REPORT ON THE 2016 FEE FRAMEWORK CONSULTATION

Executive Summary

In January 2016 a revised draft Fee Framework to apply from 1 July 2016 (the "2016-17 Fee Framework") was released for comment. The QCA received ten submissions on the proposed 2016-17 Fee Framework. Based on the submissions received, and an internal audit review of the application of the 2015-16 Fee Framework and associated costing model (a redacted copy of which is attached to this report—**Appendix A**), the following changes have been made to the proposed 2016-17 Fee Framework.

The QCA:

- commits to advise each regulated entity about the detail of the QCA work-plan for that entity for 2016–17 and the resulting fee implications for that period.
- will improve the transparency of QCA costs both at the estimate and true-up phase of the fee process. A pro-forma example of the detail the QCA will provide is attached to the revised 2016-17 Fee Framework (**Appendix B**).
- undertakes to provide regulated entities with early warning of significant cost variances relative to the estimated fee.
- has put in place a mechanism by which the regulated entity and QCA could negotiate a payment plan for large under recoveries.
- will publish the internal audit report (redacted where necessary) on the application of the 2016-17 Fee Framework and associated costing model.

The QCA acknowledges the broad stakeholder support received for these changes and thanks stakeholders for their participation in the consultation process. More detailed responses to the submissions are provided below.

The basis for the QCA charging fees

The QCA's operations are largely funded by fees paid by the entities we regulate. These fees are often passed on to the customers of the regulated entities via a QCA Levy. Section 3 of the *Queensland Competition Authority Regulation 2007 (Qld)* (the Regulation) entitles the QCA to charge fees for providing a service or performing a function set out in Schedule 1 of the Regulation provided the amount charged:

(a) is considered to be reasonable by the QCA; and

(b) is not more than the reasonable cost of providing the service or performing the function.

The majority of submissions demonstrated an understanding of the work the QCA does and hence the basis for the QCA charging fees for the regulatory services it provides. We confirm that the 2016-17 Fee Framework complies with the Queensland Government requirements[1] for recovering the costs of providing the services.

The Queensland Urban Utilities submission recommended the 2016-17 Fee Framework comply with best practice principles issued by the OECD for user charging for government services. We have compared our

[1] As set out in the Queensland Treasury Financial Management Practice Manual - March 2012 and the Full Cost Pricing Policy Statement issued by Queensland Treasury in 2010.

practices (both current and proposed) to the OECD principles and consider that the 2016-17 Fee Framework meets those principles in that the QCA:

- has a clear legal authority to charge fees;
- is consulting with entities on the fee framework;
- determines and charges the full costs of the service it provides unless there is a clear rationale to charge less;
- has an effective and efficient collection system;
- is using the information gathered through the fee process to monitor and improve its performance over time;
- uses appropriate pricing strategies in line with the OECD guidelines; and
- recognises equity considerations i.e. consideration is given to reduced charges for users where full cost recovery would represent an excessive financial burden on individual users.

The OECD best practice guidance also recommends consideration of competitive neutrality. The QCA does not supply a commercial service and is not in competition with a private sector provider. Competitive neutrality is therefore not relevant.

Consideration of the reasonableness of the fee charged

Most stakeholders accepted the QCA's calculation of, and process for setting, regulatory fees. Some stakeholders made comment on the following issues:

(1) Engagement process

(2) Test of reasonableness

(3) Independent review of fees

(4) The 1% review trigger

Each of these issues is discussed below.

Engagement process

A number of regulated entities encouraged the QCA to engage with them when considering the work to be undertaken for the coming financial year and the associated fees for that work.

The QCA notes that its work is, in large part, a function of its statutory obligations. Nevertheless, it accepts that as part of its fee setting process it should provide each regulated entity with information about the work-plan for that entity over the coming 12 months. It also agrees that a more granular explanation of the estimated fee for doing this work should be provided to regulated entities. The QCA will provide regulated entities with financial reports that include a breakdown of costs by analytical staff, consultancy costs and overheads, by regulatory service.

