ACCOUNTING AND COST ALLOCATION PROCEDURES

REQUIRED BY THE NORTHERN TERRITORY RING FENCING CODE

Version 1

9 November 2001

This report contains 34 pages

Contents

1 Introduction

1.1 Purpose

This document contains the Accounting Procedures and Cost Allocation Procedures (‘the Procedures”) required by Clause 4 of the Northern Territory Electricity Ring-Fencing Code (“the Code”).

The purpose of the Accounting Procedures is to set out how Power and Water Authority (“PAWA”) will establish and maintain a separate set of financial accounts and reports for each Prescribed Business and for its Electricity Business as a whole.

The Cost Allocation Procedures are set out at Appendix 2. They are a subset of the Accounting Procedures. Their purpose is to provide more specific guidance to PAWA’s personnel on how to allocate any costs that are shared between a Prescribed Business and a Related Business.

The accounting policies and procedures set out in these Procedures are drafted with the intent of setting out how PAWA will meet its obligations to provide the Utilities Commission (“the Commission”) with Regulatory Financial Statements under the Code. Neither these Procedures nor the Regulatory Financial Statements should be interpreted as representing any views that PAWA may hold on regulated revenue or price setting principles.

The information contained in these procedures (including the regulatory accounting pro formas and cost (and revenue) allocation procedures) is provided to meet the requirements of clause 5 of the Code. PAWA acknowledges that the financial information specified in these procedures does not represent all the information that the Commission will require of PAWA for purposes other than for meeting the requirements of clause 5 of the Code. Information required for other purposes will be subject to separate and specific requests.

1.2 Definitions

Unless defined otherwise in Appendix 3, words and phrases in these procedures will have the meanings attributed to them in Clause 11 of the Code.

1.3 Arrangements for Revision

These procedures have been drafted on the basis that they set out a cooperative arrangement between PAWA and the Commission to help PAWA to fulfil its obligations under the Code. In this spirit, the procedures introduce a number of explicit expectations of how PAWA will work with the Commission to achieve these outcomes. The procedures have also been drafted on the basis that by approving the procedures the Commission undertakes to abide by any requirements of the Commission set out in the procedures.

These procedures may need to be amended from time to time to meet the needs of the Commission and PAWA, and to respond to changing operational circumstances and regulatory and accounting requirements.

PAWA may submit applications for revision in accordance with Clauses 5.7 and 5.8 of the Code.

If the Commission should request any significant revision to the approved procedures, it will allow PAWA at least 30 days to respond with a submission of revised procedures.

1.4 Effective Date and Version History

These procedures (Version 1) become effective after approval by the Commission on [31] October 2001. Each revision to these procedures will bear the effective date and a version number.

2 Preparation

2.1 Introduction

This section addresses a number of key practical issues necessarily associated with the submission of Regulatory Financial Statements under the Code.

2.2 Responsibility

Clause 2.13 of Schedule 2 of the Code requires the directors of an electricity entity to be responsible, for the purposes of the Code, for the preparation and presentation of the financial statements and reports and the information they contain.

It is normal accounting practice to produce draft financial statements that typically progress through several versions prior to finalisation. It is conceivable that in the spirit of consultation and co-operation, the PAWA and Commission may need to discuss such drafts before finalisation. However, for the purpose of avoiding doubt and to provide a formal control, no documents, information or schedules acquired by the Commission shall comprise an actual submission of financial statements under the Code, unless they are accompanied by a formal covering letter from PAWA, indicating their status as a formal submission.

2.3 Confidentiality

The principles of disaggregation required by Clause 2.7 of Schedule 2 of the Code and described at section 3 of these procedures, necessitate the disclosure of accounting information about competitive and non-prescribed activities. This information is commercially sensitive. The Commission has indicated that commercially sensitive information will not be publicly disclosed. Therefore, for the purposes of Clause 5.11 of the Code, the accounts provided to the Commission shall comprise pro formas A1 through A4 set out at Appendix 1. All other pro formas and information concerning the Regulatory Financial Statements shall be provided to the Commission on a commercial in confidence basis to assist the Commission to understand how the Regulatory Financial Statements have been prepared.

PAWA also draws the reader's attention to section 3.3.4 of these Procedures.

2.4 Quality assurance

Clause 2.14 of Schedule 2 of the Code requires PAWA's directors to ensure that PAWA keeps accounting records that:

a) correctly record and explain the transactions and financial positions of the Prescribed Business and Electricity Business as a whole.

(This obligation is met by the directors' responsibility statement under the Financial Management Act to maintain accounting records for the reporting entity where Statutory Financial Accounts include both the Prescribed Business and the Electricity Business as a whole.)

b) *enable financial statements and reports to be prepared in accordance with the Code.*

Because the Regulatory Financial Statements are prepared from the same accounting records that are maintained for statutory purposes, this obligation is also fulfilled by the directors' obligations to maintain accounting records under the Financial Management Act; and

c) *are capable of allowing auditors to conveniently and properly furnish an opinion on the basis of those financial statements, of PAWA's compliance with Schedule 2 of the Code, the Accounting Procedures and Clause 4 of the Code.*

These procedures, together with the Cost Allocation Procedures, set out accounting records and schedules additional to those required by the Financial Management Act, to meet the requirements of Clause 2.14(c) of Schedule 2 of the Code.

