



Telfer Gas Pipeline

Financial Reporting Guideline for non-Scheme Pipelines

Basis of Preparation
April 2019

Contents

1	Introduction	1
2	Pipeline Financial Statements	3
2.1	Sources of information	3
2.2	General methodology and principles	3
2.3	Statement of pipeline revenue and expenses	4
	2.3.1 Revenue.....	4
	2.3.2 Costs.....	4
2.4	Statement of pipeline assets	5
	2.4.1 Asset valuation principles.....	5
	2.4.2 Capitalisation principles	5
	2.4.3 Depreciation principles.....	6
	2.4.4 Shared support assets	6
3	Asset value determined using the recovered capital method	7
3.1	Overview	7
3.2	Sources of information	7
	3.2.1 Original construction cost information	7
	3.2.2 Revenue and operating expenditure	7
	3.2.3 Shared support assets	7
	3.2.4 Return on capital.....	7
	3.2.5 Net tax liabilities	9
	3.2.6 Negative residual values	10
3.3	Estimates	10
4	Weighted average price information	11
4.1	Sources of information	11
4.2	Determination of revenue	11
	4.2.1 Revenue by pipeline	11
	4.2.2 Government fees and charges.....	12
4.3	Pipeline services	12
	4.3.1 Transportation services.....	12
	4.3.2 Stand-alone firm compression services	13
	4.3.3 Firm storage.....	14
	4.3.4 Imbalance/unauthorised overrun charges	14
4.4	Exempt services	14

1 Introduction

In August 2017, the Council of Australian Governments (COAG) Energy Council introduced a new Information Disclosure and Arbitration Framework to apply to gas pipelines that were not subject to other economic regulation. These pipelines are referred to as 'non-scheme' pipelines, and the framework was implemented through a new Part 23 to the National Gas Rules.

The Objective of the Scheme, as stated in Part 23 of the National Gas Rules, is as follows:

- (1) The objective of this Part is to facilitate access to pipeline services on non-scheme pipelines on reasonable terms, which, for the purposes of this Part, is taken to mean at prices and on other terms and conditions that, so far as practical, reflect the outcomes of a workably competitive market.
- (2) This Part is intended to contribute to achieving the objective in subrule (1) by means of:
 - (a) requirements for the publication and exchange of information to facilitate timely and effective commercial negotiations in relation to access to non-scheme pipelines;
 - (b) a commercially-orientated arbitration process to resolve access disputes in a cost-effective and efficient manner; and
 - (c) principles that the arbitrator must have regard to when determining access disputes, which are consistent with the outcomes of a workably competitive market.

As part of the new information disclosure requirements, pipeline service providers must publish specific financial information in accordance with a Financial Reporting Guideline developed by the relevant regulator.

The Economic Regulation Authority (ERA) has prepared a Financial Reporting Guideline as required under Rule 557. This Basis of Preparation should be read in conjunction with that Guideline and Part 23 of the National Gas Rules.

The ERA Guideline creates a new Special Purpose Financial Reporting Framework which differs in significant ways from the normal statutory reporting framework defined by Australian Accounting Standards. Because of these differences, the information produced under Part 23 will not reconcile to some of the financial information prepared by the Service Provider under Australian Accounting Standards.

Part 23 requires reporting in three distinct categories:

- 1) Pipeline Financial Information, which complies with Australian Accounting Standards, except where the Guideline provides a methodology that is not consistent with that disclosed under Australian Accounting Standards;
- 2) An asset valuation under the Recovered Capital Method; and
- 3) Weighted average price information.

The preparation of this information is discussed in this document, with the reports provided in the accompanying templates.

Rounding

Totals in the templates provided may not add due to rounding.

About EII

Energy Infrastructure Investments Pty Ltd (ABN 95 104 348 852) (“EII Pty Ltd”) owns a suite of gas and electricity infrastructure assets.

Service Provider and owner of the Telfer Pipeline asset is EII Transmission Services WA (Operations) Pty Ltd. and the ultimate owner is EII Pty Ltd.

EII Pty Ltd in turn is owned by:

- MC EII Holdings Pty Ltd (“Marubeni”) 49.9%
- Osaka Gas Energy Europe BV (“Osaka Gas”) 30.2%
- Australian Pipeline Limited (“APA”) 19.9%

None of these entities “controls” EII within the meaning of the Australian Corporations Law.

