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**Republic of the Philippines**

**ENERGY REGULATORY COMMISSION**

**San Miguel Avenue, Pasig City**

**BUSINESS SEPARATION GUIDELINES,  
As Amended**

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As Amended**

Pursuant to Section 36 of Republic Act No.9136 known as the Electric Power Industry Reform Act of 2001 and Rule 10.1 of the Implementing Rules and Regulations issued pursuant to that Act, the Energy Regulatory Commission hereby promulgates the following Guidelines for business separation and structural and functional unbundling of the business activities of Electric Power Industry Participants.

# **BUSINESS SEPARATION GUIDELINES**

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**ARTICLE I  
GENERAL PROVISIONS**

**1.1 Purpose**

The purpose of these Guidelines is to provide the framework and rules for the structural and functional unbundling of the business activities of Electric Power Industry Participants so as to, among other things:

- (a) implement the unbundling requirements of Section 36 of the Electric Power Industry Reform Act (the EPIRA) and Rule 10 of the Implementing Rules and Regulations issued pursuant to that Act (the IRR), namely to unbundle at least generation, transmission, distribution and supply activities and to have a clear separation of operations and accounts between regulated and non-regulated business activities;
- (b) implement the requirements of Section 20 of the EPIRA and Rule 6, Section 11 of the IRR that separate audited accounts be maintained for each related business undertaking in order to ensure that the transmission business conducted by TRANSCO or its Buyer or Concessionaire neither subsidizes in any way such business undertaking nor encumbers its transmission assets in any way to support such business;
- (c) implement the requirements of Section 26 of the EPIRA and Rule 7, Section 5(c) of the IRR that separate audited accounts be maintained for each related business undertaking in order to ensure that the distribution business conducted by a Distribution Utility neither subsidizes in any way such business undertaking nor encumbers its distribution assets in any way to support such business;
- (d) ensure that the costs of regulated services and activities are allocated on a fair and reasonable basis and reflect the efficient costs of the respective services and activities; and
- (e) monitor compliance with the prohibition on cross-subsidies contained in this Guideline.

**1.2 Content of the Guidelines**

These Guidelines set out:

- (a) the rules and principles for the separation of accounts necessary to satisfy the requirements of the EPIRA and the IRR as described in Section 1.1 above, including:

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- (i) the accounting records that must be maintained;
  - (ii) the requirements and format for reporting to the ERC and when such reports must be provided to the ERC;
  - (iii) how revenues and costs must be allocated, including between regulated and non-regulated activities;
  - (iv) how certain intra-group transactions must be reported; and
  - (v) audit requirements.
- (b) the structural and functional unbundling requirements that must be implemented and observed by Electric Power Industry Participants, including obligations relating to discrimination in the provision of services, the use of customer-related information, the disclosure of information relating to electricity networks and generation facilities, the cross-subsidization of non-regulated activities, business separation and common directors, officers and employees.

### **1.3 Definitions**

In these Guidelines, unless the contrary intention appears, the following words and phrases have the following meanings:

<b>Accounting Separation Statement</b>	A statement described in Section 3.1.3.
<b>Accounting and Cost Allocation Manual (or ACAM)</b>	An Accounting and Cost Allocation Manual prepared and amended by an Electric Power Industry Participant in accordance with Section 2.2.
<b>Ancillary Services</b>	Those services that are necessary to support the transmission of capacity and energy from resources to loads while maintaining the reliable operation of the Grid and/or Distribution Systems in accordance with good utility practice, the Grid Code and the Distribution Code. Such services include those listed in clause 3.3.1.2 of the WESM Rules.
<b>Act</b>	Republic Act No. 9136, otherwise known as "Electric Power Industry Reform Act of 2001".
<b>Auditor</b>	An auditor who is registered as a certified public accountant under the Revised Accountancy Law (Presidential Decree

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No. 692) and who possesses the independence as defined in Part II Section 14 of the Code of Professional Ethics for Certified Public Accountants as promulgated by the Board of Accountancy and approved by the Professional Regulation Commission.