2.5 Timing

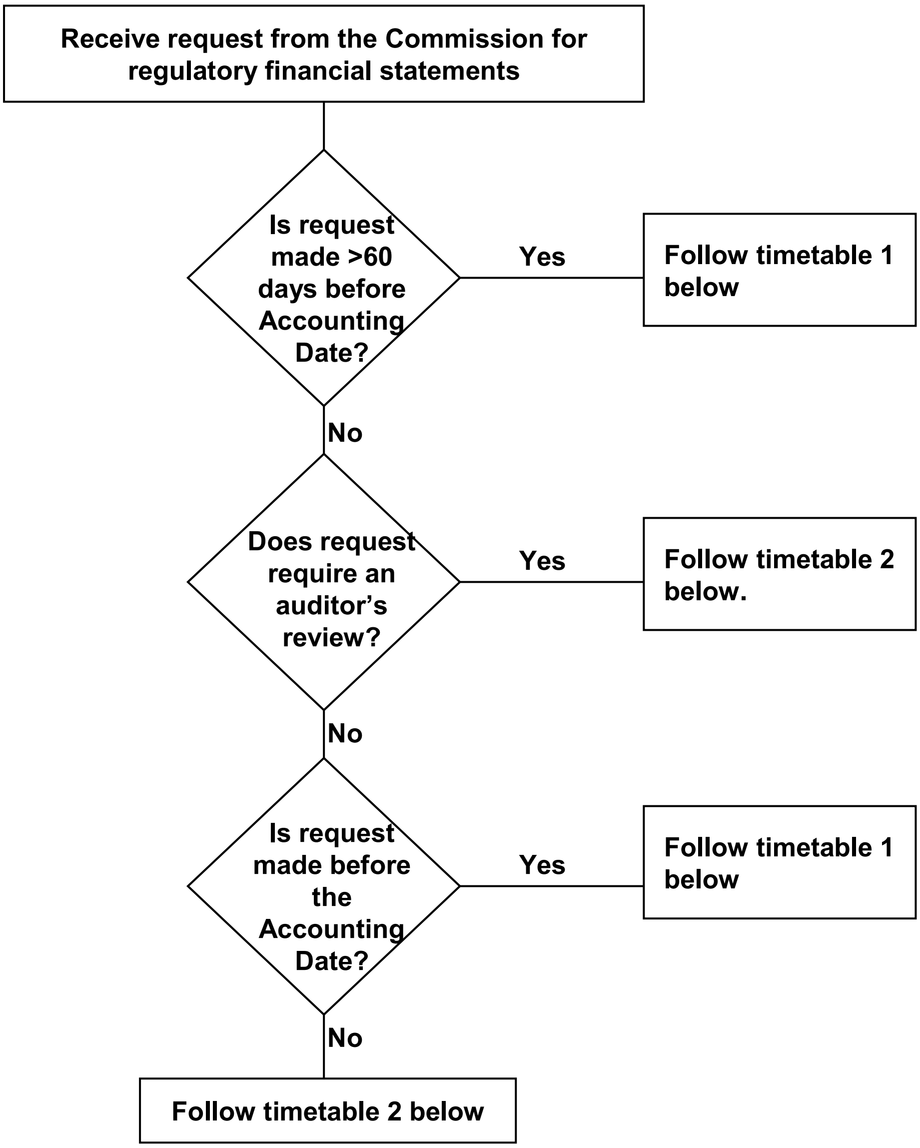
The production of Regulatory Financial Statements will accord with the timetables described below.

In these timetables:

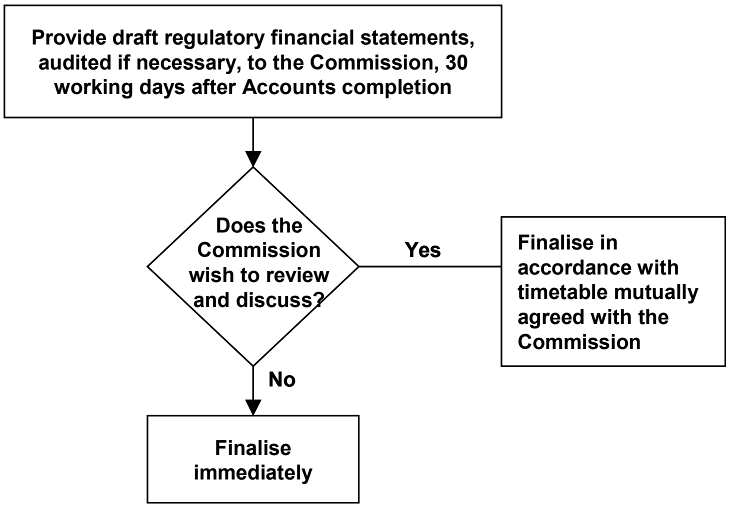
- "Accounting date" means the accounting date of the regulatory accounts and hence the Base Accounts from which they are derived; and
- "Accounts completion date" means the date on which the Statutory Accounts are signed and finalised.

The timetables allow for the audit of the Regulatory Financial Statements, should the Commission require this.

The following series of events is assumed. Regulatory Financial Statements will be submitted to the Commission within one month of the Accounts Completion Date. Where the Commission seeks information or verification in addition to that required under the Regulatory Accounting Pro formas at Appendix 1, the Commission shall use its best endeavours to request the Regulatory Financial Statements 60 days before the Accounting Date.


Receive request from the Commission for regulatory financial statements
Is request made >60 days before Accounting Date?
Yes
Follow timetable 1 below
No
Does request require an auditor's review?
Yes
Follow timetable 2 below.
No
Is request made before the Accounting Date?
Yes
Follow timetable 1 below
No
Follow timetable 2 below

Timetable 1



2.5.1 Timetable 2

PAWA shall:

- use its best endeavours to complete draft audited Regulatory Financial Statements, 30 days after accounts completion; and
- agree a specific timetable with the Commission at the time of receiving the requests to complete the draft accounts. If necessary a further timetable may be agreed to allow the Commission to review the draft accounts before finalisation.

Unlike Timetable 1, Timetable 2 essentially allows for a mutually agreed timetable. This reflects the practical reality that:

- given sufficient notice, it is reasonable to plan and conduct an auditor's review, efficiently in conjunction with the audit of the statutory accounts that form the basis of the Regulatory Financial Statements; but
- it is not feasible to make any prospective timetable commitments in the absence of fair notice of the scope and timing of any request for an auditor's review.

3 Accounting requirements

This section sets out the Procedures PAWA is to follow to produce the Regulatory Financial Statements described in Appendix 1, in accordance with the Code's requirements.

3.1 Requirements under the Ring Fencing Code

The Code requires an electricity entity that carries on a Prescribed Business in the Northern Territory to establish and maintain a separate set of financial accounts and reports for each Prescribed Business and its Electricity Business as a whole which have been prepared in accordance with the Accounting Procedures applying to that Electricity Business from time to time under Clause 5 of the Code. This document sets out those Accounting Procedures.

