Assessment of the Queensland Competition Authority's Fee Framework and Model

December 2015

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1 Introduction

The Authority has asked BDO to undertake an independent assessment of:

a) the *QCA Fee Framework 2015-16*; and
b) the associated financial model that is used to calculate fees for the services and functions listed in Schedule 1 to the *Queensland Competition Authority Regulation 2007*.

1.1 Scope

The objective of this assessment is to determine whether, in the opinion of BDO, the application of the Fee Framework and associated costing model produces fees which are reasonable.

The assessment does not comprise:

1. an audit of the source data for the model in a particular year or for a particular regulated entity; nor
2. an audit of whether the Authority's costs are solely for services and functions within scope of the services and functions listed in Schedule 1 to the Regulation; nor
3. an assessment of the reasonableness of the Authority's estimated or actual costs used in the fee calculations in a particular year.

This report on the assessment:

1. summarises, for the information of the Authority, the Fee Framework and how the model applies;
2. provides findings and makes recommendations, again for the information of the Authority, in relation to the Fee Framework and the model;
3. provides an opinion, for the potential information of one or more regulated entities, on whether the Fee Framework and model would produce fees which are reasonable.

1.2 Basis for Charging Fees

Section 245 of the *Queensland Competition Authority Act 1997* provides a regulation making power in relation to:

> … fees or charges for services provided, or functions performed, by the authority.

In consequence, section 3 of the *Queensland Competition Authority Regulation 2007* provides that:

> The fee payable to the authority for providing a service or performing a function mentioned in schedule 1 is the amount -
>
> (a) the authority considers to be reasonable; and
> (b) that is not more than the reasonable cost of providing the service or performing the function.

Schedule 1 to the regulation lists 21 services or functions for which fees are payable.

1.3 Level of Costs and Fees

For 2015-16, the Authority's budget provides for expenditure of $21,323,015. Of this amount, $14,692,662 (69%) will be invoiced quarterly to regulated entities on the basis of the estimated costs for 2015-16, with actual cost adjustments to be made after year-end.

2 Summary of Fee Framework

The Fee Framework and costing model provide the basis for the Authority's assessment of the reasonable cost of providing a service or performing a function.

The main elements of the Fee Framework are:

1. Fees are calculated based on the Authority's estimate of the actual cost of performing the Functions in respect of each regulated entity over the coming 12 months.
2. For each regulated entity, these estimates are the sum of:
   (a) the estimated costs of staff and specialist consultants' advice; and
   (b) a proportion of estimated overheads.
3. Regulatory services and the associated fee will be reviewed if the proposed fee is more than 1% of an entity's regulated annual revenue.
4. Any under or over recovery of actual costs will be adjusted after year-end.

This Fee Framework determines fees based on annual costs, whereas the previous Fee Framework determined fees based on costs over the 5-year regulatory cycle.

The change in methodology reflects the accounting policy change made in 2014-15 to recognize revenue each year on the basis of the cost of regulation that year.

The framework includes a pragmatic measure to simplify its implementation in relation to the Retail Electricity sector – namely that no fees are levied on the small retailers, with their costs being spread across, and recovered from, the larger retailers.

3 Summary of Costing Model

The Authority's costs model has a number of elements, as described below.

3.1 Cost Centres

Staff and specialist consultants' costs are allocated to:

1. industry sectors - for Retail Electricity, Electricity Distribution and SEQ Retail Water, and then to regulated entities within each sector;
2. individual regulated entities - Dalrymple Bay Coal Terminal, Aurizon Network, Queensland Rail and SunWater;
3. corporate services; and
4. non-recoverable costs.

An example of how budgeted costs have been allocated to regulated entities for 2015-16 is in Table 3.1.

Table 3.1: Allocation of Budgeted Costs in 2015-16

Sector	Regulated Entity	Cost Allocations	Fees to be invoiced in 2015-16
Electricity Distribution	Energex Ergon	Equal shares	[redacted]
Electricity Retail	**1,000 or more customers:** Origin AGL Ergon Energy Lumo Energy Energy Australia (TRU) ERM Power Click Energy Qenergy M2 (Dodo)	Estimated share of total customers	[redacted]
	Fewer than 1,000 customers: Integral Energy Australia APG (AGL) Sanctuary Energy Diamond Energy	No charge	[redacted]
Ports	Dalrymple Bay Coal Terminal		[redacted]
Rail	Aurizon Network		[redacted]
	Queensland Rail		[redacted]
SEQ Retail Water	Qld Urban Utilities UnityWater Gold Coast City Council Logan City Council Redlands City Council	Equal shares	[redacted]
Regional Water	SunWater		[redacted]
Total			[redacted]

3.2 Recording of Staff Time

The staffing levels for a year, and their allocation to projects, are estimated in the development of the annual budget.

