



## **Statement of Reasons**

**on the**

### **Water and Sewerage Accounting Ring fencing Guideline and Regulatory Accounts Template**

**March 2016**

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# 1 BACKGROUND

In 2008, legislation was introduced to reform Tasmania's water and sewerage industry. As part of the reform process a new regulatory framework was developed and applied to the industry including a range of legislation, regulations, codes and guidelines.

As part of this framework and in accordance with section 64(2) the *Water and Sewerage Industry Act 2008* (the Industry Act), the Regulator developed a draft Regulatory Accounting Ring fencing Guideline and Regulatory Accounting Template to require a regulated entity to provide sufficiently detailed financial information to the Regulator to allow the Regulator to undertake its responsibilities under the Act. In particular, the Guideline and Template require a regulated entity to separate its revenue, expenses, assets and liabilities between regulated and unregulated activities.

After a period of consultation during 2013 with the previous regulated entities – Ben Lomond Water, Cradle Mountain Water and Southern Water - Version 1 of both the Guideline and the Template were released on 29 May 2013. It was intended at that time that the Guideline and Template would apply to the previous regulated entities' regulatory financial statements for the year ended 30 June 2014.

However, due to the amalgamation of Ben Lomond Water, Cradle Mountain Water and Southern Water to form a single entity, TasWater effective from 1 July 2013, the Regulator approved a request from TasWater to defer the preparation and submission of regulatory accounts. As a result the regulatory accounts for the 2013-14 financial year submitted by TasWater were the first set of regulatory accounts submitted in respect of the Tasmanian water and sewerage industry.

After a review of the 2013-14 regulatory accounts and the associated regulatory accounts process, the Regulator commenced a review of the Guideline and Template with the objective of addressing the identified issues.

On 28 October 2015, the Economic Regulator released its *Draft Water and Sewerage Accounting Ring fencing Guideline and Regulatory Accounts Template Consultation Paper*. The Economic Regulator sought submissions and comments from interested parties on the draft Water and Sewerage Regulatory Accounting Ring fencing Guideline (the Guideline) and Regulatory Accounts Template (the Template). Submissions closed on 20 November 2015.

TasWater provided the only submission in relation to the Consultation Paper. TasWater's submission can be found on the Regulator's website at [www.economicregulator.tas.gov.au](http://www.economicregulator.tas.gov.au).

This Statement of Reasons addresses the issues raised by TasWater and outlines the Regulator's decision in respect to each issue. It also explains the rationale for other changes that have been made to the draft Guideline and draft Template.

The final Guideline and Template will apply to TasWater in respect to the preparation, submission, review and adjustment and approval of regulatory financial statements for the 2015-16 and later financial years.

## 2 SECTION 2 - INTRODUCTION

### 2.1 Clause 1.3.2.2 - purpose

#### **TasWater submission**

Clause 1.3.2.2 refers to variable water and fixed water charges for the subsequent regulatory period. TasWater queried why these charges in particular have been singled out. Fixed sewerage and other charges are not included.

**Accordingly TasWater requested that the Regulator advise as to why variable and fixed water charges have been singled out within this item, or alternatively amend the wording to capture all charges.**

#### **Regulator's Response**

Clause 1.3.2.2 has been included in response to the discussion about fixed and variable costs on page 78 of the 2015 Tasmanian Water and Sewerage Price Determination Investigation – Final Report<sup>1</sup>. At the time, the Regulator noted that:

.... the extent to which variable charges may be set above cost is a matter of judgement. It should be noted that setting variable charges at levels above cost results in large water users (such as industrial customers, hospitals and schools) subsidising low use customers (residences and office blocks). This has the effect of creating a cross subsidy and is inconsistent with the Pricing Principles in relation to cost reflective charging.

The Regulator considers collecting additional information about fixed and variable water costs will allow a fully informed decision to be made about water fixed and variable costs for the next regulatory period commencing from 1 July 2018, the extent of cross subsidies and the extent to which variable costs should be recovered through fixed charges.

#### **Decision**

No change - retain Clause 1.3.2.2 in the Guideline.

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<sup>1</sup> Tasmanian Economic Regulator, *2015 Price Determination Investigation – Regulated Water and Sewerage Services in Tasmania, Final Report*.

## 2.2 Definitions – clause 1.4.1

### TasWater submission

Clause 1.4.1 states that the 'Words and Phrases not defined in section 2 have the meaning given to them by the **Act**, or in any other relevant legislation or regulatory document. Ordinarily TasWater would have expected that a catch all would also be included within this statement for words that are not covered by the Act, other legislation or regulatory document. Typically, a comment would be included stating that these words have their 'ordinary meaning'.

**Accordingly TasWater suggest that a reference to words having their 'ordinary meaning' in circumstances where they are not defined by the Guideline, the Act, other relevant legislation or regulatory document.**

### Regulator's Response

The Regulator agrees with TasWater's suggested change.