3.1.1 How the Procedures meet the Commission's requirements

Clause 5 of the Code requires that an electricity entity that carries on a prescribed business must within 3 months of the commencement date of the Code submit to the Commission for approval final draft Procedures for its prescribed businesses.

The Accounting Procedures will only be approved by the Commission if:

- They ensure compliance with the relevant minimum ring-fencing obligations of the Code;
- They are consistent with the accounting policies and procedures for other regulatory instruments;
- Their utilisation involves a recognisable and rational economic basis;
- The resultant financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions and events is reported; and
- They comply with the principles set out in Schedule 2 of the Code.

These Accounting Procedures, including the accompanying Cost Allocation Procedures (collectively referred to as the "Procedures"), have been prepared on the bases that except where mandated otherwise by the Code, the Regulatory Financial Statements shall be prepared from the accounting records that:

- underlie PAWA's statutory accounts;
- accord with Australian Accounting Standards and the Financial Management Act; and
- fall within the ambit of the statutory audit of PAWA's annual financial statements.

Based on the above, PAWA does not propose to maintain different accounting records to those used for statutory and management reporting purposes, for the purposes of providing Regulatory Financial Statements to the Commission, except to the extent that the Commission has particular accounting requirements that differ from those required by Australian Accounting Standards and the Financial Management Act. However, PAWA notes that the Code (Clause 2.10 of Schedule 2) requires the regulatory accounting principles and policies to follow those applied to the statutory accounts in so far as is reasonably practicable. Therefore, where additional accounting records or schedules may need to be created to meet the Code's reporting requirements, such records are described in these Procedures.

PAWA also notes that the Code's accounting and cost allocation requirements closely follow precedents set by regulators in other Australian jurisdictions. Therefore in drafting its Procedures, PAWA has considered the accounting and cost allocation procedures required by regulators in other jurisdictions where these are relevant to the Commission's reporting requirements.

On these bases, PAWA believes that the following Procedures fully meet the requirements of the Code.

3.2 Bases of accounting principles and policies

In accordance with Clause 2.10 of Schedule 2 of the Code, the accounting policies used to prepare PAWA's Statutory Financial Statements shall also be used to prepare the Regulatory Financial Statements. The Statutory Financial Statements provide full disclosure of the policies in accordance with statutory disclosure requirements and Australian Accounting Standards.

Should the accounting policies disclosed in the Statutory Financial Statements be modified or replaced or supplemented with other policies, in order to produce Regulatory Financial Statements, the additional or changed policies shall be disclosed in the Regulatory Financial Statements as "Regulatory Accounting Policies".

3.3 Disaggregation of accounts

The Code requires PAWA to provide financial statements and reports for the Electricity Business as a whole and for each Prescribed Business. The following table outlines the Prescribed Businesses within the Electricity Business.

Business	**Prescribed Businesses**
Electricity Business	Regulated Segment of Networks Business
	Non-contestable retail
	Regulated Segment of System Control Business
	Generation

The Statutory Financial Statements of PAWA include the Electricity Business, the Prescribed Businesses and Business Segments. Therefore, to provide Regulatory Financial Statements for each of the Prescribed Businesses and the Electricity Business as a whole, the Statutory Financial Statements need to be disaggregated.

3.3.1 Definition of Electricity and Prescribed Businesses

Prior to the preparation of annual regulatory Financial Statements PAWA shall review its general ledger structure to determine:

- which cost centres or other form of general ledger accounts are classified as comprising the Electricity Business; and
- within the Electricity Business, which are classified as comprising each Prescribed Business.

PAWA anticipates that:

- it may from time to time require the Commission's advice to help clarify and agree the appropriate classification of specific general ledger accounts;
- where a cost centre or other form of general ledger account may not be wholly directly attributable to the Electricity Business or a single Prescribed Business, the procedures set out in Appendix 2 will be applied to allocate the costs within the accounts or cost centre; and
- the attribution of relevant general ledger accounts to the Electricity Business and Prescribed Businesses will be recorded in a way that will provide an audit trail which if

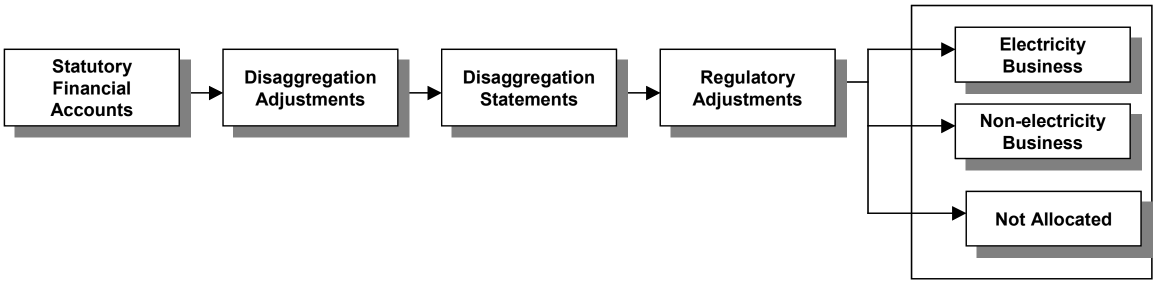
required, can be used to explain to the Commission how the attribution has been conducted.