2 Pipeline Financial Statements

2.1 *Sources of information*

APA Group provides operation and commercial services for the Telfer gas pipeline. The APA Oracle financial system is the primary source of financial information. This system supports EII's audited financial statements which are prepared in accordance with the requirements of Australian Accounting Standards and other authoritative pronouncements of the Australian Accounting Standards Board (AASB) and also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Financial information generated by the APA Oracle financial system underpins the reported *Statement of Pipeline Revenue and Expenses* and *Statement of Pipeline Assets* for the following categories:

- **Revenue:** The APA Oracle financial system's revenue recognition complies with the revenue recognition principles prepared in accordance with the requirements of Australian Accounting Standards.
- **Operating direct costs:** EII's operating cost categories are in line with the categories identified in the section 3.1.1.2 of the Guideline.
- **Assets:** Consistent with the ERA Guideline, fixed asset opening cost bases reflect the acquisition value of the assets to the owners of EII Pty Ltd. Post-acquisition capital additions are recorded consistent with statutory financial reporting requirements.

2.2 *General methodology and principles*

Methodologies used for the preparation of the *Statement of Pipeline Revenue and Expenses* and *Statement of Pipeline Assets* are broadly consistent with the methods used in the preparation of EII's statutory financial accounts.

Financial information for the Telfer non-scheme pipeline has been prepared based on the relevant Service Provider's Trial Balance. The *Statement of Pipeline Assets* includes all assets connected with the asset base of the non-scheme pipeline which, consistent with the Guideline, reflects the acquisition value to the owners of EII Pty Ltd.

There are instances where the reporting of non-scheme pipelines does not align with legal entity reporting. In these instances, the financial information provided is generally supported by EII's management reporting, and the information has been further verified through underlying customer contract, third party operating agreements, direct costs and detailed reviews of invoices and asset registers as relevant.

The *Statement of Pipeline Revenue and Expenses* and *Statement of Pipeline Assets* for the Telfer Gas Pipeline has been audited by Deloitte Touche Tohmatsu, in accordance with the Australian Auditing Standards.

2.3 *Statement of pipeline revenue and expenses*

2.3.1 Revenue

In accordance with Australian Accounting Standards, revenue is recognised to the extent that it is probable that the economic benefits will flow to the service provider and can be reliably measured. Amounts disclosed as revenue are net of duties and taxes paid. Direct revenue is earned from the transportation of gas.

Revenue is directly attributed to the pipeline that earns the revenue¹ based on the underlying contract and has been allocated to revenue categories in accordance with the Guideline as direct revenue. In those instances where a type of service does not align with a template category, it has been presented as “other direct revenue” in Table 2.1.1 of the reporting template.

2.3.1.1 *Related party transactions*

The Telfer pipeline does not provide any related party services.

2.3.1.2 *Revenue from Multi Asset Services and allocation methodology*

Where EII provides services across the Nifty and Telfer pipelines under a single contract (“Multi Asset Services”) it is necessary to allocate the revenue from those services across both pipelines providing that service. The allocation methodology for Multi Asset Services is designed to take into account any regulatory and contractual obligations that may dictate the tariffs that would be charged on the individual pipelines used to supply a Multi Asset Service.

Consequently, the allocator that is applied for each revenue item will vary, depending on the specific nature of the Multi Asset Service, and in particular, the non-scheme pipelines involved.

EII considers that this is the most appropriate method of allocation, as it reflects the reality of the regulatory and contractual restrictions on prices (and therefore revenue) that may be earned on individual pipeline segments. This method ensures that, where regulatory and/or contractual limitations apply, the revenue allocated to individual pipeline segments is consistent with those limitations.

The portion of revenue attributed to the service provider is reported as direct revenue in Table 2.1.1 of the reporting template.

2.3.2 Costs

All costs (operating and capital) are invoiced monthly from the operator to EII, identifying the relevant asset to which the cost relates.

The operator has attributed costs directly to projects, activities and services where possible and appropriate.