### Decision

Clause 1.4.1 of the Guideline will be amended to refer to words having their 'ordinary meaning' in circumstances where they are not defined by the Guideline, the Act, other relevant legislation or regulatory document.

## 2.3 Amendments to this Guideline – Clauses 1.8.2 and 1.8.4

### TasWater submission

Clause 1.8.4 introduces 'fast track' amendments to the Guideline that will not require consultation. TasWater believes that this clause isn't required as 1.8.2 provides for the Regulator to make changes without consultation as long as they are not substantive. Further 1.8.4 removes the protection provided by clause 1.8.2 to the regulated entity and other stakeholders by not limiting the operation of this clause to issues that aren't substantive.

With regard to the circumstances listed at (a) to (d) of 1.8.4, TasWater agrees to most of the circumstances that allow for these changes to occur. However, we do not agree that the Regulator should be able to make changes without consultation where industry technical standards are the driver. These can be subjective and can have different application across different regions.

**Accordingly TasWater requests consideration be given to deleting clause 1.8.4 or if retained the word 'unsubstantive' be added after the word 'any' in the opening paragraph and 'or industry technical standards' be deleted from clause 1.8.4 (b).**

## Regulator's Response

The proposed insertion of the fast track amendments clause aligns with similar provisions in other codes and guidelines issued by the Regulator and is considered to be good regulatory practice.

The Regulator notes that TasWater agrees with most of the circumstances that allow for these fast track changes to occur.

The Regulator also notes that TasWater does not agree that the Regulator should be able to make changes without consultation where industry technical standards are the driver. TasWater considers that these changes can be subjective and can have different application across different regions. The Regulator agrees with TasWater's suggestion to remove the reference to technical standards being a driver for a fast-track amendment being made.

## Decision

Clause 1.8.2 of the Guideline will be removed and Clause 1.8.4 of the Guideline will be amended as suggested by TasWater.

## 2.4 Definitions – clause 2.1

### TasWater submission

The definition of **Consumer Price Index** in Clause 2.1 does not agree with what TasWater have previously been advised by the Regulator and has been applied in our regulatory financial statements for year ending 30 June 2015. The definition currently included in the draft Guideline reads as follows:

'means the weighted average of eight capital cities (Weighted median) for the June quarter in the **financial year** to which the **regulatory financial statements** relate as published by the Australian Bureau of Statistics (6401.0 Consumer Price Index, Australia).

The definition of **Consumer Price Index** previously advised by the Regulator and applied in TasWater's regulatory financial statements for the year ending 30 June 2015 is:

- Firstly, the CPI should be the weighted average of the eight capital cities for the four quarters (Sep, Dec, Mar, Jun).
- Secondly, indexation is applied at the start of the financial year not the end of the financial year as per schedules 500C and 500CC which have rows stating 'Inflation adjustment to opening value'.

As such the definition for CPI should not refer to the **financial year** to which the **regulatory financial statements** relate. The reference should actually be to the quarters in the preceding year.

**Accordingly TasWater request that the CPI definition be amended to refer to the weighted average of the four quarterly CPI figures for the prior financial year.**

### **Regulator's Response**

The Regulator understands that TasWater has developed systems to report on the basis of previous advice provided by the Regulator in relation to the application of CPI.

On this basis and as the information currently reported meets the Regulator's requirements, the Regulator will change the Guideline so as the requirements align with the Regulator's previous advice on this issue.

### **Decision**

Clause 2.1 of the Guideline will be amended to align the definition of CPI with the previous advice the Regulator provided to TasWater.

### **3 SECTION 3 - REQUIREMENT TO PREPARE, MAINTAIN AND SUBMIT REGULATORY FINANCIAL STATEMENTS**

#### **3.1 Submission of regulatory financial statements and other information**

##### **TasWater submission**

Clause 3.3.1 requires TasWater to submit a soft copy and hard copy of the unaudited regulatory financial statements. In the interest of expediency and efficiency, TasWater would prefer to submit a soft copy submission only

**Accordingly TasWater request that the Regulator consider accepting a soft copy only of the unaudited accounts.**

##### **Regulator's Response**

The Regulator agrees that it is not necessary for TasWater to submit both hard and electronic copies of its unaudited accounts.

##### **Decision**

Clause 3.3.1 of the Guideline will be amended to require TasWater to submit its regulatory financial statements in electronic format only.

#### **3.2 Submission of regulatory financial statements and other information**

##### **TasWater submission**

Clause 3.3.3 is confusing as it would seem to indicate that TasWater is required to submit unaudited regulatory financial statements along with a signed Directors' Responsibility Statement, corresponding Board minute and final Regulatory financial statements. TasWater would not be in a position to issue these items until the final audit was complete.

**Accordingly TasWater request that the Regulator amend this clause to make it clear what is required to be submitted with the unaudited accounts and what is required to be submitted with the final accounts (noting that items (e) and (g) will not be submitted with the unaudited accounts).**

##### **Regulator's Response**

The Regulator agrees that, as currently drafted, the Guideline does not make it clear what documentation is to be submitted at different stages of the regulatory accounts process.