The actual allocations of staff time to projects are recorded weekly on a time allocation sheet through the intranet. Any adjustments of the estimated staffing costs to the actual staffing costs are made at year-end by reference to the actual time allocation data for the year, as well as any unbudgeted changes to salary costs.

3.3 Cost Allocation Drivers

The Authority uses a single cost driver – staff costs - to allocate corporate overheads.

Corporate overheads are allocated to regulated sectors and entities in the same proportion as the cost of Staff Salaries for those sectors and entities. The Staff Salary costs for each sector and entity are the gross payroll costs for each employee working on that project, including the Peer Review team members.

3.4 Options to Refine the Model

3.4.1 Time Recording

The Authority could implement a daily time recording system for allocating staff costs.

As changes in staff allocations between projects are recorded on a weekly basis, our view is that it is very doubtful that a move to daily time recording would provide a more reliable method of allocating costs to regulated sectors and entities than the current system.

3.4.2 Cost Drivers

The Authority could develop and use a more sophisticated cost allocation methodology which uses more detailed cost drivers for certain overheads (such as rent based on the floor space allocated to each project or team).

In our view, it is unlikely that this would lead to any material difference in the amount the Authority would allocate to a particular entity.

3.4.3 Invoicing Actual Costs Quarterly

The Authority could calculate its actual costs on a quarterly basis and recover these, rather than one-quarter of its estimated costs for the year, through the quarterly invoices.

The disadvantage of this option is that some actual costs would not be known until after the end of each quarter, or at year-end. This would include the significant cost of consultancies undertaken during the year. As well, it would require the year-end cost accruals, such as for employee leave entitlements, to be calculated quarterly (and which, in any case, are estimates).

This option would only change the timing of the recovery of costs for a year, and would not reduce the level of fees for any particular regulated entity.

4 Findings and Recommendations

4.1 Findings

Our findings in relation to the Fee Framework and costing model are as follows:

1. the accounting for staff costs and consultancy costs to cost pools for the regulated sectors (Retail Electricity and Electricity Distribution) and to the other regulated entities (Dalrymple Bay Coal Terminal, Aurizon, Queensland Rail and SunWater) is accepted practice in cost accounting;
2. the equal allocation of staff costs and consultancy costs to the two entities within the Electricity Distribution sector (Energex and Ergon) is reasonable, given that much of the Authority's now reduced workload between these entities is similar;
3. the allocation of staff costs and consultancy costs to the larger entities within the Retail Electricity sector based on customer numbers, is equitable and reasonable as the regulatory effort varies with the size of entity, and the smaller retailers collectively only account for 0.13% of customers (which proportion equates to $3,010 of the overall costs for that sector);
4. the equal allocation of staff costs and consultancy costs between the five entities in the SEQ Retail Water sector is reasonable, given that there is a separate regulatory report provided on each entity;
5. the use of staff costs as the cost driver for the allocation of corporate overheads is a reasonable method of allocating such costs.

4.2 Opinion on Reasonableness

In our opinion, the Authority's Fee Framework and model provide a basis for setting reasonable fees for regulated entities, based on the allocation and recovery of the Authority's costs.

No opinion is given on whether the Authority's estimated or actual costs for a particular year have been reasonably allocated in determining the fees for a particular regulated entity or for all regulated entities.

4.3 Recommendations

Based on the above findings, we make no recommendation for improvement to the Authority's costing model.

At the same time, we propose some revisions to the Fee Framework so that it more precisely reflects the wording of the Regulation, the Framework's objective, and the way the model applies in practice:

a) *Basis of calculating fees for general regulatory services* – replace the section with:

"The fees to be paid to the QCA for general regulatory services by a regulated entity that is subject of the QCA's fee charging regime will be calculated by the QCA based on its estimate of the cost of providing the services and performing the functions in respect of that entity over the coming 12 months, as later adjusted to the actual costs.

The QCA's costs of providing the services and performing the functions in relation to a regulated entity will be the sum of:

a. the cost of staff providing services and performing functions in relation to that entity; and

b. the cost of specialist consultants' advice incurred in providing services and performing functions in relation to that entity; and

c. a reasonable proportion of overhead costs.

The overhead costs will be allocated across the regulated entities in proportion to the cost of staff providing services and performing functions in relation to those entities."

b) *Reasonableness of fees* - delete that phrase "in respect of the retail electricity industry" - to clarify that the statement applies to all regulated entities.

c) *Fees payable* – replace the second sentence with "Any under or over recoveries of fees for the financial year will be accounted for at year-end when the actual costs are known." – this leaves it open to make refunds or issue adjusting invoices in July, as needed, rather than waiting for the audit.

d) *Review of fees* – delete the phrase ", after the accounts have been audited" – for the same reason as for c) above.