Test of reasonableness

Queensland Rail expressed a view that the appropriate test for reasonableness was not the budgeted or actual cost of providing the service. Aurizon Network suggested that the QCA should consider benchmarking the costs of regulation against those of other Australian based regulators providing similar services.

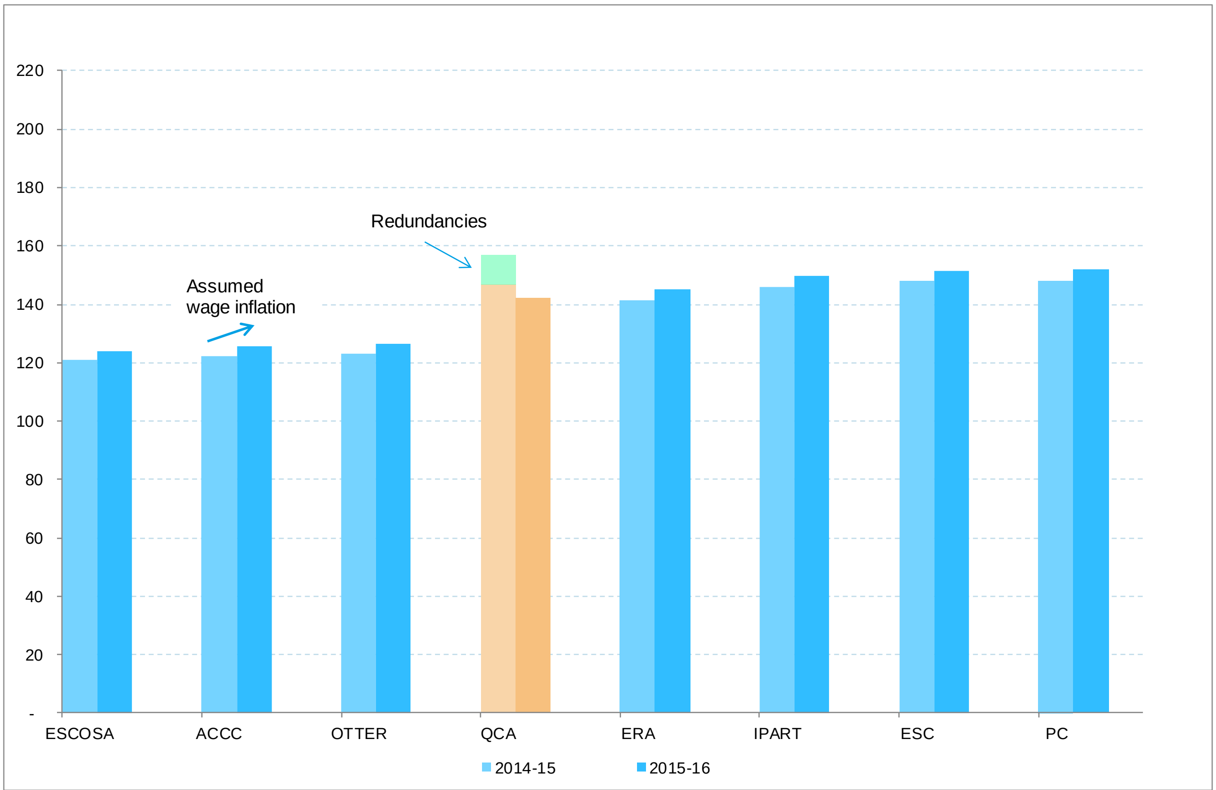
The QCA notes that it is subject to the requirements of the Financial Administration Act and therefore must ensure that the operations of the QCA are carried out efficiently, effectively and economically. In establishing its budget, the QCA considers its work program for the coming year and estimates the required resources to meet its statutory commitments based on its experience in providing the regulatory services concerned. That said, the complexity and size of each project is dependent on a number of factors many of which are outside of the QCA's control or ability to predict. For example, the Brookfield bid for Asciano at the time of the DBCT 2015 DAU review could not have been anticipated nor could the additional work that was required to address the potential ring fencing issues. It is for this reason that the budget can only be an estimate of the costs of providing the regulatory service and that a true-up mechanism is needed at year end to deal with the difference between the actual costs and estimated costs.