**Decision**

Clause 3.3.3 of the Guideline will be amended to make it clear what documentation is to be submitted with the unaudited accounts and the documentation that is to be submitted after the unaudited accounts have been submitted.

## 4 SECTION 4 – PRINCIPLES FOR THE PREPARATION OF THE REGULATORY FINANCIAL STATEMENTS

### 4.1 Basis for the regulatory financial statements - Clauses 4.3.7 and 4.3.8

#### **TasWater submission**

Clause 4.3.7 requires TasWater to justify to the Regulator's satisfaction that there is likely to be a strong positive correlation between the non-causal allocation basis and the actual cause of resource or service consumption or utilisation that those expenditure represent.

TasWater are of the view that it should be required to justify any non-causal allocation basis to the independent auditor, not the Regulator.

**Accordingly, TasWater requests that the Regulator considers amending this clause to require that the auditor be satisfied with any non-causal allocation basis, rather than the Regulator as currently drafted.**

Similar to Clause 4.3.7, Clause 4.3.8 requires TasWater to provide justification as to why multiple allocation bases are required and justify each of the allocation bases. Unlike Clause 4.3.7, this clause is silent on who TasWater are required to justify this to.

**Accordingly TasWater requests that the Regulator considers amending this clause to require that the auditor be satisfied with why multiple allocation bases are required and each of the allocation bases.**

#### **Regulator's Response**

Under the revised Review and Adjustment process, TasWater will be required to justify that there is likely to be a strong positive correlation between the non-causal basis and the actual cause of resource or service consumption or utilisation that those expenditure represent.

In practice the Regulator considers that it will be the auditor that has to be satisfied as to the appropriateness of TasWater's cost allocation bases in the event that the Regulator's terms of reference requires the auditor to review the cost allocation bases.

#### **Decision**

Clauses 4.3.7 and 4.3.8 will be amended by replacing the phrase "to the Regulator's satisfaction" with a requirement for TasWater to provide detailed justification for its cost allocations in its regulatory financial statements.

## **4.2 Capital contributions – Clause 4.4.1(b) (Schedules 500C and 500CC of the Template)**

### **TasWater submission**

Clause 4.4.1(b) states that the assets of the three previous regulated entities which are to be vested in the regulated entity are not to be treated as capital contributions in the regulated entity's regulatory financial statements. This wording potential has unintended consequences. We believe that the intent is for any contributed assets received by the previous regulatory entities subsequent to 1/7/2009 should retain their status as a non-regulatory asset. The existing wording of 4.4.1(b) does not align with this and would seem to indicate that the contributed assets received post 1 July 2009 should be included in the RAB.

**Accordingly TasWater requests that the Regulator considers amending this clause to make it clear how to treat any capital contributions between 1 July 2009 and 30 June 2013.**

### **Regulator's response**

Noting that TasWater's comments actually relate to Clause 4.4.2 rather than Clause 4.4.1(b) of the Guideline, the Regulator confirms TasWater's view that capital contributions received by the previous regulatory entities after 1 July 2009 should not be included in TasWater's RABs.

### **Decision**

The Guideline will be amended by making minor changes to Clause 4.4.2 to reflect that additional assets of the previous regulated entities may vest with TasWater in the future and that capital contributions received between 1 July 2009 and 30 June 2013 by the previous regulated entities are not to be included in TasWater's RABs for the 2013-14 and later financial years.

## **4.3 Reuse Water - Clause 4.4.6 (Schedule 500X of the Template)**

### **TasWater submission**

Clause 4.4.6 states that TasWater should disclose the estimated costs that are avoided by providing wastewater to external parties rather than treating it. This is unclear as to whether we need to disclose the total costs avoided by not treating the wastewater to the same standard or the net savings after taking into account the net costs of providing the re-use water to an external party. In some circumstances the net cost of providing re-use water may actually be higher than treating on pre-existing inherited arrangements.

Of even greater concern is the cost that TasWater would incur in order to meet with this additional disclosure. TasWater are of the opinion that the provision of this information would be at a substantial cost and would not provide any significant benefit to the Regulator with respect to meeting their objectives as stated in Clause 1.1.1.

**TasWater also requests the Regulator consider excluding the new reporting requirement as the cost and time to prepare it will be substantial. If this is not**

**accepted at a minimum the new clause needs to be re-worded to ensure it is clearer as to exactly what is to be reported.**

### **Regulator's Response**

The Regulator notes TasWater's concern about the costs of providing the requested information. However, the intention behind the inclusion of this new requirement is for TasWater to provide the details of net savings or costs of providing re-use water after taking into account the net costs (eg pumping costs including electricity, repairs to the pipeline) of providing the re-use water to external parties thereby identifying any cross-subsidies that may exist between regulated and unregulated services (as outlined in the Guideline objectives (section 1.1)).

TasWater has advised that all wastewater is treated irrespective of whether it is reused or returned to the environment but the agreements with the end use farmers are inconsistent with respect to volumes and payments for the reuse water.

