

Review of the Power and Water Corporation's Cost Allocation Policies and Practices

In September 2005, the Commission commenced a review of the cost allocation policies and practices of the Power and Water Corporation ("Power & Water").

The review focussed on Power & Water's allocation of costs – both operating and capital – between products, regions and customer groupings, and whether the associated policies and practices are in accordance with the Competition Principles Agreement and relevant Northern Territory legislation.

The Commission appointed the Allen Consulting Group (ACG) to assist with this review. ACG provided a draft set of findings and recommendations to the Commission in January 2006, and Power & Water provided comments on this draft in February 2006. ACG's final report was provided to the Commission in March 2006.

ACG's general conclusion was that Power & Water's cost allocation policies broadly comply with its legal/regulatory obligations but that its internal documentation operationalising the approved cost allocation procedures and practices are deficient in certain respects and may result in an unreliable allocation of costs across regions and customer classes.

ACG's specific findings included that:

- Power & Water has, as a general statement, implemented a single and internally consistent model of cost allocation across its entire business;
- the cost allocation principles and practices implemented by Power & Water are consistent with the core requirements of the NT Electricity Ring-fencing Code, and with relevant objectives of economic efficiency, equity and competitive neutrality; and
- the cost allocation mechanism (and Financial Management System) appears to provide an allocation of costs across Power & Water's lines of business sufficient for the purposes of regulation of network and system control charges.

Power & Water itself has conceded the following adverse findings made by ACG:

- the cost allocation mechanism and transfer pricing mechanisms are poorly documented; and
- staff members of Power & Water do not appear to have a good understanding of how the cost allocation process operates and how the different cost drivers are determined and implemented.

Power & Water has undertaken to address these issues within an acceptable timeframe.

ACG's findings also confirm certain concerns the Commission itself has had regarding the reliability of financial information provided by Power & Water broken down in particular by region and customer class. For example, the ACG report confirms that Power & Water's cost allocation mechanism does not yet provide an allocation of costs across regions and customer classes sufficient for an assessment of the cost of meeting any community service obligations (CSOs) to these regions and customer classes. Therefore, not only is inadequate documentation an issue, but Power & Water's internal data collection and recording procedures may also be insufficiently robust or reliable to justify the level of analysis required of the Commission.

The Commission looks forward to working with Power & Water over the coming year to ensure that financial information provided to the Commission is of the quality necessary for all regulatory purposes. Provided improvement is evident over the next year, the Commission will not need to give further consideration to how Power & Water might be stimulated to operate its data collection and reporting at a standard necessary for regulatory purposes.

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