3.3.2 Principles of Disaggregation

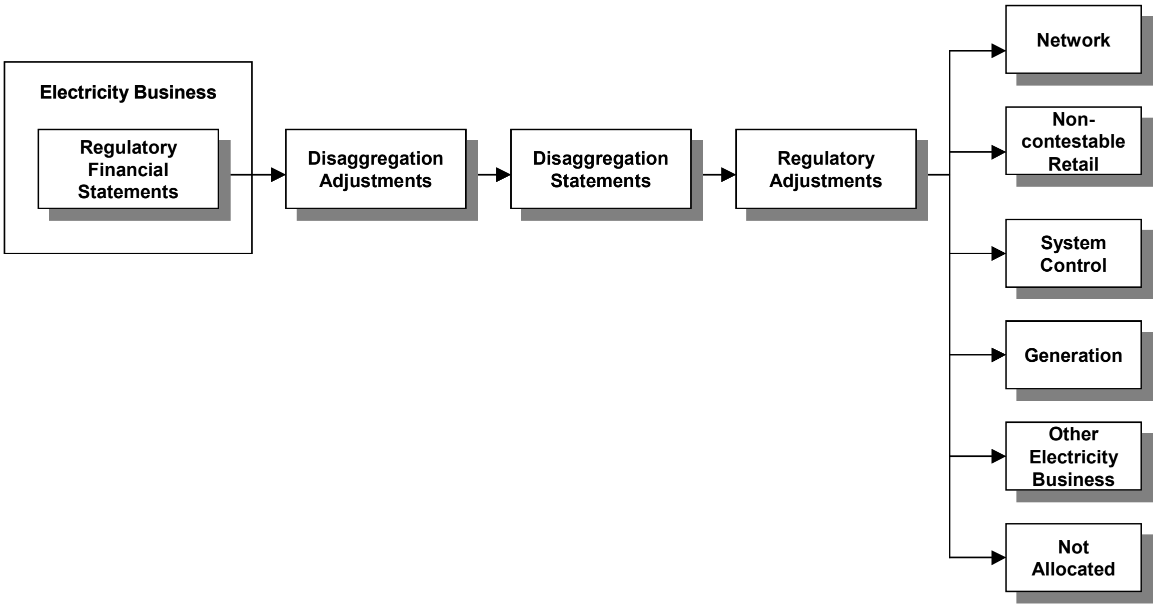
These procedures have been drafted on the basis that the entirety of the Electricity Business and the Prescribed Businesses are encompassed by a single set of Statutory Financial Statements that would be prepared regardless of the requirements of this Procedure.

The Regulatory Financial Statements for each of the Prescribed Businesses and the Electricity Business are to be prepared by disaggregating the Statutory Financial Statements of the consolidated entity. This is to be undertaken in two steps:

- **Step 1**: The Statutory Financial Statements are disaggregated into accounts for the Electricity Business and Non-electricity Business, to generate the Regulatory Financial Statements for the Electricity Business as a whole. This is shown in the diagram below.



- **Step 2**: The second step is to generate Regulatory Financial Statements for each of the Prescribed Businesses from the Electricity Business' Regulatory Financial Statements. This may require further disaggregation and regulatory accounting adjustments. The following diagram illustrates the second step.



Both steps may identify certain items that cannot be fairly allocated or do not need to be allocated for the purposes of PAWA meeting its regulatory accounting obligations. However, these are necessary balancing items and shall be disclosed as such in the disaggregation statements to provide an audit trail.

PAWA neither proposes nor anticipates any regulatory accounting policies at present. However, where a regulatory accounting policy is applied, adjustments will be carried out.

3.3.3 Commercially sensitive information

Except for:

- the Statutory Financial Statements; and
- the *outcomes* of Steps 1 and 2 set out in pro formas A1 through A4,

all information provided to the Commission on the pro formas in Appendix 1 and any other information concerning or supporting the Regulatory Financial Statements that PAWA may provide to the Commission, shall be presumed to be commercial in confidence, unless PAWA specifically denotes it as not being otherwise. This is because transparent disclosure of the disaggregation necessarily requires disclosure of both prescribed and non-prescribed and hence commercially sensitive, business information.

3.3.4 Accounts that form bases of disaggregation

PAWA will prepare Disaggregation Statements for the profit and loss account and for capital employed for the Electricity Business and each of its Prescribed Businesses. The Disaggregation Statements shall be prepared by a deconsolidation of the Statutory Financial Statements. This shall include disaggregation adjustments to reverse the eliminations of transactions between Businesses that are necessary to prepare consolidated or aggregated accounts.

3.4 Audit trail

The Regulatory Financial Statements provided to the Commission will be supported by an audit trail consisting of work papers provided with the Regulatory Financial Statements and the retention of supporting accounting records.

The following working papers and supporting information will be provided to assist the Commission to understand the Regulatory Financial Statements:

- Statutory Financial Statements
- a reconciliation between depreciation charges and closing values of plant, property and equipment assets presented on a DORC basis of valuation and the respective amounts included in the statutory accounts (to be provided in the regulatory adjustment journals); and
- disclosure of working capital attributed to the Prescribed Network and System Control Businesses.
- Disaggregation Statements (Pro formas D1 and D2), including:
  - an explanation of the basis of allocation of the nominated cost categories (operating, maintenance, transfers, other) for all component items representing greater than 10% of the total of each category.
- Adjustment Journals (Pro formas J1 and J2)
- Asset Schedules and supporting papers (Pro forma Assets).

3.5 Treatment of taxation

PAWA will report the total actual Australian income tax charge incurred for the whole of the consolidated entity. PAWA does not propose to attribute taxation charges to the Electricity Business or to Prescribed Businesses as these charges are incurred for the legal entities which do not correspond with the Electricity Business or to the Prescribed Businesses.

3.6 Revenue

The following table indicates the principal sources of revenue for each Prescribed Business segment and how each is to be accounted for the purposes of deriving Regulatory Financial Statements.

Prescribed Business	Source of revenue	How it is accounted for
Non-contestable retail	Tariff income	Direct attribution of billings in the financial accounts
	CSO income for all non-contestable customers	Direct attribution of amounts due, the financial accounts
Networks	Scheduled network charges for non-contestable retail customers Scheduled network charges for contestable retail customers	Direct attribution on the bases of scheduled charges applicable to customers
System control	System control charges for non-contestable retail customers System control charges for contestable retail customers	Allocation on the bases set out in section A.5.4 of Appendix 2
Generation	Generation charges at agreed transfer prices for non-contestable retail customers Generation charges at agreed transfer prices for contestable retail customers	Allocation on the bases set out in section A.5.5 of Appendix 2

Other revenue that may arise and that is not described in the above table will be directly attributed to Prescribed Businesses and other business segments where possible or on a causation basis where not.