<b>Business Segment</b>	A Business Segment as defined in Article IV.
<b>Competition Rules</b>	The rules promulgated by ERC to promote and ensure competition in the electric power industry pursuant to the Act and its Implementing Rules and Regulations.
<b>Connection Assets</b>	With respect to the Grid, the components used to provide transmission connection services as defined in Section 4.3.6(a), and with respect to a Distribution System, the components used to provide distribution connection services as defined in Section 4.4.6(a).
<b>Connection Point</b>	With respect to the Grid, a point of connection of a User System or Equipment to the Grid, and with respect to a Distribution System, a point of connection of a User System or Equipment to that Distribution System. For the avoidance of doubt, a Connection Point includes both a point where electricity may flow out of the Grid or Distribution System (as the case may be) and a point where electricity may flow into the Grid or Distribution System (as the case may be).
<b>costs</b>	Includes both costs and expenses.
<b>CPI</b>	The All Items Consumer Price Index published by the National Statistics Office of the Philippines or, if it is no longer published or a change in its calculation occurs which renders its continued use inappropriate, such alternative price index as the ERC determines to be appropriate.
<b>Distribution Connection Assets</b>	The components of a Distribution System used to provide distribution connection services as defined in Section 4.4.6(a).
<b>Distribution System</b>	In respect of a Distribution Utility, the Distribution System (as defined in the Grid Code) operated by that Distribution Utility, together with such Subtransmission Systems as are connected to it and as are operated only by that Distribution Utility.



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<b>Electric Power Industry Group</b>	In relation to an Electric Power Industry Participant, that Electric Power Industry Participant and its Affiliates (if any).
<b>EPIRA</b>	Republic Act No.9136, otherwise known as the Electric Power Industry Reform Act.
<b>Equipment</b>	Equipment as defined in the Grid Code.
<b>Financial Year</b>	In respect of an Electric Power Industry Participant, the period covered by the General Purpose Financial Statements that pertain to the Electric Power Industry Group of which the Electric Power Industry Participant is a member.
<b>General Purpose Financial Statements</b>	The audited or duly attested annual financial statements of the members of an Electric Power Industry Group that are prepared (where so required) in accordance with Republic Act No. 8799, otherwise known as the Securities Regulation Code, and are provided to the Philippine Securities and Exchange Commission.
<b>Grid</b>	The Grid as defined in the Grid Code, together with such Subtransmission Systems as are connected to it and as are operated by TRANSCO or its Buyer or Concessionaire.
<b>Inter-segmental Cost</b>	A cost that arises from transactions between Business Segments or between a Business Segment and another activity that is conducted by a member of the relevant Electric Power Industry Group.
<b>Inter-segmental Revenue</b>	A revenue that arises from transactions between Business Segments or between a Business Segment and another activity that is conducted by a member of the relevant Electric Power Industry Group.
<b>Inter-segmental Transaction</b>	An Inter-segmental Cost and an Inter-segmental Revenue.
<b>IRR</b>	The Implementing Rules and Regulations issued pursuant to the EPIRA.
<b>Last Resort Supply</b>	The supply of electricity that a customer will receive from a SOLR. This involves the sale of electricity, billing, collection and provision of basic customer service.