The reported directly attributable costs and other attributable costs in the *Statement of Pipeline Revenue and Expenses* are inclusive of a margin on outsourced operation

¹ The Nifty lateral, exempt under Part 23, commences at the end of the Telfer pipeline.

under the Management, Operations, Maintenance, and Commercial Services Agreement (MOMCSA) as approved by the AER for EII's regulated assets.

2.3.2.1 *Depreciation expense*

Depreciation expense for the non-scheme pipeline has been calculated in line with the standard lives as set out in Appendix 1 of the Guideline.

2.3.2.2 *Shared support costs*

EII outsources its corporate support costs to APA under the Management, Operations, Maintenance, and Commercial Services Agreement (MOMCSA) as approved by the AER for EII's regulated assets. The total corporate support costs are allocated among the EII assets on the basis of revenue and are reported in Table 2.1 as part of Other direct costs category.

2.4 *Statement of pipeline assets*

2.4.1 Asset valuation principles

Consistent with section 2.3.2 above, all capital is captured in the APA Oracle financial system through cost centre and project reporting. Capital costs are assessed in accordance with *AASB 116 Property, Plant and Equipment*. Once it has been determined that it is appropriate to capitalise the costs, they have been attributed directly as described in section 2.3.2.

The asset values in the *Statement of Pipeline Assets* have used the depreciated book value method, which is consistent with Australian Accounting Standards. The asset values represent acquired cost, plus capital expenditure, less disposals and less depreciation based on the asset lives identified in Appendix A of the Guideline adopted at inception.

No revaluations of the asset base have been included in the *Statement of Pipeline Assets*.

2.4.2 Capitalisation principles

Construction, acquisition, major maintenance and asset replacement costs are capitalised in accordance with *AASB 116 Property Plant and Equipment*. The asset is capitalised when commissioned and any capital work in progress at period end is reported in the *Statement of Pipeline Assets* as "Other depreciable assets".

Consistent with *AASB 116 Property Plant and Equipment*, the cost of major inspections has been added onto the carrying value of the pipeline asset in the capital maintenance line of the reporting template where applicable. Costs of previous major inspections are simultaneously derecognised.

The following costs associated with routine maintenance and repairs are expensed as incurred:

- administration and general overhead costs;
- labour and consumables; and
- staff training costs.

2.4.3 Depreciation principles

Depreciation has been calculated consistently based on the asset lives principles in section 3.2.3 of the Guideline.

For non-pipeline asset classes, EII has applied depreciation principles in line with statutory reporting, which is in accordance with Australian Accounting Standards.

2.4.4 Shared support assets

As EII outsources its corporate support function to APA, EII has no shared supporting assets.

3 Asset value determined using the recovered capital method

3.1 Overview

An asset valuation calculated using the Recovered Capital Method (RCM) is intended to estimate the remaining value of a pipeline asset, in nominal terms, after allowing for ongoing capital expenditure, recovery of operating costs, a commercial return on capital, and tax thereon. It also includes an allowance for end-of-life decommissioning and environmental rehabilitation costs.

This calculation requires information regarding the original construction cost of the pipeline, in nominal terms in the hands of the original project proponent, and annual information on ongoing capital expenditure, operating costs, the required returns on capital in any given year commensurate with prevailing conditions in the market, and an estimate of the tax burden on the return on capital.

Column totals may not add due to rounding.

3.2 Sources of information

While some of the required information can be drawn from published financial information, some cannot be observed, and consistent with section 4.1 of the Guideline, must be estimated or calculated based on a set of inputs.

This section outlines the sources of information applied, and the calculation methodologies and relevant inputs where appropriate.

3.2.1 Original construction cost information

The Telfer gas pipeline was constructed by APA, and accordingly original construction cost information was extracted from the APA financial accounting system and fixed asset registers, as appropriate. Historical archived hard copy documents were consulted where necessary.

Disposals have been recorded at gross historical cost to avoid double counting (book and RCM) depreciation.

3.2.2 Revenue and operating expenditure

Revenue information has been drawn directly from the APA financial systems. For some periods, it was not possible to delineate revenue associated with the Telfer pipeline from that associated with the (exempt) Nifty lateral. This is discussed in Tab 6 of the reporting template.

3.2.3 Shared support assets

As EII outsources its corporate support function to APA, it does not have any shared supporting assets.