3.7 Costs

Costs will be attributed to Prescribed Businesses and other business segments based on the principles outlined in the Cost Allocation Procedures in Appendix 2.

3.8 Statement of property, plant and equipment and capital expenditure

PAWA will provide a statement of property, plant and equipment balances, capital expenditure, depreciation and disposals, based on the book value of assets. This statement will reconcile to the Statutory Financial Statements and is set out at Appendix 1 (the

"Assets" pro forma). Assets and capital expenditure will be allocated to prescribed business based on the principles outlined in the Cost Allocation Procedures. At this stage no regulatory accounting or disaggregation adjustments to assets are anticipated. Therefore in the interests of brevity, no disaggregation statements are to be prepared for fixed assets.

3.9 Working capital

For the purpose of the Statement of Capital Employed (pro formas A3 and A4), working capital shall only be allocated to the Network Prescribed Business at this stage, because:

- of its low materiality;
- of the inherently short life and rapid replacement cycle; and
- a causal relationship cannot be established without undue cost and effort

PAWA also believes that its Statutory Financial Statements disclose sufficient information about its working capital which together with the information provided in the Regulatory Financial Statements, would allow any retrospective allocation to the Electricity Businesses or the Prescribed Businesses, should this be required.

A note setting out the Network Business' working capital and its derivation will accompany the regulatory pro forma "A3".

3.10 Materiality

The following standard of materiality (as defined in Clause 3.10 of Schedule 2 of the Code) will be applied in the preparation of Regulatory Financial Statements:

An item is material if its omission, misstatement or non-disclosure has the potential to prejudice the understanding of the financial position and nature of the Prescribed Business or the Electricity Business as a whole (whichever is applicable), gained by reading the Regulatory Financial Statements.

Appendix 1: Regulatory Accounting Pro formas

Type	Regulatory Reporting Pro formas	Pro forma No.
Regulatory Financial Statements for public disclosure per Clause 5.11 of the Code	**Statement of financial performance - Prescribed Business**	
	- Network	**A1**
	- System Control	**A2**
	Statement of capital employed - Prescribed Business	
	- Network	**A3**
	- System Control	**A4**
Disaggregation Statements	**Statement of financial performance**	
	- Electricity Business	**D1**
	- Prescribed Business	**D2**
Disaggregation and Adjustment Journals	**Electricity Business**	**J1**
	Prescribed Businesses	**J2**
Asset statements	**Statement of property, plant and equipment.**	**Assets**

Note: The shaded areas in the templates indicate that input data is not required to be separately supplied by PAWA (but are to be included in the "other/not allocated" columns.

Pro formas A1 and A2

Regulatory Financial Statements for public disclosure per Clause 5.11 of the Code
Statement of financial performance for the period ended [……]

Description	**[Business segment name] $'000**
Income	
Sales of goods and services	
Community service obligations	
Customer contributions	
Net gain on disposal of plant, property and equipment	
Interest and investment income	
Other	
Expenses	
Operating costs (Note 2)	
Maintenance costs	
Depreciation (Note 1)	
Other	
Earnings before interest and tax	

Note 1: The period's depreciation charge on a DORC basis.

Note 2: PAWA does not separately report operating and maintenance costs in its financial accounts. The separation of these costs is undertaken for presentation in the Regulatory Financial Statements only.

Pro formas A3 and A4

Regulatory Financial Statements for public disclosure per Clause 5.11 of the Code
Statement of capital employed for the period ended [……]

Description	**[Business segment name] $'000**
Plant, property and equipment (Note 1)	
Working capital (Note 2)	
Total capital employed (regulated capital base)	

Note 1: The period's balance carried forward on a DORC basis.

Note 2: There shall be a note appended to this schedule setting out the derivation of any working capital attributed to the prescribed businesses at the end of the accounting period.

Pro forma D1 – Commercial in Confidence

Disaggregation statement
Statement of financial performance
For the period ended [ ]

Description	Statutory Financial Statements	Reference to Adjustment Journal J1	Electricity Business	Non-Electricity Business	Not allocated	Workpaper reference
	$'000		$'000	$'000	$'000	
Income						
Sales of goods and services						
Community service obligations						
Customer contributions						
Net gain on disposal of plant, property and equipment						
Interest and investment revenue (not allocated)						
Other						
Total income						
Expenses						
Operating costs (Note 1)						
Maintenance costs (Note 1)						
Depreciation (Note 2)						
Other (Note 1)						
Earnings before interest and tax						
Tax Charge						

Note 1: To be accompanied by working papers setting out the basis of allocation for all component items >10% of the total and for all transfer charges (SLA) items.

Note 2: The period's depreciation charge on a book basis, not DORC.

Note 3: Disaggregation of data to this level will be required in future. At the time of preparation of these procedures PAWA did not record operations and maintenance costs in a manner which would allow their accurate presentation in these accounts.

Pro forma D2 – Commercial in Confidence

Disaggregation statement **(Note 1)**

Statement of financial performance

For the period ended [ ]

Description	**Electricity Business**	**Journal J2 Reference**	**Regulated Network**	**Non-reg Network**	**Non-contestable Retail**	**Contest'le Retail**	**Reg'd System Control**	**Non-reg System Control**	**Generation**	**Other/not allocated**	**Workpaper reference**
	$'000		$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	
Sales of goods or services											
Community service obligations											
Customer contributions											
Net gain on disposal of plant, property and equipment											
Interest and investment revenue (not allocated)											
Other											
Total income											
Operating costs (Note 2)											
Maintenance costs (Note 2)											
Depreciation (Note 3)											
Other (Note 2)											
Total expenses											
Earnings before interest and tax											

Note 1: the grey shaded areas indicate financial information that is not required to be provided.

Note 2: To be accompanied by working papers setting out the basis of allocation for all component items >10% of the total and for all transfer charge (SLA) items.

Note 3: The period's depreciation charge on a book basis, not DORC.

