

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
Supplies and Services Total	629	727	628

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,⁴ 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
Total Depreciation	571	646	683

⁴The 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 (%)	5.04	5.16	5.26

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
Forecast Capital Expenditure	88	157	216	461

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 ¹
(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 ²
(f) Procedure making functions	YES	YES
(g) to monitor compliance by persons with the Rules or Procedures	YES	NO ³
(h) to investigate breaches or possible breaches of the Rules or the Procedures	YES	YES ⁴
(i) to take enforcement action under the GSI Regulations	YES	NO ³
(j) information gathering and disclosure functions ⁵	YES	YES
(k) any other functions conferred on the IMO under the GSI Act, GSI Regulations and the Rules	YES	YES ⁶

Notes:

¹ – AEMO operates and maintains the GBB

² – Rule making function performed by AEMC

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

⁴ – Investigations undertaken in conjunction with AER

⁵ – This includes information collected for and published via the GBB and GSOO

⁶ – 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.

Embargoed