Determining what is reasonable is a question of judgement. In this regard, the QCA notes that it reviews the estimated fees to be charged for regulatory services as part of the annual budgeting process. These estimates are based on an assessment of the number of analytical staff required to deliver the project and, an estimate of consultancy costs for the project. A separate allocation for overheads is made in accordance with the fee framework. Taking each of these categories of cost in turn, the QCA makes the following observations.

Staff costs

Excluding consultancy costs, which are project specific and hence variable, staff costs represent approximately 75% of the QCA's fixed costs. The QCA has conducted a benchmarking analysis of its staff costs against data published by other regulatory organisations in Australia. The analysis, which compares total employee costs divided by full time equivalent (FTE) staff numbers, suggests QCA staff costs are in line with those of its peers (see **Figure 1**).

Figure 1 Employee costs per employee ($000)



Source: 2014-15 Annual reports

Consultancy costs

Consultancy costs are project specific and hence they are difficult, if not impossible, to benchmark because very few projects are directly comparable to one another. The QCA observes that consultancy costs are a function of the complexity of the project concerned and the QCA's obligations in respect of that project as prescribed by the QCA Act. To deal with that complexity and those obligations the QCA appoints consultants in line with its procurement policy which complies with the Queensland Government purchasing requirements for government agencies.

Other costs

Other costs are largely overheads. As part of the budgeting process the QCA reviews the expected overhead costs for the coming 12 months. Individual cost items are scrutinised and challenged for prudency and efficiency in line with the QCA's commitments as a Government agency and normal corporate governance practices. When setting the QCA fee the QCA excludes those overhead costs it considers are not reasonable to be charged to regulated entities. For example, in 2015-16 the QCA excluded over $900,000 in rent and other costs expected to be incurred in supporting services now transferred to the Queensland Productivity Commission.

Independent review of Fees

Aurizon Network and Queensland Urban Utilities suggested that it was inappropriate for the QCA to set the level of cost recovery without arms' length oversight and, proposed that an external party should review the reasonableness of the fee.

The QCA notes the QCA Regulation clearly assigns the duty of oversight to the QCA Board. The QCA Board considers that the QCA's audit programme and the Board's oversight of the QCA's finances is consistent with corporate governance best practice. In the absence of evidence to the contrary, the QCA considers that it is unnecessary to impose an additional level of oversight on the fee setting process.

1% Review Trigger

Aurizon Network and Queensland Rail considered that using 1% of regulated annual review as the trigger for initiating a review of fees charged by the QCA is an inappropriate test for triggering a review.

The QCA notes that the commitment to review the fee is in addition to the other considerations of reasonableness discussed in this report. Taken together, the QCA is of the view that the 1% review trigger supplements the controls described in this report and hence it should be retained.

Basis for accounting for regulatory fees

The majority of stakeholders accept that the QCA's calculation of fees and the overhead cost allocation methodology are reasonable. Queensland Rail requested further information about how the services relate to Schedule 1 of the Regulation and suggested that this should be subject to external audit.

The QCA agrees to expand the scope of the internal audit conducted by BDO to include sample-based testing of the costs charged to projects so as to provide a level of assurance that those costs do, in fact, relate to the projects identified in the fee notification documentation.

Queensland Rail suggests that the general overheads of the QCA are not intended, or appropriate, to be on-charged to regulated entities as they are already covered by the general grant from the Queensland Government.

The QCA considers that it meets the requirements of the Queensland Government and OECD best practice guidelines by charging the full cost of its services inclusive of overheads. The QCA's receipt of an annual grant from the Queensland Government has no bearing on the assessment of reasonable costs contemplated by the Regulation.

Queensland Rail has also suggested that regulated entities should not be paying a proportion of all overheads but rather, a proportion of overheads expended on the performance of statutory functions and services listed in Schedule 1 of the Regulation.