Pro forma J1 – Commercial in Confidence
Regulatory Adjustment Journals
Electricity Business
for the period ended [ ]

Journal Number	**Account Debited** **Account Credited**	**Amount**	
		Debit $000	**Credit $000**

Pro forma J2 – Commercial in Confidence
Regulatory Adjustment Journals
Prescribed Businesses
for the period ended [ ]

Journal Number	**Account Debited Account Credited**	**Amount**	
		Debit $000	**Credit $000**

Pro forma "Assets" – Commercial in Confidence
Analysis of property, plant and equipment (Note 1)
For the period ended [ ]

	Whole of business				Electricity Business (Note 2)					
	Electricity Business	**Non-electricity Business**	**Not allocated**	**Total**	**Reg'd Network**	**Non-contestable Retail**	**Reg'd System Control**	**Generation**	**Other/ Not Allocated**	**Total**
	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Gross book value										
Balance brought fwd										
Revaluation adjustments										
Additions										
Disposals / retirements										
Balance carried fwd										
Accumulated depreciation										
Balance brought fwd										
Revaluation adjustments										
Depreciation charges										
Disposals										
Balance carried fwd										
Net book value at end of period										

Note 1: Based on book values, not DORC.

Note 2: the grey shaded areas indicate financial information that is not required to be provided.

Appendix 2: Cost (and Revenue) Allocation Procedures

A.1 Introduction – relationships between costs and revenues

The purpose of these procedures is to provide practical guidance to PAWA's personnel on how to achieve:

- the cost allocation outcomes prescribed in the Northern Territory Electricity Ring-Fencing Code ("the Code"); and
- corresponding revenue allocation procedures

for the purposes of preparing Regulatory Financial Statements.

The Code's cost allocation requirements are set out at section A.3 of this appendix. The Code also requires PAWA to account for the financial performance and assets of each Prescribed Business on a ring fenced basis. Where one Prescribed Business provides services to another under a SLA, the disaggregation principles set out in section 3.3 of these Procedures, require the Business providing the service to account for revenue and for the Business receiving the service to account for costs. Accordingly, the amount of intra PAWA revenue accounted for under a SLA influences the costs of a Prescribed Business "paying" such revenue. Because of this, section A.4 of this appendix provides guidance on the bases for setting and attributing revenue under SLAs. This guidance is consistent with the Code's cost allocation requirements.

A.2 Application

These procedures do not provide detailed task descriptions or requirements. They describe constraints and guidance within which PAWA's personnel will use their professional judgement to plan and execute the operational tasks necessary to meet the Code's requirements.

Section 3.3 of the Accounting Procedures describes how certain general ledger accounts may be wholly directly attributed to the Electricity Business or Prescribed Business. Where an account or cost centre:

- can be wholly attributed, no further cost allocation will be necessary;
- cannot be wholly attributed, the costs allocation procedures set out here should be used to attribute costs to the Electricity Business or a Prescribed Business.

These Cost Allocation Procedures describe the allocation of both operating and capital costs, ie debits in the profit and loss account and balance sheet. Procedures for the allocation of revenues are dealt with in section 3.6 of the Accounting Procedures and section A.5 of this appendix.

Words and phrases in this Appendix shall have the meanings ascribed to them by the Code except where additional definitions may be provided in the Glossary at Appendix 3.

A.3 Outcomes required by the Northern Territory Electricity Ring-Fencing Code

The following cost allocation principles are embodied in the Code:

- PAWA is to allocate any costs that are shared between a prescribed business and a related business in a manner that complies with the cost allocation procedures and is otherwise fair and reasonable (section 4(b));
- The utilisation of the procedures involves a recognisable and rational economic basis (Schedule 2, section 3.1(c));
- The resultant financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions and events is reported (Schedule 2, section 3.1(d));
- The cost allocations prepared must be capable of certification as such by an auditor (Schedule 2, section 3.3);
- The allocation of accounts is to be based on the principle that items which are directly attributable are assigned accordingly and items not directly attributable are to be allocated using an appropriate allocator (Schedule 2, section 3.4);
- Items that are not directly attributed are to be allocated on a causation basis. Allocation based on avoidable cost is not permitted (Schedule 2, section 3.6);
- The electricity entity must produce for each item that has not been directly attributed supporting paper work that includes the amounts that have been allocated and amounts that have not been so allocated and the numeric quantity of each allocator (Schedule 2, section 3.7); and
- Immaterial items where a causal relationship cannot be established without undue cost and effort may be allocated on a non-causal basis. The aggregate of all items subject to all non-causal bases of allocation must not have a material effect on the statements or reports (Schedule 2, section 3.8 & 3.9).

To assist the interpretation of bullet point 3 in particular, PAWA refers to the following commonly accepted definitions for accounting purposes.

Relevance means that the financial information must have value in terms of assisting users in making and evaluating decisions about the allocation of scarce resources and in assessing the rendering of accountability by preparers. If information is to assist users in making decisions about the allocation of scarce resources, it must assist them in making predictions about future situations and in forming expectations, and/or it must play a confirmatory role in respect of their past evaluations.[1]

The ***reliability*** of financial information will be determined by the degree of correspondence between what that information conveys to users and the underlying transactions and events that have occurred and been measured and displayed. Reliable information will, without bias or undue error, faithfully represent those transactions and events.[1]

A.4 Cost attribution options

PAWA has identified the following options that are consistent with the Code, for the allocation of costs. In order of preference, these are:

1. Direct attribution;
2. Allocation on a causation basis; and
3. Allocation on a non-causal basis.

Allocation based on avoidable cost is not permitted.

These concepts are illustrated and further explained overleaf.

[1] ICAA Members' Handbook June 2001, SAC 3.

