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WIC Act Cost Allocation Guide  
Independent Pricing and Regulatory Tribunal  
PO Box K35  
Haymarket Post Shop NSW 1240

Dear Mr Harmstorf

## **DRAFT IPART COST ALLOCATION GUIDE**

Hunter Water appreciates the opportunity to comment on the Independent Pricing and Regulatory Tribunal's (IPART's) Draft *Cost Allocation Guide, Water Industry Competition Act 2006* (WIC Act), *December 2017* (the guide).

Hunter Water notes that IPART is preparing the guide to assist service providers in preparing cost allocation manuals (CAMs) for declared infrastructure services. A declared service provider under Section 42 of the WIC Act, must within three months after an infrastructure service becomes the subject of a coverage declaration:

- a) keep separate accounts for such of its infrastructure services as are the subject of the declaration, and
- b) submit a cost allocation manual to IPART in relation to that infrastructure.

Hunter Water does not currently have any declared infrastructure services under the WIC Act. We are therefore not presently required to provide a CAM to IPART. The comments below are provided in the context of the potential application of the cost allocation guide to any future declared Hunter Water services.

### **General comments**

Hunter Water considers that the guide provides a sound framework to assist in the preparation of individual CAMs. In particular we support:

- The proposed governance arrangements outlined in section 2.2
- The stepped approach to cost allocation outlined in the draft guide's section 3
- The guidance on identifying and defining cost objects (S3.1), cost classifications (S3.2), the causality principle in allocating costs (S3.3), allocating costs only once (S3.5), periodic reviews (S3.6)
- The guidance contained in Chapter 4 on the detail required in the cost allocation methodology.
- The checklist and further guidance provided in Appendix A (subject to comments below) and
- The cost attribution examples provided in Appendix B.

### **IPART's guidance should focus on the declared service**

Hunter Water is concerned that the guide's proposed coverage potentially extends well beyond the Section 42 (b) requirement that only requires a CAM for declared infrastructure services. The draft guide states at section 3.1.1 (page 10) that

***"To permit review of the provider's cost allocation methodology, information should also be included on how costs are attributed or allocated to the provider's non-declared services."***

The draft guide states on pages 10 and 11 that in addition to Sydney Water's declared sewerage services at Bondi, Malabar and North Head, that Sydney Water's CAM should cover at a minimum all cost objects related to:

- Services upstream and downstream of the declared services (i.e. sewage treatment and retail services) in the Bondi, Malabar and North Head sewerage systems
- Sewerage services (i.e. sewage reticulation, treatment and disposal retail services) in its other 21 distinct geographic wastewater systems
- Trade waste services (reticulation, treatment and retail) by geographic system, and
- Other wastewater services, by geographic system (eg, ancillary and miscellaneous services).

The services included under the first cost object may be relevant to the allocation of costs to declared services depending upon the specifics of an access proposal. However, the other items are clearly well outside the boundary of the declared services.

Hunter Water notes that the WIC Act does not require service providers to allocate costs to non-declared services. Section 42 (5) of the WIC Act contains a requirement that service providers must ensure that costs are allocated between each declared service and between those services and its other activities, in accordance with the manual. Hunter Water interprets this section as requiring the CAM to set out how a service provider's total costs are allocated between declared services and other activities rather than requiring a detailed costing of those other activities.

We consider that from the perspectives of efficiency and clarity it is important that the cost allocation guide focus on its intended purpose of assisting service providers to prepare CAMs for declared services only. This is consistent with the draft guide's section 3.1 on page 9, which states that

*“In accordance with the requirements of the WIC Act, the subjects of a service provider's cost allocation manual are its **declared infrastructure services**. These are the primary cost objects of the allocation process.”*

From an efficiency perspective the establishment and ongoing implementation of a cost allocation methodology imposes additional costs on a business. These costs include:

- Development of the specific cost allocation methodology
- Modification of financial systems to capture and report the relevant data
- Development and implementation of governance arrangements, procedures and training to ensure the integrity of the data collected, and
- Ongoing data input, reporting and quality assurance.

In relation to a regulated requirement such as development and implementation of a CAM for declared services, any additional costs should be minimised by ensuring that the CAM does not extend beyond its intended purpose.

It is important from a clarity perspective that those seeking access to declared services are provided with costing information that is only relevant to the task of establishing fair and efficient access charges to declared services. A requirement to provide comprehensive and detailed information on unrelated non-declared services would not contribute to that task.

The guide could therefore be improved by establishing a clearer boundary around costing information that is relevant to setting access charges for declared services including relevant examples.

Hunter Water agrees that the costs allocated to declared services should be consistent with those underpinning regulated prices for relevant determination periods (Section 3.5). However, we consider that such alignment could be demonstrated in a transparent manner utilising a service provider's financial management and reporting systems, without the need to undertake a detailed and comprehensive allocation of costs to non-declared services.

The CAM should provide a cost allocation framework and potentially relevant examples of how that framework would be applied to allocate specific costs. However, a CAM should not contain actual costing data which would be subject to change and potentially not relevant to the specific circumstances of an access request.

### **Using cost allocation methodologies for other purposes**

Hunter Water recognises that cost allocation methodologies could be adopted for purposes other than costing declared services under the WIC Act including:

- To facilitate benchmarking of a service provider's costs to assist in determining efficient retail prices, and
- To inform negotiations for voluntary access undertakings in relation to non-declared services.

Before cost allocation methodologies are developed for other specific purposes, Hunter Water considers that there needs to be clarity around the relevance of those purposes, the statutory authority underpinning them and relevant information requirements. It would also be necessary to assess the costs and benefits of specific proposals and proposed timeframes for any next steps.

### **Annual Information Return**

Hunter Water has previously discussed concerns with IPART regarding the considerable time and effort for both organisations associated with analysing, collating and checking the data that goes into Annual Information Return (AIR). We believe that IPART should prioritise a thorough review of the purpose and relevance of all AIR content, taking into account the administrative effort in preparing the various categories of financial and non-financial data and the usefulness of that information for regulatory purposes.

Hunter Water looks forward to the opportunity to work with IPART on the review of the AIR, and anticipates that it should be possible to finalise a streamlined AIR spreadsheet by the end of 2018.

Yours faithfully

Fiona Cushing  
Chief Finance Officer