for the fact that IT Technology changes at a rapid pace and that by the end of the IT roadmap, in 2015/16, a number of components of the GBB may need to be upgraded or replaced to ensure they stay within support windows from vendors. The Authority notes the amount forecast of \$50,000 is approximately 11 per cent of the total expenditure on the GIS IT systems.
114. Corporate Support includes the direct support of administration activities, such as maintaining phones, Microsoft Office, and accounting systems. Capital expenditure on Corporate Support items is consistent across each year of the Review Period. The Authority notes this is around one third of the level of expenditure allowed for in relation to corporate support for the IMO's electricity market functions.
115. The Authority considers that, in line with its recommendations for the IMO in its March 2013 Determination of Allowable Revenue and Forecast Capital Expenditure for its WEM Functions, improvements in this process could be made by documenting overarching IT project governance guidelines and incorporating post implementation reviews as part of the standard implementation process.
116. The Authority notes that the IMO has not incorporated any major capital expenditure items in its proposal, with all amounts being less than \$80,000.
117. Taking account of this and the advice from GBA in relation to the IMO's governance and budgeting procedures, the Authority considers that the costs appear reasonable and consistent with the implementation and commencement of the new GSI Services.

## Appendix 1: IMO & AEMO Gas Function Comparison

### **IMO Functions outlined in Gas Services Information Rules 2012:**

(Part 1, Division 4, Rule 8)

FUNCTION	IMO	AEMO
(a) to establish, operate and maintain the GBB	YES	YES <sup>1</sup>
(b) to register certain Gas Market Participants as Registered Participants	YES	YES
(c) to register certain Facilities as Registered Facilities, and to exempt certain facilities from the requirement to be registered	YES	YES
(d) to prepare and publish the GSOO	YES	YES
(e) Rule making functions	YES	NO <sup>2</sup>
(f) Procedure making functions	YES	YES
(g) to monitor compliance by persons with the Rules or Procedures	YES	NO <sup>3</sup>
(h) to investigate breaches or possible breaches of the Rules or the Procedures	YES	YES <sup>4</sup>
(i) to take enforcement action under the GSI Regulations	YES	NO <sup>3</sup>
(j) information gathering and disclosure functions <sup>5</sup>	YES	YES
(k) any other functions conferred on the IMO under the GSI Act, GSI Regulations and the Rules	YES	YES <sup>6</sup>

Notes:

<sup>1</sup> – AEMO operates and maintains the GBB

<sup>2</sup> – Rule making function performed by AEMC

<sup>3</sup> – AEMO monitors compliance on behalf of and for the AER (as a service) but enforcement is performed by AER

<sup>4</sup> – Investigations undertaken in conjunction with AER

<sup>5</sup> – This includes information collected for and published via the GBB and GSOO

<sup>6</sup> – Under relevant legislation

AEMO Functions outlined in the National Gas (South Australia) (National Gas Law – Australian Energy Market Operator) Amendment Act 2009:

(Under the National Gas Law in Part 6 Division 1 section 91A)

(1) AEMO has the following functions:

- (a) to operate and administer markets for natural gas in accordance with this Law, the rules and the Procedures;
- (b) to promote the development, and improve the effectiveness of the operation and administration of, gas markets;
- (c) to register persons as Registered participants;
- (d) to exempt certain persons from being registered as Registered participants;
- (e) to facilitate retail customer transfer, metering and retail competition (including balancing, allocation and reconciliation of gas deliveries and withdrawals to and from sub-networks);
- (f) for an adoptive jurisdiction – the declared system functions;
- (g) to make, amend or revoke Procedures;
- (h) to operate and maintain the Natural Gas Services Bulletin Board;
- (i) to prepare, periodically review, revise and publish the gas statement of opportunities;

- (j) to investigate breaches or possible breaches of the Procedures;
- (k) any functions conferred by jurisdictional gas legislation or an application Act;
- (l) any other functions conferred under this Law, the Rules or the Procedures.

AEMO functions (a), (e) & (f) are separately funded based on the following additional services provided to participants in the identified jurisdictions:

- i. Full Retail Contestability (VIC, QLD, NSW & SA) - operational and administrative roles (viz. facilitate retail customer transfer, metering and retail competition - including balancing, allocation and reconciliation of gas deliveries and withdrawals to and from sub-networks;
- ii. Short Term Trading Markets (STTM) – market operation/administration roles and a role in contingency gas; and
- iii. Declared Wholesale Gas Market (VIC) – security and emergency powers, and market operation/administration, gas quality, and pipeline operational roles.

These functions do not currently exist under GSI.