3.2.4 Return on capital

The Guideline requires that the return on capital (p20):

... should be determined for each year and should be commensurate with the prevailing conditions in the market for funds and reflect the risks the service provider faces in providing pipeline services.

The return on capital to be reported in accordance with this Guideline cannot be read from the published financial statements; it must be estimated using reasonable input parameters and assumptions as outlined below.

The return on capital has been calculated for each non-scheme pipeline on a stand-alone basis. This approach is consistent with the requirement in Section 3.3 of the Guideline (p18):

Return on assets is to be provided on a standalone pipeline basis.

Capitalisation

In estimating the return on capital for the purposes of the RCM calculation, it is necessary to assume a level of debt and equity capitalisation.

The reported RCM calculations assume that the total capital held by the business in any given year equals the opening value of the RCM capital base plus half the current year capital expenditure. This cannot be read from the statutory financial statements, even where the business is a single asset service provider.

For example, where an asset has been acquired, the amount of debt and equity capital financing held by the business would be expected to reflect the acquisition cost of the asset. It is likely that the amount of capital held by the business would differ from the value of the capital base as reported under the RCM.

Capital structure

The EII RCM analysis commences with an assumed capital structure made up of 60% debt and 40% equity.

In any given year, the outstanding amounts of debt and equity sum to the running total opening capital base as calculated to date under the RCM, plus the current year's capital expenditure.

The original construction cost is considered to be funded according to the opening 60/40 capital structure. However, the capital structure may be amended through the RCM analysis. In particular, where the RCM asset valuation shows a revenue shortfall,² this shortfall is modelled to be made up by additional contributions from equity holders rather than by additional borrowing (following the well accepted principle that lenders will not finance losses). New capital expenditure is assumed to be funded by the 60/40 proportions of debt and equity. Capital expenditure earns a half-year return in the year incurred.

Return on debt

A market interest rate was determined by an expert firm in the financial services sector, reflecting the opportunities for a business such as the service provider to raise capital, including any adjustments to the gearing ratio that may be required. This

² ERA Financial Reporting Guideline p20: "Note that under the recovered capital method, if a service provider has not generated sufficient revenue to recover the operating expenditure, return on capital and net tax liabilities in a year, then the return of capital value will be negative, which will increase the value of the capital base."

analysis allowed a market return on debt to be estimated, having regard to the observed spread above a well-reported swap rate and a premium applied for smaller size and single-asset businesses. The expert firm has calculated a cost of debt for all years included in the RCM analysis.

Return on equity

The return on equity has been estimated using the Capital Asset Pricing Model (CAPM):

$$R_e = R_f + \beta (R_m - R_f)$$

Where:

- R_e is the Return on equity in the relevant year;
- R_f is the Risk Free Rate in the relevant year;
- β is Beta, a measure of the risk of the asset relative to the market; and
- $(R_m - R_f)$ is the "Market Risk Premium".

Historical data set

The data set used to estimate the R_f component for historical years is that developed by Brailsford, Handley and Maheswaran (2012)³ as updated to 31 December 2018.

Beta

The service provider adopts a beta value of 1.0, reflecting the risks the service provider faces in providing pipeline services as a single-asset unregulated pipeline business, subject to the market and the market of its customers.

Market risk premium

A market risk premium of 6.5% has been applied in the Capital Asset Pricing Model as described above. This is consistent with the standard market accepted risk premium over the reporting period.

Return on equity

The calculated return on equity is applied to the "running total" opening RCM capital base multiplied by the equity ratio (as discussed under "capital structure" above).

3.2.5 Net tax liabilities

In order to estimate a net tax liability, EII has adopted a post-tax approach with net tax liabilities, by undertaking an abbreviated tax calculation as below:

1. starting with revenue as reported above;
2. less operating expenditure as reported above;
3. interest expense was taken to match that used in the Return on Capital calculation as discussed above;

³ Tim Brailsford, John C. Handley, and Krishnan Maheswaran. (2012) "The historical equity risk premium in Australia: Post-GFC and 128 years of data" Accounting and Finance, 52 (1), 237-247.

4. tax depreciation was calculated based on accumulated capital expenditure as reported above, with tax depreciation calculated on a straight line basis over a 20 year life, commencing in the year after expenditure; and
5. tax liability was calculated as this taxable income, multiplied by the prevailing tax rate for the relevant year, as shown below. Where tax losses are generated through this calculation, they are accumulated and preserved, and used to offset against future net tax liabilities as they arise.