The Regulator expected that TasWater would have detailed data of the relative costs of re-using wastewater compared to returning that wastewater to the environment and would be able to report on same. However discussions with TasWater have revealed that this is not the case. The Regulator considers that there is therefore little value in pursuing the inclusion of this issue in the regulatory financial statements at this stage. The Regulator does however remains of the view that TasWater should collect and report this data in future.

### **Decision**

The proposed change to Clause 4.4.6 will not be made ie the wording in Clause 4.4.6 of version 1 of the Guideline is to be retained.

However, the Regulator intends requiring TasWater to collect the necessary data with respect to its reuse water activities for submission with its proposed price and service plan for the regulatory period commencing on 1 July 2018.



## 5 CHAPTER 5 – REVIEW AND ADJUSTMENT OF REGULATORY FINANCIAL STATEMENTS TO ACHIEVE COMPLIANCE

### 5.1 Review and adjustment process – Section 5

#### **TasWater submission**

Section 5 of the Guideline represents a fundamental change on the existing approach. TasWater strongly believes that this change is likely to result in the regulatory financial statement process becoming inefficient, noting that final accounts are not due until seven months after the financial year end and four months after the due date for the initial submission.

**Accordingly TasWater requests that the Regulator consider leaving the audit and lodgement process unchanged from the existing Guideline.**

#### **Regulator’s Response**

The current review and lodgement process is not delivering the information the Regulator requires in order to be able to meet its objectives.

The Regulator has consulted with the Victorian Essential Services Commission (ESC) whose process formed the basis of the revised Review and Adjustment process. Based on those discussions the Regulator considers the proposed process addresses the issues identified with the current process.

The Regulator has further reviewed the Review and Adjustment process and, after additional discussions with TasWater, has made further changes to the process particularly with respect to the duration of the regulatory accounts process. The Regulator considers that the further changes to the process eliminates unnecessary steps. This means that the process is more streamlined and efficient. The Regulator understands that TasWater is unable to prepare its regulatory financial accounts until the statutory financial accounts have been finalised. However, the regulatory accounts process should be concluded within three months of TasWater submitting its unaudited regulatory financial accounts

In the additional discussions, TasWater raised concerns about the process within the context of the differences of opinion between the Regulator and TasWater. Due to the nature of regulation, there will be differences of opinion between the Regulator and TasWater. However, the Regulator needs to be satisfied with the methods or evidence that TasWater provides the auditor so as it can be confident that TasWater is complying with the Guideline.

#### **Decision**

Section 5 of the Guideline will be amended to reflect changes to streamline the Review and Adjustment process.

## 5.2 Audit costs – Clause 5.5

### TasWater submission

Clause 5.5 requires TasWater to meet all costs of the auditor yet there is no requirement for the Regulator to advise us of the forecast costs of such services. It would be preferable if the Regulator was required to provide an estimate of the likely costs so we can adequately budget.

**Accordingly TasWater requests that the Regulator consider adding a requirement for the Regulator to provide TasWater with an estimate of the audit costs.**

### Regulator's Response

In accordance with the revised Review and Adjustment process, the Regulator considers that the further changes to the process that have been made to the process following discussions with TasWater should eliminate unnecessary audit costs.

The role of the auditor will not be to give an opinion as occurs with the audit of statutory financial accounts but instead to investigate and report on issues identified by the Regulator in accordance with terms of reference issued by the Regulator.

Under the revised Review and Adjustment process, until the Regulator has reviewed the unaudited regulatory financial accounts, the scale of the audit is unknown. There is a clear incentive for TasWater to provide sufficient supporting evidence. The more evidence and justification that TasWater provides in its unaudited regulatory financial statements, the less issues may need to be resolved.

### Decision

The Regulator has decided against including a requirement in the Guideline for the Regulator to provide TasWater with an estimate of audit costs.

However, once the audit for the first year under the revised Review and Adjustment process has been conducted the costs of that audit will provide a useful guide as to the likely costs for future audits and will therefore assist TasWater in budgeting for these costs.

## 5.3 Regulator's power to require changes to the regulatory financial statements – Clause 5.6

### TasWater submission

Clause 5.6 provides the Regulator with the power to require TasWater to:

- make any adjustment to the regulatory financial statements
- change its regulatory accounting principles and policies to ensure future compliance with the Guideline.

This raises the fundamental question as to who is the owner of these accounts. Is it TasWater and its Directors or is it the Regulator?

The Board are required to sign a Directors' Responsibility Statement which attests to the accuracy of the accounts, however, they do not necessarily have control over the content should there be any disagreement with the Regulator (or the auditor for that matter). In a statutory audit the auditor does not have the power to require the Board to make any amendments. Their powers lie in the type of audit opinion they issue.

