

30 November 2016

Queensland Competition Authority
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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 (October 2016 revision).

QRC previously provided comments (19 October 2015) on an earlier draft Costing Manual. The 2016 version includes significant changes, most of which respond to the suggestions provided in our October 2015 submission. We generally welcome the proposed changes, subject to the remaining comments provided in this submission.

Our comments on the current draft will be provided in two parts. Firstly, we will comment on the key changes as summarised in Aurizon Network's covering letter. Secondly, we will comment on the adequacy of the information which we would expect to receive if the proposed Costing Manual was approved.

Key changes (2016 draft versus 2015 draft):

- Statement of Earnings replaced by Statement of Earnings Before Depreciation, Amortisation, Interest and Tax. We have no concerns with this proposed change, primarily due to the information regarding depreciation which is available in the RAB Roll Forward Report.
- Removal of Statement of Investments: We have no concerns with this proposed change, due to the information which is available in the annual capital expenditure claim.
- Additional notes to the financial statements:
 - Original and revised allocators: We welcome this additional information, which was requested in our previous submission. Aurizon Network has stated that this information will be provided "*so that changes in the underlying costs can be distinguished from changes in allocation percentages*". However, it is not clear to us whether the relevant costs will be reported only in aggregate (for example, as "Corporate Costs"), or by individual item (using the breakdown in table 4.4). For information regarding changes in the allocators to be useful, we would require reporting of the relevant line items, which was also requested in our previous

submission. The note to the statements described in Part 5.3(h) of the Costing Manual may be intended to provide this information, however, we would suggest that this should be clarified.

- Reporting on self-insurance in accordance with section 3.7.2 of the undertaking: Supported.
- Alignment of costing methodology for corporate costs to the methodology used in the calculation of the approved UT4 allowances: We welcome this change and note that Aurizon Network states that this change has been made “so that a comparison can be made between actual costs and approved allowances”. As noted above, this will only be possible if the cost elements are disclosed at the same level of detail as the approved costs within the final UT4 decision, and it is not clear to us whether this is Aurizon Network’s intention.
- Aurizon Network has retained the Statement of Assets within the Financial Statements, but proposed that the QCA give consideration to its deletion. QRC would have no objection to the deletion of this report.

Adequacy of information:

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 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.

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.

Proposed disclosure: The level of detail proposed under the pro-forma financial statements is inadequate. 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.

Proposed disclosure: As was discussed above, it is unclear to us whether the notes to the financial statements are intended to include a breakdown of costs at the level of detail adopted for the approval of the MAR (including a breakdown of Corporate Costs into the categories shown in table 4.4 of the Costing Manual). As explained in our previous submission, we suggest that:

- 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.
- Data should be presented separately for each coal system where relevant (although we note that this breakdown is separately available for maintenance, and is not meaningful in the case of allocated corporate overheads).

Thank-you for considering our submission. We note that Financial Statements based on a Costing Manual have not been prepared for the 2014, 2015 or 2016 financial years, and will be prepared following approval of a revised Costing Manual. As this information will be useful when considering Aurizon Network's claims under UT5, we would encourage discussion between stakeholders and the QCA regarding an expedited process for review and approval of a Costing Manual.

Please contact me on 3316 2502 if you have any questions or would like to discuss our submission.

Yours sincerely



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