3.2.6 Negative residual values

The ERA Guideline (p19) and the reporting template provides for a negative residual value to be recorded to account for end-of-life decommissioning and reclamation costs.

EII has not included negative residual values in this reporting.

3.3 *Estimates*

For those few occasions where there were gaps in a series of historical financial information, EII undertook a range of estimation approaches as appropriate to the circumstances:

- where the data stream (revenue, operating expenditure, etc) evidenced a steady pattern, EII interpolated gaps using a straight line methodology; and
- where gaps existed in the capital expenditure stream, EII applied a straight-line approach to interpolate between the historical asset values before and after the gap.

Further detail in relation to estimates are provided in Tab 6 of the reporting template.

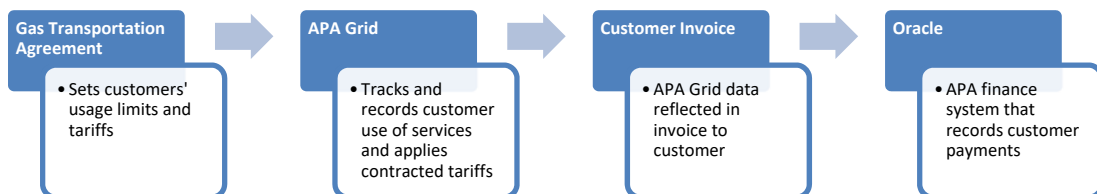
4 Weighted average price information

4.1 Sources of information

EII has used invoice data for each pipeline for each month of the reporting period to derive weighted average price information. Invoice data is the source for both the revenue and usage data required to perform the weighted average price calculation. In all cases, actual revenue and usage data from invoices has been used – there has been no need to estimate revenue or usage information.

Invoice data is derived from “APA Grid”, which is a suite of Information Technology systems that track pipeline usage and apply relevant tariffs to generate invoice data. APA’s Oracle finance system records customer payments.

The prices contained in APA Grid are sourced from Gas Transportation Agreements with customers.



4.2 Determination of revenue

4.2.1 Revenue by pipeline

Revenue has been allocated to individual services in line with contracted services and usage. In most cases, Gas Transportation Agreements include prices that are expressed on a pipeline-by-pipeline basis, and the allocation of revenue between pipelines adopts these individual pipeline prices and contracted usage (for capacity charging) or measured usage (for volumetric charging).

Where a single service is contracted with a customer across multiple pipelines, such that there is no explicit price set for each pipeline segment involved in providing the service, revenue is allocated between pipelines using the allocation methodology described below:

- where regulatory obligations, including those applying to pipelines covered by full or light regulation, specify or limit the price that may be charged on that pipeline segment, the revenue allocated to that pipeline segment will reflect the revenue to be derived from the price that is subject to that specification or limitation;
- where contractual obligations specify a price or revenue arrangement for a pipeline segment, the revenue allocated to that pipeline segment will reflect those specifications or limitations; and

- where allocation is not dictated by regulatory or contractual obligations, revenue will be allocated based on the actual or nominated relative usage of particular pipelines within the service.

This allocation also determines the reporting of revenue by pipeline and pipeline services in EII's financial reporting under section 2.3.1.2 of this document.

The allocation methodology for multi-asset services is designed to take into account regulatory and contractual obligations which dictate the tariffs that would be charged on the individual pipelines used to supply a multi-pipeline service.

Consequently, the numeric quantity or percentage of the allocator that is applied for each revenue item will vary, depending on the specific nature of the multi-pipeline service, and in particular, the pipelines involved.

EII considers that this is the most appropriate method of allocation, as it reflects the reality of the regulatory and contractual restrictions on prices (and therefore revenue) that may be earned on individual pipeline segments. This method ensures that, where regulatory and/or contractual limitations apply, the revenue allocated to individual pipeline segments is consistent with those limitations.

4.2.2 Government fees and charges

In some jurisdictions, governments levy additional fees and charges on pipelines or pipeline licences. Where these fees are passed on by EII through a discrete charge, these charges have not been included in the revenue used to calculate weighted average prices.