**Accordingly TasWater request that the Regulator consider removing this power from the draft Guideline. Ultimately if the Directors are required to sign the accounts they need to be able to control the content.**

#### **Regulator's Response**

The power to change information after it has been submitted so as it complies with statutory/regulatory requirements is no different to that held by the Australian Taxation Office, the Australian Securities and Investment Commission and other regulators.

#### **Decision**

The Regulator's power to require TasWater to amend its regulatory financial statements after those statements have been approved is to be included in the Guideline.

### **5.4 Satisfaction that the regulatory financial statements comply with the Guideline – Clause 5.7**

Clause 5.7 requires the Regulator be satisfied that the regulatory financial statements comply with the Guideline. TasWater are of the opinion that the purpose of the independent auditor is to provide comfort that the accounts comply. The way this clause is currently drafted allows for the auditor to provide this guidance and for the Economic Regulator to form a different view.

**Accordingly TasWater request that the Regulator consider amending this clause to require that the auditor be satisfied that the regulatory financial statements comply with the Guideline rather than the Economic Regulator.**

#### **Regulator's Response**

Under the revised Review and Adjustment process the auditor will be required to report to the Regulator against terms of reference set by the Regulator ie the Regulator will be seeking the auditor's view on a specific aspect of the regulatory financial statements rather than seeking an opinion on the truth and fairness of those statements per se.

While the statutory financial statements are required to be presented as true and fair the Regulator sees no value, in terms of the Regulator achieving its regulatory accounting objectives, in the auditor providing a similar opinion with respect to the regulatory accounts as has occurred under the current Review and Adjustment process.

The Regulator agrees that the auditor, in carrying out the audit, will need to be satisfied that the specified aspect of TasWater's regulatory accounts complies with the Guideline.

However, in its initial review the Regulator will be checking to ensure that the regulatory financial statements comply with the Guideline in the sense that all required information has been submitted.

#### **Decision**

Clause 5.7 will be amended to reflect the revised Review and Adjustment process.

### **5.5 Approval of regulatory financial statements – Clause 5.8**

Clause 5.8 states that upon receipt of the information listed in clause 5.7, the Economic Regulator will approve the regulatory financial statements. This approval makes it unclear as to who is the owner of the accounts (refer to comments in relation to clause 5.6 also).

**Accordingly TasWater request that the Regulator consider amending this clause to simply acknowledge receipt of the final accounts.**

#### **Regulator's Response**

As in the ESC's process the regulator approves the final set of regulatory accounts. The ESC have reviewed the process and have advised OTTER that, from its perspective and in its experience, the process works well.

#### **Decision**

No change to be made to Clause 5.8.

### **5.6 Amending previously approved regulatory financial statements – Clause 5.9**

Clause 5.9 allows the Regulator to amend the previously approved regulatory financial statements if information becomes available that changes the results or values. The clause does not overtly provide any ability for TasWater to have input into whether it agrees with the changes or not.

**Accordingly TasWater request that the Regulator consider amending this clause to require the Regulator to consult with TasWater on any subsequent changes.**

#### **Regulator's Response**

The Regulator considers it reasonable to agree to TasWater's request for the Regulator to provide TasWater with the opportunity to comment on any changes before they are made as part of the Review and Adjustment process.

## **Decision**

Clause 5.9 of the Guideline will be amended to state that the Regulator will provide TasWater with the opportunity to comment on any changes before they are made as part of the Review and Adjustment process.

### **5.7 List of changes required to be made to the regulatory financial statements – Clause 5.10**

Table 1 in Clause 5.10 refers to the Economic Regulator's power to issue a list of changes that TasWater is then required to make to the regulatory financial statements. The ownership of the accounts continues to be brought into question by this approach.

Furthermore, the Table requires TasWater to respond to a list of queries raised by the Regulator. It is TasWater's expectation that the list of queries would come from the auditor and a response be submitted to the auditor, not the Regulator. We are unsure how the auditor can issue an opinion on accounts that have potentially changed due to additional changes that may be required by the Regulator.

As noted previously the Table requires that the Regulator be satisfied that the regulatory financial statements comply with the Guideline. It is TasWater's view that the auditor is the party that needs to be satisfied, with the Regulator then placing reliance on the auditor's opinion. TasWater is of the opinion that this is the most efficient approach.

A further reference to the Regulator approving the regulatory financial statements is provided in the last row of the table. As noted earlier this approval makes it unclear as to who is the owner of the accounts.

#### **Accordingly TasWater request that the Regulator consider;**

- removing the Regulator's ability to enforce changes to the accounts, particularly where they are based on a matter of opinion rather than a definitive fact. If this ability is not removed then TasWater requests that the requirement for the accounts to be signed by TasWater be removed.
- clarifying the role of the auditor given the Regulator appears to be conducting its own review prior to and post that of the auditors. The proposed process creates duplication and inefficiencies.

#### **Regulator's Response**

During the audit the Regulator expects that the auditor would ask questions and seek clarification from TasWater.

It is highly unlikely that the Regulator would seek the auditor's opinion on the accounts per se under the new Review and Adjustment process.