A.4.1 Cost allocation decision tree

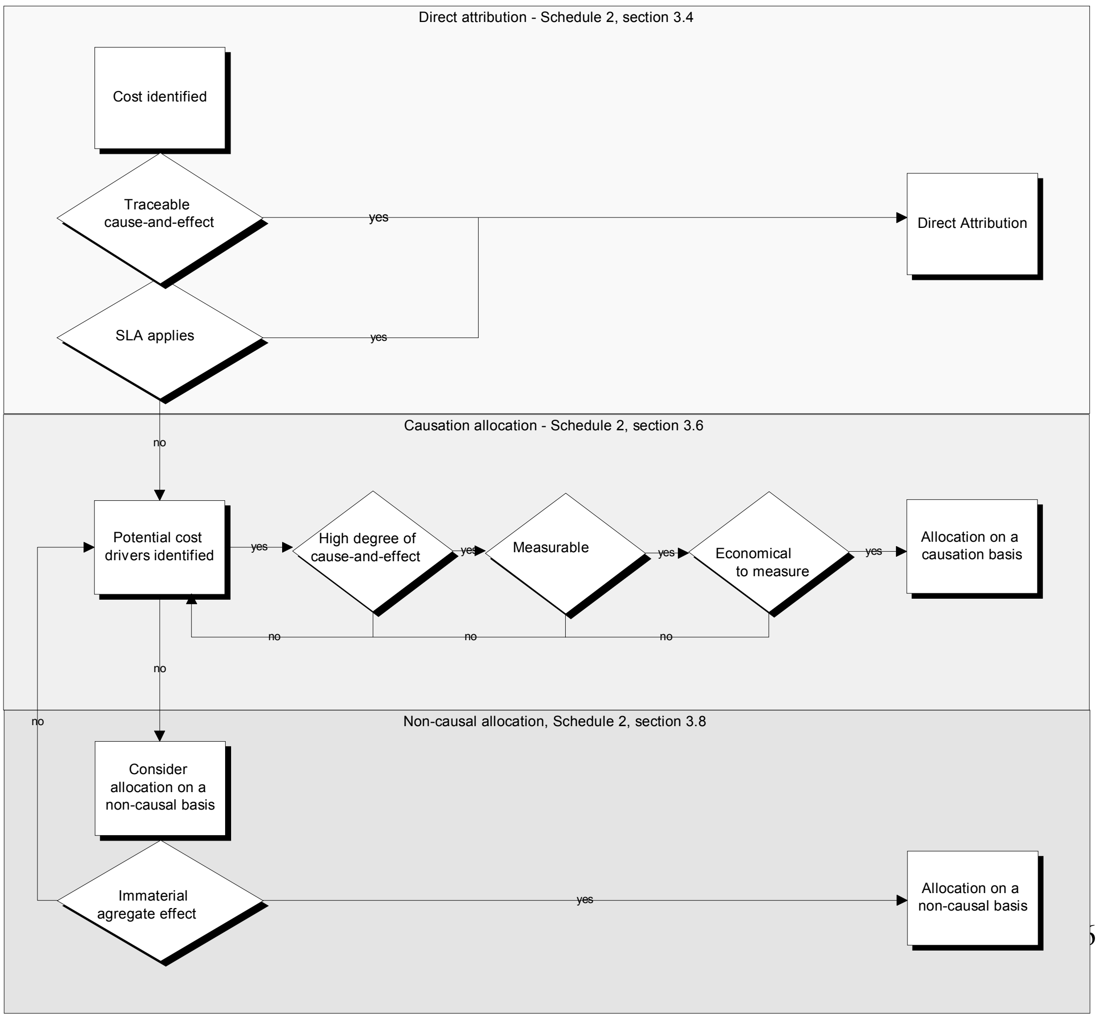
The following cost allocation decision tree is consistent with the Code's principles set out in section A.3. For clarity of explanation, the relevant sections of the Code are referred to in the diagram.

A.4.1.1 Direct attribution

This is the preferred method of cost allocation. A cost that is tracable to a particular business should be directly attributed to the business by coding within the general ledger.

A cost is traceable where there is a clear cause-and-effect between the cost and the business. For example:

- labour costs within a particular business where the person works solely for that business would be traceable to that business;
- direct attribution of labour costs is also achieved where an employee works for more than one business but maintains timesheets attributing their time to the various businesses; or
- where goods and services are invoiced directly to and wholly consumed by a specific business in the conduct of its trade; and



- costs incurred under Service Level Agreements ("SLA's") are directly attributable to the party paying the cost on the basis that the SLAs are priced in accordance with section A.5 of these procedures.

Whilst it is envisaged that most costs incurred will be directly attributed by direct tracing and/or by SLA's, there are occasions when this is not possible or practicable. In these cases the costs will be allocated either on a causation or non-causal basis as outlined below.

A.4.1.2 Allocation on a causation basis

Where a cost cannot be directly attributed it will be allocated on a causation basis.

As there may be a large number of activities or "cost drivers" within various businesses that cause a cost to be incurred, the appropriate cost driver is selected from the available cost drivers based upon the degree to which it captures a cause-and-effect relationship between the activity and the cost. An example of a cost driver capturing a cause-and-effect relationship for allocating depreciation is square meters of building space. However, the identification of cost drivers is inherently judgemental and in general terms, costs that possess unique cost drivers are uncommon. Therefore in forming a judgment on an appropriate cost driver it is necessary to refer to the Code's outcome criteria described above, and specifically that costs are to be allocated in a manner that:

- is otherwise fair and reasonable;
- ensures the substance of the underlying transactions and events is reported; and
- is capable of certification by an auditor.

Once an appropriate driver has been identified consideration should be given to the measurability of the cost driver, and the costs of measuring and applying the cost driver.

- If a driver cannot be readily measured and applied without undue cost and effort an alternative causal cost driver should be identified; and
- Where no causal relationship can be established without undue cost and effort, cost may be allocated on a non-causal basis.

A.4.1.3 Allocation on a non-causal basis

Where a cost cannot be directly attributed or practicably allocated on a causal basis, or the causal basis cannot be established, the cost should be allocated on a non-causal basis.

The aggregate of all items subject to non-causal bases of allocation should be assessed to ensure that they do not have a material effect on the financial information. Should a material effect be identified the bases are to be reassessed and appropriate allocators identified and applied until the total value of the remaining items subject to non-causal bases of allocation is immaterial.

A.4.1.4 Allocation between businesses on an avoidable cost basis is prohibited

The avoidable costs of an activity or service are those costs that would be avoided if the activity or service ceased. Short term variable costs are generally accepted as practical surrogates for avoidable cost.

