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3 November 2017

Dr Michael Vertigan
Independent Chair
Gas Market Reform Group
COAG Energy Council Secretariat
GPO Box 787
Canberra ACT 2601

Dear Dr Vertigan

Draft Financial Reporting Guidelines for Non-Scheme Pipelines – Consultation Paper

Santos welcomes the opportunity to provide comments on the Gas Market Reform Group's (GMRG) consultation paper on the draft financial reporting guidelines for non-scheme pipelines.

Santos is supportive of the GMRG's proposal to develop consistent financial reporting guidelines to assist in balancing the current information asymmetry when negotiating price and non-price terms with pipeline owners. This reform if implemented as intended should assist with contract negotiations leading to lower cost transport for downstream users.

As requested, Santos has provided a response to some of the detailed design questions raised by the GMRG in the table below.

Should you have any questions in relation to this letter, please contact me at matt.sherwell@santos.com or on (08) 8116 5824.

Yours sincerely

Matt Sherwell

Manager Policy & Regulatory Affairs
Santos Ltd

Feedback Template

	Questions	Feedback
3	**Entity financial statements**	
1.	What existing entity level financial statements are prepared by service providers? • Are these existing statements prepared in accordance with Australian accounting standards or international financial reporting standards? • Where the pipeline is operated by a joint venture, does the joint venture prepare financial information?	
2.	Do you think service providers should be required to provide annual reports for the entity that owns or operates the pipeline? • If so, please explain what benefits you think this information will provide users that are seeking access to the services provided by non-scheme pipelines. • If not, please explain why not.	Entity level financial reports would be of limited value where the owner/operator has multiple asset interests. This is likely to be the case for the majority of all pipeline owners on the east coast.
3.	Are service providers likely to face any challenges publishing entity level financial statements?	

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4.	If entity level financial statements are not required, do you think there would be value in requiring the service provider to report the entity level return on assets and return on equity?	A return on equity is specific to the financing structure put in place at the entity level. Each individual pipeline may have a different financing structure commensurate with risk profile of the pipeline. We do not believe this information is relevant.
4	**Pipeline financial statements**	
5.	Are there any categories of revenue missing from the income statement that you think should be reported? If so, please what information is missing is and why it is required?	
6.	Are there any categories of revenue that be particularly difficult to find a basis for allocation to a pipeline?	
7.	Are there any categories of expenses missing from the income statement that you think should be reported? If so, what information is missing is and why is it required?	
8.	Should interest expense and tax expense be required to be included in the pipeline income statement?	
9.	Are there any categories of assets and liabilities missing from the balance sheet that you think should be reported? If so, please what information is missing is and why it is required?	
10.	Should liabilities and equity be disclosed in the pipeline balance sheet?	

	Questions	Feedback
11.	Do you think any additional notes should be provided to the financial statements?	
12.	Do you think any other financial statements (e.g. cash flow statements) should be published? If so, please explain what value this would provide prospective users when assessing the reasonableness of an offer.	A cash flow statement would assist the reader identify the non-cash income and expenditure line items that would assist a user estimate the actual cash flow to equity holders, or in other words, the return on capital achieved by the owner.
13.	Is it feasible to report pipeline financial information in the event the pipeline is owned by multiple service providers (e.g. through a joint venture)? If so, what process do you suggest is used to identify the service provider responsible for publishing pipeline financial information?	
14.	Should asset value impairments be allowed? If so, in what circumstances?	
15.	Do you have any concerns with the use of acquisition values for the purposes of calculating the book value used in the Balance Sheet? If so, please explain why.	
16.	Do you agree with the proposed capitalisation principles?	
17.	Are there any categories of revenue, costs, assets or liabilities which will be particularly difficult to find a basis for allocation to a pipeline?	
18.	What difficulties arise in allocating interest and tax expenses to an individual pipeline?	Some users may simply look at the historical financial result on an ungeared, pre-tax basis which would make it easier for the user to benchmark against other comparable

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		pipelines (for example, comparing fair market rates of return). If this is the case, the allocation of interest and tax is largely irrelevant.
19.	Do you think shared costs should be separated into the various categories in Section 4.1.1 of the draft guideline, or is it sufficient for these to be reporting as one line "shared costs"?	
20.	If liabilities and equity are disclosed in the pipeline balance sheet, how should shared debt / equity be allocated?	Some users may simply look at the historical financial result on an ungeared, pre-tax basis which would make it easier for the user to benchmark against other comparable pipelines (for example, comparing fair market rates of return). If this is the case, the allocation of debt and equity is largely irrelevant.
21.	If allocation principles form part of an arbitrator's final determination under Part 23 of the NGR, should the service provider be required to note this in the pipeline financial information?	
22.	Are there any methods, principles or inputs that you think should be specified in the guideline?	
23.	Should the pipeline statements (performance metrics) show the return on equity for the pipeline, or is it sufficient to show the return on assets only? What benefit could shippers derive from understanding a pipeline's return on equity?	
24.	What other financial performance metrics would be useful to shippers and why?	
5	**Recovered capital**	
25.	If a service provider does not have records of all the historic information required to apply the recovered	