4.3 *Pipeline services*

EII has classified pipeline revenue into service type as follows:

- Transportation services
 - Firm forward haul transportation services (includes bi-directional services, if a pipeline operates in a bi-directional manner)
 - Interruptible or as available transportation service
 - Backhaul services
- Stand-alone firm compression services
- Firm storage (combined park and park and loan) services.

EII has determined the pipeline service type of each of its contracted services in line with the nature and substance of the contracted service.

4.3.1 Transportation services

Firm forward haul

Firm services have been identified as those services that provide for the receipt and delivery of gas at specified points up to a reserved maximum daily quantity (MDQ) on a firm basis and without interruption except as expressly permitted under contract.

The Telfer Gas Pipeline is currently a single direction pipeline, firm forward haul service reported values relate to one direction only.

Interruptible or as available transportation services

EII has identified services in the Interruptible, As Available and Authorised Overrun transportation service category as transportation services provided to customers with the following characteristics:

- No firm reserved MDQ;
- Scheduled only on a day-ahead or within day basis; and
- Have a priority below the firm forward haul service.

EII has reported Authorised Overrun services with Interruptible and As Available services, as they are similar in substance to the listed services.

A customer may hold a contractual right to nominate Interruptible, As Available and/or Authorised Overrun transportation services, but not use these services within a reporting period.

EII has used the number of customers with contracted Interruptible, As Available and Authorised Overrun transportation services to determine whether it must publish weighted average price information for these services.⁴

Where there is no usage of Interruptible, As Available and Authorised Overrun transportation services within a reporting period by contracted customers, EII is unable to publish a weighted average price for these services.

EII will publish a weighted average price for these services when there are more than two contracted customers and at least one customer transporting gas under these services in the reporting period.

The reporting units for Interruptible, As Available and Authorised Overrun transportation services are \$/GJ/day.

Backhaul services

Backhaul services are identified as interruptible services provided on a single direction pipeline in a direction other than the direction of firm forward haul services provided on that pipeline.

Backhaul services can only arise on pipelines that offer a firm transportation service in one direction and have more than one gas Receipt Point on the pipeline. As there is only one Receipt Point on the Telfer Gas Pipeline, no Backhaul services are available.

4.3.2 Stand-alone firm compression services

The Telfer Gas Pipeline does not offer firm stand-alone compression services.

⁴ As noted in section 4.4 below, EII is not required to publish weighted average price information in certain circumstances. This includes where a pipeline service was provided, directly or indirectly, to no more than two users of the non-scheme pipeline.

4.3.3 Firm storage

The Telfer Gas Pipeline does not offer Firm Storage, Firm Park, or Firm Park and Loan services.

4.3.4 Imbalance/unauthorised overrun charges

Customers may incur additional charges depending on their nomination and usage behaviour. This includes the potential for Imbalance charges and Unauthorised Overrun charges.

Imbalance and Unauthorised Overrun charges are not considered by EII to be charges for any of the transportation services for which weighted average price information must be published under the Guideline. These charges will not ordinarily be incurred by a customer taking a transportation service, provided that the customer's nominations are accurate.

Therefore, such charges incurred by customers have not been included in the calculation of weighted average prices for the transportation, compression or storage services referred to in the Guideline.

However the revenue from these additional charges has been included as part of "other direct revenue" reporting in Table 2.1 of the reporting template.

4.4 *Exempt services*

Pursuant to Rule 556(3), service providers are not required to publish weighted average price information for a pipeline service if:

- The pipeline service was provided, directly or indirectly, to no more than two users of the non-scheme pipeline; and
- The service provider gives notice to the ERA at least 20 business days before the date required for publication certifying this.

These provisions are intended to maintain the confidentiality of customers on the pipeline. EII has notified the ERA of those services that are exempt from reporting, and listed those services in Table 5.1.1 of the reporting template.

EII provided a Notice to the ERA dated 26 February 2019 certifying that the Firm forward haul transportation services and Interruptible or As Available transportation services were provided to no more than two users during the reporting period.

In accordance with the Guideline, EII has not reported revenue in respect of exempt services on the Telfer Gas Pipeline against the relevant service category in Table 5.1. Instead, revenue associated with exempt services is aggregated and reported under "Total exempt services" in Table 5.1.