The Code prohibits cost allocation to Prescribed Businesses on an avoidable cost basis. However *within* a Business Segment, avoidable cost allocation may be appropriate to determine the minimum price at which a service should continue to be provided to a customer with a competitive alternative.

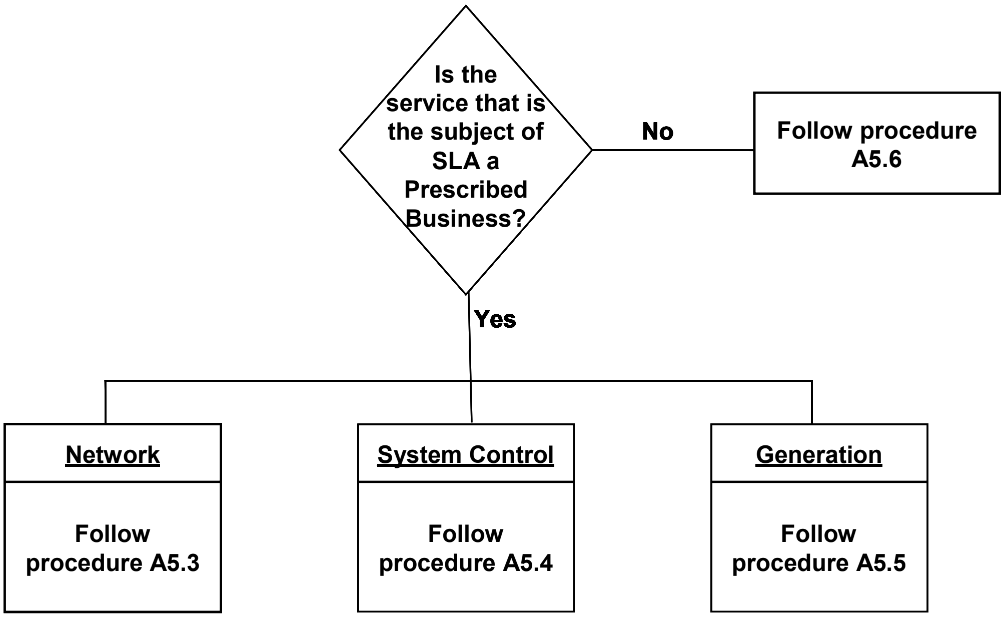
A.5 Revenue allocation procedures

A.5.1 Introduction

These procedures shall be used to account for any item of inter Business revenue that may arise within the disaggregation statements when preparing Regulatory Financial Statements. These procedures follow the principle of substance over form by seeking to ensure that the intent of the Code with regard to cost transfer via SLAs is fulfilled. This need arises because under double entry bookkeeping principles and Accounting Standards, the costs accounted for by the Business receiving the services are directly accounted for as revenue not costs, in the Business providing the service. However, PAWA understands that the substance of the Commission's intent is for revenues to be attributed to Businesses on the basis of an attribution of the costs and profits of the Prescribed Business providing the service. For Prescribed Businesses profits shall be assumed to be equivalent to returns on capital that are for accounting purposes, notional costs.

A.5.2 Specific bases of attributions under SLAs

Note: These procedures address the attribution of revenue under SLAs which the Electricity Business or a Prescribed Business is party to. Tariffs and charges to non-contestable customers for Prescribed Services shall be accounted for in the Non-Contestable Retail Business.



A.5.3 Network revenue

This shall be based on a direct attribution of network tariffs and charges to non-contestable customers on the basis that scheduled network tariffs are consistent with the revenue cap for PAWA's network business.

A.5.4 System control revenue

This shall be based on a direct attribution of system control tariffs and charges to non-contestable customers on the basis of the regulated system control tariffs.

A.5.5 Generation revenue

The SLAs for generation are to be priced at amounts that recharge actual costs and returns on capital, according to the following principles:

- assess for each generation region the total costs of generation including returns on capital. This represents a direct attribution of costs to each region, namely:
  - Darwin/Katherine;
  - Alice Springs;
  - Tennant Creek;
- within each region, wherever possible directly attribute costs to customers and hence contestable and non-contestable businesses. For example, because of the nature of the

generation services, costs for certain tranche 1 contestable customers can be separately identified and attributed to those customers; and

- allocate the remaining costs within each region, to groups of contestable and non-contestable customers within that region. Ideally, this would require sophisticated modelling of loads and profiles based on the characteristics of each customer. This is a difficult problem, which experience with the introduction of full retail contestability in the National Electricity Market indicates cannot be readily resolved. Accordingly, in the absence of more detailed information on which to base attribution, costs that cannot be directly attributed are to be allocated between contestable and non-contestable on a per kWh basis.

Note:

- these procedures address the attribution of revenues between contestable and non-contestable customer groups, not pricing to customers within each group.
- reference should be made to the Commission's "Contestable Pricing Guidelines" for further guidance on how the risk of practicing discriminatory pricing for generation services should be avoided.

A.5.6 SLAs for non-prescribed services

Certain services for which competitive market alternatives may exist, may be subject to recharge to or by a Prescribed Business, by means of a SLA. Certain corporate or business services could be examples. If so, prices in the SLA shall be no less than the minimum of:

- the fully distributed cost to PAWA including any profit margin on returns for providing the service; or

- the competitive price at which equivalent services could be obtained by PAWA on the open market.

A.6 Documentation and quality control

All bases of allocation are to be documented to an extent that is sufficient to permit an independent reader of the documentation to reconstruct the bases and quanta of the amounts allocated. The documentation shall include a description of the numeric quantity of each allocator that is used.

Appendix 3: Glossary

Words and phrases have the meanings ascribed to them by the Code. The following additional terms are defined for the purposes of these Procedures.

Procedures	mean Accounting Procedures and Cost Allocation Procedures, but not Information Procedures
Regulatory Financial Statements	mean special purpose Financial Statements prepared under the Code and in accordance with these Procedures solely for the purpose of meeting the Commission's requirements
SLA	Means "Service Level Agreement"
Statement of Financial Performance	The terminology under the Accounting Standards for the statement commonly referred to as a profit and loss account.