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Aurizon Network's proposed Costing Manual – QRC Submission

The Queensland Resources Council (QRC) appreciates the opportunity to provide feedback on Aurizon Network's proposed Costing Manual.

We understand that the proposed Costing Manual has been provided under the current (2010) Access Undertaking. Despite this, we consider that any revision of the Costing Manual at this point in time should be designed to meet the needs of stakeholders under the new Access Undertaking (UT4). We have therefore taken into account the QCA's January 2015 Draft Decision on the 2014 Draft Access Undertaking when preparing our comments.

Aurizon Network has proposed only very limited changes to the current approved Costing Manual. Our concerns with the proposed approach are:

- The proposed output of the process, which is limited to three pages of high level financial statements, is of little use to QRC or its members.
- Some of the methodologies specified in the costing manual, including allocation methodologies, would prevent the data (even if provided at a greater level of detail) from being useful.

For QRC and its members, information regarding Aurizon Network's actual costs and revenues is of use primarily because it will assist us to consider and provide submissions on Aurizon Network's claimed Maximum Allowable Revenue ("MAR") under future undertakings. Part 10 of the proposed UT4 requires that Aurizon Network provide a range of reports, of which the Annual Financial report (prepared in accordance with the Costing Manual) is one example. In the following sections, we provide comments on each element of information which is proposed to be provided in these financial statements, and the extent to which this information (when considered in conjunction with the remainder of the reporting requirements under Part 10) is likely to meet our needs.

In addressing information shortfalls, QRC is not concerned as to whether additional detail is provided within the financial statements, or is provided through separate reporting, provided that the principles reflected in the Costing Manual (with amendments discussed below) should be followed when preparing other financial information under Part 10 of the Undertaking.

REVENUES:

Purpose of information: Information on Aurizon Network's revenues is useful for a range of purposes. Information which assists stakeholders to understand the extent and nature of revenue being earned by Aurizon Network beyond the regulated access charges is particularly important. Examples of how this information may be useful include:

- Disclosure of significant 'non-coal' revenue would indicate that certain Aurizon Network costs should be notionally allocated to 'non-coal', reducing the MAR which is recoverable from coal customers under future undertakings.
- Significant amounts of unregulated revenue earned from coal customers is also relevant to cost allocations (such as overheads) and may also be relevant to the consideration of whether the ability of Aurizon Network to levy these unregulated charges can undermine the effectiveness of the undertaking.

Disclosure under UT4: The level of detail proposed under the pro-forma financial statements is inadequate, and there is no additional reporting proposed under UT4. We would suggest that greater detail is required in regard to revenue items beyond regulated access charges, including a separate breakdown for each material additional charge. In the FY2013 financial statements, Aurizon Network reported over \$40 million of revenue in the category "Other".

EXPENSES (OPERATING COSTS):

Purpose of information: When considering Aurizon Network's claimed costs within the MAR for future undertakings, we would expect that QCA and stakeholders will have regard to a range of information, including:

- The actual or approved costs of similar entities (benchmarking).
- Aurizon Network's actual costs.
- Efficient costs estimated through a 'shadow benchmark' approach, in which the efficient cost of activities is directly calculated, rather than derived from the costs of existing operations which may or may not be efficient.

QRC understands that Aurizon Network's actual costs are not necessarily a reliable indicator of efficient costs, however, actual costs are inevitably considered during the assessment process. From QRC's perspective, any evidence that actual costs are below claimed UT5 costs would raise concerns regarding whether the claimed cost is efficient, and we would seek an explanation for the claimed increase.

Disclosure under UT4: The proposed financial statements provide only very high level information regarding Aurizon Network's expenses. This is partially addressed through the proposed Annual Maintenance Cost Report (10.1.3 of the proposed UT4). What is lacking is a similar report for operating expenses including corporate overheads. Such a report (or additional detail within the financial statements) should be prepared and presented on a basis which aligns with the methodologies accepted by the QCA when approving these elements of the MAR under UT4. Therefore:

- Line items/expense elements should be presented in the same categories, and at the lowest

level of detail, for which costs were determined under the final UT4 decision.

- Actual costs should be reported against the comparable MAR allowance, and variances shown.
- All data should be presented separately for each coal system.
- Where actual costs require allocation, the allocation methodology used in the preparation of reports should align with the allocation methodology adopted by the QCA in determining the MAR, rather than allocating on a 'reasonable basis' as proposed under 3.2(c)(ii) and (iii) of the Costing Manual. This would apply to costs allocated from other group entities (such as corporate overheads), and allocations within Aurizon Network (for example, allocations between regulated below rail services and other functions).
- If allocation percentages have varied from those used in the final UT4 decision (for example, a percentage based on the Aurizon Network share of employee numbers has been updated), then the updated and original allocator should be displayed so that changes in underlying costs can be distinguished from changes in allocation percentages.
- Intercompany transfers of costs should be included in Aurizon Network's actual costs only to the extent that the transfer is consistent with the UT4 decision.
- Actual costs should not be replaced by efficient costs in the reports as Aurizon Network proposes in the revised Costing Manual (3.2(b), 4.1(b)(ii)). To the extent that actual costs are higher or lower than efficient costs (as determined by the QCA under each new undertaking), this should be reported. Higher actual costs may indicate an area in which Aurizon Network could improve, or could indicate that efficient costs have been underestimated. Lower actual costs may indicate that efficient costs have been overestimated. In either case, actual costs, including actual costs allocated based on an approved methodology, should be reported. Reporting efficient costs in place of actual costs would provide no useful information, as efficient costs (as approved by the QCA) are already available in the documents which lead to the approval of each undertaking.

DEPRECIATION AND AMORTISATION:

Information on depreciation and amortisation provided in the Statement of Earnings Before Interest and Tax, and the Statement of Assets, is of little use to QRC or its members. Our understanding is that the assets referenced in these statements may not align with the assets in the RAB, and that depreciation rates used may not align with those used for regulatory purposes. Also, the information is not presented for each Coal System. We expect that the information provided in the Annual Regulatory Asset Base Roll-Forward Report (10.1.6 of the draft undertaking) will provide more useful information.

TRANSPARENCY:

QRC seeks transparency of the calculation of approved tariffs, and an ability to compare actual costs with the approved allowances on a like to like basis. We refer to Section 5.2 of the QCA's recent draft decision on Queensland Rail, which states that "access holders are entitled to transparency regarding the calculation of tariffs" and which supports reporting of actual costs against the forecasts which were used to derive tariffs.

COMMENTS ON DRAFTING OF COSTING MANUAL:

QRC seeks improved reporting of Aurizon Network's costs and revenues. The financial statements prepared in accordance with the Costing Manual are of lesser interest. The Costing Manual itself appears an overly detailed description of processes which could be described in a page of dot points as a Schedule to the undertaking. The key requirements from our perspective are that:

- Aurizon Network provides reports containing details set out in Part 10 of the undertaking, which should be expanded to include more detailed information on revenues and costs (similar to the propose Maintenance Cost Reports).
- Cost reports should be prepared in a way which is consistent with the development of the MAR, particularly where costs need to be allocated (including corporate costs).

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Yours sincerely



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