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	capital method (either due to the age of the pipeline or because the pipeline has changed hands), what steps do you think the service provider should be required to demonstrate they have taken to obtain this information?	
26.	If the service provider has exhausted all avenues for obtaining this information, do you think it should be required to develop an estimate of the missing information? • If not, please explain why not? • If so, what guidance should be provided in the guideline on how these estimates are to be generated?	To the extent historical information is not available to accurately estimate the current capital base, a methodology to estimate construction cost and historical return generated could be as follows: • Construction cost: estimate current replacement cost and convert back to 'dollars of the day' using actual CPI data when the pipeline was constructed. • Historical return on capital: Assume the pipeline has achieved a rate of return equal to the prevailing risk free rate for that year plus an appropriate risk premium commensurate with the pipeline risk.
27.	If estimates are permitted: • how reliable do you think the estimates are likely be and is there a risk that this information could be misleading to shippers? • how could estimates be tested or reviewed to ensure they have been arrived at on a reasonable basis and reflect the best estimate in the circumstances? • what level of certification is relevant / possible if the information is based on estimates?	The estimate above could be either prepared by a Valuations Expert or reviewed by a Valuations Export by issuing an indicative opinion. A Valuations Expert would be a party who has an appropriate AFSL and relevant experience in providing valuation advice and/or Independent Expert Reports.
28.	Are there likely to be any challenges including shared assets in this valuation approach?	

	Questions	Feedback
29.	Are there likely to be any challenges in determining a commercial rate of return for each year (including the rate of return for a previous owner of the pipeline)?	
30.	Is any further prescription required regarding what net tax liability amounts consist of?	
	Other feedback provided - asset valuation with rule 569(4)	DRG section 5(b)(i) uses a "term cost of construction". This term appears to be defined in section 4.2.2 under the Construction Cost section to include the acquisition cost of the pipeline and not just the cost of construction. The effect is that the Asset Valuation methodology that is intended to look at capital recovered doesn't actually achieve this as the asset value is reset every time it was bought or sold. DRG section 5(b)(ii) uses a defined term Capital Expenditure. This Term is defined on and references section 4.2.2 which under the Construction Cost section again then allows the acquisition cost to be included in the asset value methodology. DRG section 5 under the bullet "For shared assets" allows acquisition costs if the asset is not of a type constructed by the service provider. This would easily allow for pipeline owner that did not build the pipeline to claim acquisition costs, again defeating the purpose of the recovered capital method.
	Other feedback provided – forecast demand information	A number of key pieces of information are required to generate an estimated tariff using the recovered capital method. There are certain key pieces of information where there is not a reasonable publicly available view, these are: • the capital base of the pipeline - provided for in Section 5: *Asset valuation in accordance with rule 569(4)*; • price information for each revenue generating pipeline service - provided for in Section 6: *Requirement to publish weighted average price information*; and • a forecast demand profile for each revenue generating pipeline service – for example, firm capacity.

	Questions	Feedback
		With regard to the forecast demand profile it is unlikely a potential shipper would be able to generate a reasonable estimate of forecast demand given the confidential nature of GTAs. Together with weighted average price information pipeliners should be required to provide an appropriate long-term demand forecast for each pipeline service by the pipeline owner to potential shippers. This forecast should include detail of demand which is contracted and demand which would be expected to be recontracted, together with an explanation of assumptions used to create the forecast.
6	**Weighted average price**	
31.	Do you agree with the proposed approach to calculating weighted average prices by service type and charging method? If not, please explain why not and set out the alternative methodology you think should be employed.	
32.	Should estimates be allowed where agreements do not separate revenue? If not, how should these revenues be allocated?	
33.	Is the proposed level of disaggregation of services appropriate, or could some service categories be aggregated and still provide a meaningful benchmark against which prices and offers can be compared?	
7	**Certification**	
34.	What level of assurance is appropriate for the pipeline financial statements? Would this change if	

	Questions	Feedback
	there is information in the pipeline statement that is required to be estimated?	
35.	What level of assurance is required for the asset valuation carried out using the method set out in rule 569(4)? If agreed upon procedures are appropriate, what should these procedures be?	The valuation could be either prepared by a Valuations Expert or reviewed by a Valuations Export by issuing an indicative opinion. A Valuations Expert would be a party who has an appropriate AFSL and relevant experience in providing valuation advice and/or Independent Expert Reports.
36.	What level of assurance is required for the weighted average pricing information? If agreed upon procedures are appropriate, what should these procedures be?	
37.	What mechanism should be used in the guideline to ensure any revisions to accounting standards are reflected?	
38.	Where there are changes in accounting standards, should the service provider be required to outline the impact of changes in accounting standards, or is it sufficient for the guideline to state the information prepared for prior periods should not need to be amended for changes in accounting standards?	
39.	What level of assurance is appropriate for initial reporting requirements? Why?	
8	**Confidentiality**	
40.	Do you think that any of the information required by the draft guideline is confidential? If so: • What information do you believe is confidential and why?	

	Questions	Feedback
	• What impact would the disclosure of this information have on service providers?	
41.	How could this information be presented to avoid confidentiality concerns but still meet the objectives of the NGR? For example, could this information be aggregated in a manner that was still meaningful?	
42.	Is a confidentiality regime required? If so, how do you suggest this should operate?	