The Regulator will rely on the findings outlined in the auditor report in terms of requiring TasWater to make changes to its regulatory accounts.

The Regulator's initial review is required to identify the issues that the auditor will then be required to review and report back on.

The Regulator has responded to concerns raised by TasWater about the duration of the process by compacting the timeframes but these are achievable only if, for example, TasWater responds to queries within the 14 day timeframes.

The changed process includes only requiring the final set of regulatory accounts to be signed off by TasWater prior to submission ie after auditor's review and after any changes have been made.

### **Decision**

The Guideline will be amended to reflect the further changes that have been made to the steps and timeframes in the Review and Adjustment process in response to the concerns raised by TasWater.

## **6 APPENDIX E - PRO FORMA DIRECTORS' RESPONSIBILITY STATEMENT**

### **TasWater submission**

This statement refers to the **Water and Sewerage Accounting Ring fencing Guideline** in bold font indicating that it is a defined term. However, Accounting Ring fencing is not a defined term. Furthermore, the draft statement now excludes a reference to which version of the Guideline the regulatory accounts have been prepared with respect to. We believe that this is important in order to understand exactly what the signatories are attesting to.

**Accordingly TasWater request that the Regulator consider reverting to the existing language.**

### **Regulator's response**

Due to the changes to the Review and Adjustment process, future audits will be specific and tailored to address specific issues. The purpose of the directors' responsibility statement is to state that the regulatory financial statements comply with the Guideline. The directors' responsibility statement is submitted at the end of the process with the final regulatory financial statements.

### **Decision**

The pro forma directors' responsibility statement will be amended to align the statement with the changes made to the Review and Adjustment process.



## **7 REGULATORY ACCOUNTS TEMPLATE**

### **7.1 Schedule 100A – Disaggregated Income Statement**

#### **TasWater submission**

The Regulator proposes a greater level of detail to be disclosed with respect to revenue in Schedule 100A. TasWater are of the opinion that this statement should remain at a high level as the detail revenue detailed is disclosed within schedule 500J, 500JJ and 500JJJ.

**Accordingly TasWater requests that the Regulator consider retaining the existing Schedule 100A.**

#### **Regulator’s Response**

The Regulator has reviewed Schedules 500J, 500JJ and 500JJJ and agrees that each of those schedules provide the required level of detail as proposed in the revised Schedule 100A.

#### **Decision**

The existing Schedule 100A will be retained in the Template.

### **7.2 Schedule 100B - Disaggregated Balance Sheet**

#### **TasWater submission**

The Regulator has requested TasWater to provide a balance sheet reconciling the audited financial statements with a dissection of regulated and unregulated activities.

While providing an essential pricing and service level regulatory function the Regulator is also charged with the responsibility to manage the regulatory requirements under the Act on a cost effective basis to the industry. The proposed balance sheet dissection in Template 100B in the opinion of TasWater does not provide additional relevant information to support the activities of the Regulator but just increases the complexity and cost of regulatory reporting by TasWater on an ongoing basis.

**Accordingly, TasWater requests the Regulator review the requirement to fully dissect the range of Balance Sheet accounts currently set out in table 100B. The Regulator should be aware of the value of the resultant information given the range of assumptions made to determine the allocation criteria. Particularly in respect of how the balance sheet dissection will aid the Regulator to:**

- Undertake price determination investigations;
- Monitor compliance with relevant price determinations;
- Regulate for monopoly activities;
- Monitor competition and anti-competitive cross subsidies.

### **Regulator's Response**

Standard regulatory accounting practice requires the regulated and unregulated components of a business to be separated to enable regulators to verify the accuracy of the information provided to support the disaggregation of the business activities into those required to provide regulated services and those required to provide unregulated services. The aim of this exercise is to ensure there is no cross-subsidy between regulated and unregulated business activities.

The Regulator requires disaggregation of the Balance Sheet to understand the regulated entity's business, in particular the financial relationships between parts of the regulated entity's business that relate to regulated services and those parts that relate to unregulated services.

Assets used to provide regulated services are used to determine the Regulated Asset Base (RAB) which, in turn, is used to determine the regulated entity's maximum allowable revenue and, ultimately, prices charged to customers.

The Regulator considers that the requirements in Schedule 100B are fair and reasonable and in line with standard regulatory practice.

### **Decision**

No change to Template. The requirement for TasWater to provide a disaggregated Statement of Financial Position (Balance Sheet) is retained.

## **7.3 Schedule 400 – Regulatory adjustment journals**

### **TasWater submission**

This schedule is not supported by commentary as to what its purpose is. TasWater believe that it is to be used to show the adjustments required to the Statutory Financial Statements in order to produce the Regulatory Financial Statements.

**Accordingly TasWater request that the Regulator consider adding commentary as to the purpose of Schedule 400.**

### **Regulator's Response**

The Regulator agrees with TasWater's suggested change.

## Decision

The Template will be amended to add commentary as to the purpose of Schedule 400.