The QCA notes the advice of BDO on the question of overhead cost allocation methodology. In particular, the finding that "the use of staff costs as the cost driver for the allocation of corporate overheads is a reasonable method of allocating such costs" and, the observation that "the Authority could develop and use a more sophisticated cost allocation methodology which uses more detailed cost drivers for certain overheads [but]… [in BDO's] view, it is unlikely that this would lead to any material difference in the amount the Authority would allocate to a particular entity." The QCA is satisfied that its current methodology for allocating overheads is reasonable.

Setting regulatory fees in advance

All stakeholders accepted it is reasonable for the QCA to set fees based on an estimate of its costs for regulatory services to be provided over the coming 12 months and that the difference between the actual costs and estimated costs are settled via a true-up of under and over recoveries after year end.

Ergon Energy requested notification of when the actual costs are more than 15% higher than the estimated fee for the period. The QCA agrees to this request and undertakes to provide regulated entities with early warning of significant cost variances relative to the estimated fee.

Aurizon Network suggested the estimation of costs should be informed by s. 147A of the QCA Act relating to time periods and subsequent length of time required to make a decision. The QCA understands its responsibilities in this regard and confirms it takes account of this and other requirements placed on it by the QCA Act.

Queensland Rail suggested that the fee framework should make it clear when the QCA's final decision on costs are made. The QCA confirms that the final decision on the fees for a particular financial year will be made after the end of that financial year when the actual costs are known and the QCA's accounts for that year have been audited.

Reconciliation of settlement of under and over recoveries of Fees

DBCT Management and Aurizon Network both requested consideration be given to delaying the settlement of under and over recoveries by 12 months to better align payments and receipts with the QCA Levy. DBCT Management suggested that where regulated entities receive large over recoveries that cannot necessarily be immediately passed through via the QCA Levy, customers may perceive that the regulated entity is inappropriately benefiting from a windfall gain.

The QCA notes that it is legally required to recover no more than the cost of providing its services. It is therefore more likely that the QCA will be seeking payment of under recoveries each year than repaying over recoveries. Nevertheless, in the event of an over recovery the regulated entity may elect to net these funds against the next year's fees. Both Aurizon Network and Queensland Urban Utilities expressed support for this approach. If actual costs are significantly higher than the estimated costs and the regulated entity affected can demonstrate that the payment of an under recovered fee in October of the relevant year will impose financial hardship, the QCA is open to negotiating a repayment plan that includes compensation to the QCA for the time value of money.

Apportionment of fees to particular sectors

The QCA received a number of submissions in relation to the allocation of regulatory costs between the water retailers in Southeast Queensland. Redland Council, Logan City Council and Unitywater all favoured allocating fees to water retailers in proportion to their market share. Queensland Urban Utilities supported the current approach based on splitting costs equally between all five retailers.

The QCA allocation of costs has, in the past, been determined by the nature of the investigation or regulatory service provided. The QCA is open to allocating fees across regulatory entities in line with the nature of the work performed provided the allocation fairly allocates the costs to the beneficiaries of the service. The 2016–17 Fee Framework has been amended to leave open the question of the allocation of costs for the water businesses until the regulatory framework has been settled. The QCA will consult further with the water retailers regarding this matter when the regulatory regime has been determined.

Pass-through of fee via a QCA Levy

Queensland Rail made representations regarding the pass-through mechanism. These considerations are beyond the scope of this review nevertheless, the QCA confirms that they will be taken into account when it considers QCA Levy applications.

Additional Fees

Queensland Rail observed that the costs of arbitration are not always to be charged to a regulated entity. The QCA understands this point and notes that it has obligations under s. 208 of the QCA Act to assign arbitration costs appropriately. References to these charges have been removed from the fee framework.

Queensland Urban Utilities raised issues where a fee is paid in anticipation of a service being provided but, due to uncertainty regarding regulatory processes outside of either the regulated entity's or QCA's control, the service does not proceed as expected. The QCA Fee Framework has been amended to better respond to these circumstances.

Payment Schedule

The proposal that fees will be invoiced quarterly was not commented on by stakeholders. We have therefore made clear when those invoices will be issued by the QCA.

Appendices

(a) BDO's December 2015 Assessment of the Queensland Competition Authority's Fee Framework and Model

(b) QCA 2016-17 Fee Framework