

# IPART REVIEW OF THE WORKING CAPITAL ALLOWANCE



SUBMISSION TO INFORMATION PAPER  
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## HUNTER WATER'S ASSESSMENT

### 1.1 Prepayments

IPART proposes to exclude prepayments from the calculation of working capital on the basis that these amounts have been either or small in past years. This position assumes no changes to commercial procurement practices and the negotiation of payment terms over coming price periods. Hunter Water considers that IPART should retain prepayments in the method for calculating net working capital, only including an amount for this component where the utility can demonstrate material and efficient prepayment costs.

### 1.2 Measuring receivables

IPART currently assumes that a water business delivers its services smoothly over each billing cycle, pays the associated costs as it delivers its services, and is paid by its customers at the end of each cycle for services that it has already delivered.<sup>1</sup> IPART calculates the working capital required for receivables based on half the number of days in the billing cycle. This number of days accounts for the businesses' average holding cost period for receivables before payments are received.

However, IPART note that its current method does not provide for:

- a delay between the last day of the billing cycle and when the business receives payment, and
- cases where water businesses bill a proportion of fixed charge in advance which means that customers provide a proportion of a businesses' working capital requirements.<sup>2</sup>

Hunter Water currently bills customers three times a year. Fixed charges are billed in advance and usage charges in arrears. Our customers are given 21 days to pay their bills from the date of issue.

Hunter Water is currently planning to introduce quarterly billing. which will need to be taken into account in the future calculation of our working capital allowance. We will document the timing and impacts of this for the working capital allowance in our 2019 price submission.

We note that the net impact of IPART's proposal to adjust receivables to reflect the billing payment delay and payment of fixed charges in advance would be a reduction in Hunter Water's working capital allowance. Under IPART's proposed approach, the net number of days that Hunter Water bills in arrears for fixed charges are zero. That is, over each of the three billing cycles the days of fixed charges received in advance equals the days of fixed charges received in arrears.

#### ***Unbilled usage charges on unread meters***

Hunter Water considers that IPART's method should take into account the unbilled revenue associated with unread meters throughout the year. Usage charges are all recovered in arrears for a four-month period until the date of meter reading, followed by addition delay between data verification and invoicing.

During 2017-18, Hunter Water's accrued outstanding revenue on unread meters averaged \$23.9 million each month – \$23.1 million for water and \$0.8 million for wastewater. We suggest that Hunter Water would propose a way of incorporating unbilled usage for unread meters in the working capital allowance as part of our 2019 price submission.

#### ***Bill payment delays***

Hunter Water charges interest on overdue accounts after 22 days. Hunter Water has previously implemented a late payment fee but does not currently charge any additional amount.

Hunter Water does not charge interest on overdue accounts for those on a payment plan – under hardship arrangements or where Hunter Water has agreed to an instalment plan with the customer or if they contact Hunter Water and request an extension. On average, we have around 10,000 residential customers and

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<sup>1</sup> Ibid, page 6

<sup>2</sup> Ibid, page 6



around 500 non-residential customers per quarter request a payment plan or extension. We carry about \$6.5 million in debt that is under one of these arrangements or not paid after 90 days.

Hunter Water asks IPART to consider an adjustment to the benchmark number of days of delay to factor in the assistance provided to customers who have difficulty paying bills within the 21 days.

### **1.3 Measuring inventory**

The information paper notes that IPART currently measure inventory in days of operating and capital expenditure. IPART decide on the appropriate number of days with reference to the business's actual historical data and/or other relevant information.<sup>3</sup>

IPART consider that its current approach to measuring inventory is problematic in that it can lead to unrealistic variations in inventory due to factors such as wage increases or lumpy capex. IPART also considers that given that inventory for a regulated business is likely to be made up of items such as spare parts and inputs such as chemicals there is no reason that it should vary in proportion to capex.<sup>4</sup>

Accordingly, IPART propose to measure inventory as a fixed dollar amount that remains unchanged in real terms over the determination period.

Hunter Water supports IPART's proposed use of a fixed dollar amount to measure inventory. Hunter Water's inventory costs tend to be relatively stable. In our case we would propose using the annual average inventory cost over a regulatory period as the fixed amount. This could be adjusted for any significant annual variations.

### **1.4 Applying a nominal WACC**

Hunter Water agrees with IPART that it is appropriate to use a nominal WACC to calculate the return on working capital. Unlike the Regulatory Asset Base (RAB), which is rolled over at each pricing determination and indexed for inflation, working capital is not rolled over. Accordingly, IPART's use of a nominal rate of return for the working capital allowance provides a business with compensation to cover the cost of inflation through the price period.

Hunter Water also supports IPART's reasoning for adopting a business's full WACC to calculate the working capital allowance rather than its cost of debt or calculating separate WACC's for the RAB and working capital allowance.

### **1.5 Measuring payables**

Hunter Water understands that IPART intends to maintain its current approach towards calculating the payables component of its net working capital calculation. Under this approach payables are measured as 30 days of forecast annual capital and operating expenditure.

Hunter Water's purchasing procedure in relation to payment of accounts provides that payments will be made consistent with contractual obligations between Hunter Water and third parties. In the event of simple supply arrangements, payment will be made in 30 days. This is consistent with Hunter Water's practices.

Hunter Water supports IPART's proposal to maintain its current approach towards measuring payables.

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<sup>3</sup> IPART, 2018, page 7

<sup>4</sup> IPART, 2018, page 7



## REFERENCES

Independent Pricing and Regulatory Tribunal, 2018, *Review of working capital allowance*, Sydney, August

Deloitte, 2018, *Return on Working Capital in the Notional Revenue Requirement – Final report for the Independent Pricing and Regulatory Tribunal*, July