The Regulator will also amend each worksheet in the Template to include a description of the purpose of each Schedule.

## 7.4 Schedule 500AA - Third Party Transactions

### TasWater submission

TasWater is unclear on how the provision of details pertaining to third party transactions in Schedule 500AA (as required by Clause 4.4.4) assists the Regulator in meeting its stated objectives of accounting ring fencing.

**Accordingly TasWater request that the Regulator consider removing the requirement to report third party transactions.**

### Regulator's Response

The Regulator notes and agrees with the reasons provided by the ESC as to the importance of collecting information in relation to third party transactions. That is, the ESC stated that it considered that this information was required to be provided:

...to ensure that it has a more complete understanding of how amounts that have been recorded as the actual cost of providing prescribed services have been determined. Where a business enters into an arrangement with another party to provide services, the contracted amount will generally be recorded as the cost. In most cases, the contracted amounts are likely to be recognised by the Commission as the efficient cost of undertaking a particular activity, particularly where it has been determined through a competitive process or has been market tested.

However, there may be instances where the Commission may need to better understand the basis on which contracted amounts have been determined, particularly where the incentives to minimise the cost of the services may be absent or where the contract is with a single entity to perform a substantial share of the regulated business's activities. By collecting this information as part of the regulatory accounting statements the Commission will be in a position to identify any issues related to how these transactions are treated in advance of undertaking future price reviews.<sup>2</sup>

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<sup>2</sup> Essential Services Commission, *Water Regulatory Accounting Code Consultation Paper*, October 2008, page 18.

## Decision

No change to Template. The current requirement to provide third party transaction information will remain in the Guideline (Clause 4.4.4 of the Guideline) and Schedule 500AA will remain in the Template.

## 7.5 Schedules 500C and 500CC – Indexation of the RAB

### TasWater submission

As noted in *Section 2.1 Definitions*, the CPI definition and timing is incorrect:

- Firstly, the CPI should be the weighted average of the eight capital cities for the four quarters (Sep, Dec, Mar, Jun).
- Secondly, indexation is applied at the start of the financial year not the end of the financial year as per schedules 500C and 500CC which have rows stating 'Inflation adjustment to opening value'. As such the definition for CPI should not refer to the **financial year** to which the **regulatory financial statements** relate. The reference should actually be to the quarters in the preceding year.

### Regulator's Response

The Regulator understands that TasWater has developed systems to report on the basis of previous advice provided by the Regulator in relation to the application of the Consumer Price Index.

On this basis, and as the information currently reported meets the Regulator's requirements, the Regulator will change the Guideline so as the requirements align with the Regulator's previous advice on this issue.

## Decision

Schedules 500C and 500CC of the Template will be amended to align the definition of CPI with the previous advice the Regulator provided to TasWater.

## 7.6 Schedules 500D/500DD – Capex – Regulated water/sewerage services

### TasWater submission

The Regulator has proposed deleting Schedule 500D, however, is silent on Schedule 500DD. These schedules are exactly the same except one is for Water and the other one is for Sewerage.

**Accordingly TasWater request that the Regulator consider removing Schedule 500DD.**

**Regulator's Response**

The Regulator has reviewed the proposed deletion of Schedules 500D and 500DD and, as each schedule provides useful additional information about capital expenditure by cost driver that is not reported elsewhere, considers that the schedules should be retained.

**Decision**

Schedules 500D and 500DD are to remain in the Template.

**7.7 Schedule 500-d – Initial Capex disaggregation****TasWater submission**

Schedule 500-d states that it must agree to Schedules 500D and Schedule 500DD although it appears that these Schedules will be deleted in this version of the Templates.

**Accordingly TasWater request that the Regulator consider removing the requirement for this schedule to reconcile with Schedules 500D and Schedule 500DD.**

**Regulator's Response**

As noted in section 7.6, the Regulator has reviewed the proposed deletion of Schedules 500D and 500DD and, as each schedule provides useful additional information about capital expenditure by cost driver that is not reported elsewhere, considers that the schedules should be retained.

**Decision**

No change - Schedule 500-d will continue to be required to reconcile with Schedules 500D and 500DD.

**7.8 Schedules 500G and 500H - Provisions****TasWater submission**

Schedule 500G and 500H contain several line items that TasWater do not track individually by water and sewerage segments. As an example, provisions for long service leave, annual leave and superannuation are tracked at employee level, however, not all employees are assigned specifically to water or sewer. Employees may work on just water, just sewerage, both water and sewerage or neither. As such the schedule is difficult to prepare and requires substantial levels of allocation. Furthermore, TasWater do not see how this detail assists the Regulator with its stated objectives.

**Accordingly TasWater request that the Regulator consider removing Schedule 500G and Schedule 500H.**

## **Regulator's Response**

The Regulator agrees with TasWater's suggested change on the basis that the information collected via these schedules is not required to enable the Regulator to achieve its regulatory financial statement objectives.

## **Decision**

Schedules 500G and 500H will be removed from the Template as suggested and amend the Guideline as necessary to align the Guideline and the Template.

## **7.9 Schedule 500JJJ - Miscellaneous Fees Income**

### **TasWater submission**

The Regulator requires all revenue noted on this schedule to be directly allocated. This is not actually possible as not all revenue required to be listed in this schedule specifically relates to water or sewerage. As an example Advisory income, service location fees, right to information requests may relate to water, sewerage, water and sewerage or potentially neither. For instance, if a service location fee identifies both water and sewerage services the fee does not change. It is a flat rate for attendance at the property. It would be inefficient and ultimately uneconomic to try and allocate these costs directly between water and sewerage.

**Accordingly TasWater request that the Regulator consider removing the requirement to directly allocate all revenue listed in this schedule. A requirement to justify where costs have not been directly allocated could be included instead.**

### **Regulator's Response**

The Regulator agrees with TasWater's suggestion to include a requirement to explain why costs have not been directly allocated.

### **Decision**

Schedule 500JJJ will be amended to remove the requirement for all revenue to be directly allocated and include a new requirement for TasWater to justify why costs have not been directly allocated.

## **7.10 Schedule 500X – Reuse (Clause 4.4.6 of the Guideline)**

### **TasWater submission**

TasWater is required to disclose the estimated costs that are avoided by providing wastewater to external parties rather than treating it. This is unclear as to whether we need to disclose the total costs avoided by not treating the wastewater to the same standard or the net savings after taking into account the net costs of providing the re-use water to an external party. In some circumstances the net cost of providing re-use water may actually be higher than treating on pre-existing inherited arrangements.

Of even greater concern is the cost that TasWater would incur in order to meet with this additional disclosure. TasWater are of the opinion that the provision of this information would be at a substantial cost and would not provide any significant benefit to the Regulator with respect to meeting their objectives as stated in Clause 1.1.1.

**Accordingly TasWater requests the Regulator consider excluding the new reporting requirement as the cost and time to prepare it will be substantial. If this is not accepted at a minimum the schedule needs to be re-worded to ensure it is clearer as to exactly what is to be reported.**

### **Regulator's Response**

The Regulator notes TasWater's concern about the costs of providing the requested information. However, the intention behind the inclusion of this new requirement is for TasWater to provide the details of net savings or costs of providing re-use water after taking into account the net costs (eg pumping costs including electricity, repairs to the pipeline) of providing the re-use water to external parties thereby identifying any cross-subsidies that may exist between regulated and unregulated services (as outlined in the Guideline objectives (section 1.1)).

TasWater has advised that all wastewater is treated irrespective of whether it is reused or returned to the environment but the agreements with the end use farmers are inconsistent with respect to volumes and payments for the reuse water.

The Regulator expected that TasWater would have detailed data of the relative costs of re-using wastewater compared to returning that wastewater to the environment and would be able to report on same. However discussions with TasWater have revealed that this is not the case. The Regulator considers that there is therefore little value in pursuing the inclusion of this issue in the regulatory financial statements at this stage. The Regulator does however remains of the view that TasWater should collect and report this data in future.

### **Decision**

The proposed change to Schedule 500X will not be made ie the content of Schedule 500X in version 1 of the Template is to be retained.

However, the Regulator intends requiring TasWater to collect the necessary data with respect to its reuse water activities for submission with its proposed price and service plan for the regulatory period commencing on 1 July 2018.

## **7.11 Schedules 500C and 500CC – Regulatory depreciation (Clause 4.4.1 of the Guideline)**

In addition to the issues raised by TasWater in its submission, the Regulator has also identified an issue with respect to depreciation rates.

It has become apparent to the Regulator from further discussions on the Guideline and Template that TasWater is continuing to apply its preferred view of its regulatory depreciation rates and associated methodology in calculating the RABs instead of applying the regulatory depreciation rates and methodology adopted by the Regulator in calculating TasWater's revenue limits under the 2015 Water and Sewerage Price Determination Investigation. The Regulator notes that this issue was subject to substantial discussion during the course of that Investigation.

Given that price changes during the 2015-18 regulatory period are limited by price constraints, TasWater's RABs to date have had no direct impact on prices. However this will not be the case in future regulatory periods as the price transition is completed and the RABs and consequential revenue limits determine prices.

To address this particular issue and to assist the Regulator in gathering information that will be a useful input into future price determination investigations the Regulator will require TasWater to provide additional details about the depreciation rates it has used in calculating the RABs.

### **Decision**

The Regulator will amend Clause 4.4.1 and Schedules 500C and 500CC to require TasWater to disclose, for both Initial Assets and New Assets, the weighted average regulatory depreciation rate it has used for each of the Asset categories listed in those schedules (ie the Asset categories listed in Clause C.5.1 (a) to (d) inclusive).

## **8 ADDITIONAL CHANGES**

In addition to the specific changes discussed in this document, a number of minor drafting changes have been made to the Guideline to include omitted definitions, correct typographical and grammatical errors and to improve the Guideline's clarity.