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- Last Resort Supply Event** Any of the following situations where a contestable customer is served by the Supplier of Last Resort:
- a. the customer's Retail Electricity Supplier (RES) has ceased to operate;
  - b. the license of the customer's RES has been revoked or not renewed by ERC;
  - c. the arrangements for distribution wheeling service between the customer's RES and the distribution utility have been terminated;
  - d. the customer's RES is no longer permitted to trade electric energy through the wholesale electricity spot market (WESM), if WESM member; or
  - e. the customer fails to exercise its option to choose its supplier of electricity upon the implementation of retail competition and open access.
- Quarter** A period of three months from 1 January to 31 March (both dates inclusive), 1 April to 30 June (both dates inclusive), 1 July to 30 September (both dates inclusive) or 1 October to 31 December (both dates inclusive).
- Retail Electricity Supplier (RES)** Any person or entity licensed by ERC to sell, broker, market or aggregate electricity to end-users.
- Significant Inter-segmental Transaction** An Inter-segmental Transaction, or a number of Inter-segmental Transactions intended to achieve a common commercial effect, that has, or collectively have, a value of more than the lesser of:
- (a)  $10 \text{ million Pesos} \times [(CPI_i / CPI_b) - 1]$   
where:  
CPI<sub>i</sub> is the CPI for the last Quarter in the Financial Year for which the Accounting Separation Statements, in which the relevant Inter-segmental Transaction or Inter-segmental Transactions are disclosed, are prepared; and  
CPI<sub>b</sub> is the CPI for the Quarter ending on 30 June 2003;  
and
  - (b) 3% of the revenue of the relevant Electric Power Industry Group.

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<b>Supplier of Last Resort (SOLR)</b>	A regulated entity designated by the ERC to serve end-users in the contestable market following a Last Resort Supply Event.
<b>SOLR Customer</b>	An end-user in the contestable market who is served by the SOLR following a Last Resort Supply Event.
<b>Transmission Connection Assets</b>	The components of the Grid used to provide transmission connection services as defined in Section 4.3.6(a).
<b>User System</b>	User System as defined in the Grid Code.
<b>Wholesale Aggregation</b>	The sale of electricity to distribution utilities, by an ERC-registered wholesale aggregator.
<b>Wholesale Electricity Spot Market (WESM)</b>	The electricity market established by the Department of Energy (DOE) in accordance with the Act.

In addition, words and phrases used in these Guidelines which are defined in the EPIRA or the IRR have the meaning given to them in the EPIRA or the IRR (as the case may be).

### **1.4 Business Separation and Unbundling Plan**

Rule 10 of the IRR requires each Electric Power Industry Participant to structurally and functionally unbundle their business activities in accordance with a business separation and unbundling plan prepared by the Electric Power Industry Participant and approved by the ERC. Upon submission by the Electric Power Industry Participant of its business separation and unbundling plan, the ERC shall:

- (a) adopt that plan;
- (b) recommend modifications to that plan; or
- (c) reject that plan for revision and direct the Electric Power Industry Participant to file a new plan based on its comments.

The ERC must render its decision within 6 months from the filing of the business separation and unbundling plan, and compliance with the requirements of these Guidelines (except as otherwise approved by the ERC) is a necessary component of each such business separation and unbundling plan.

**ARTICLE II**  
**GENERAL PRINCIPLES FOR ACCOUNTING SEPARATION**

**2.1 General accounting policies**

2.1.1 The Accounting Separation Statements prepared by an Electric Power Industry Participant for the purposes of these Guidelines must:

- (a) comply with the relevant Accounting and Cost Allocation Manual prepared by that Electric Power Industry Participant under Section 2.2 (as amended from time to time in accordance with Section 2.2) and with the requirements of Articles III and IV;
- (b) comply with generally accepted accounting principles (as defined in rule 68 of the Implementing Rules and Regulations issued pursuant to Republic Act No.8799, otherwise known as the Securities Regulation Code), unless a particular provision of this Guideline requires non-conformity with those principles;
- (c) result in financial information that is relevant and reliable and that reflects the substance of the underlying transactions and events (see Section 2.3); and
- (d) report all material items (see Section 2.4).

2.1.2 The Accounting Separation Statements prepared for the purposes of these Guidelines are additional to any other statutory financial reporting obligations of Electric Power Industry Participants and their Affiliates.

**2.2 Documentation of accounting policies used**

2.2.1 Each Electric Power Industry Participant must prepare an Accounting and Cost Allocation Manual (ACAM) which provides full and proper documentation of the accounting policies and principles used to prepare the Accounting Separation Statements in accordance with these Guidelines, including:

- (a) the allocation methodologies used to allocate costs and revenues to and between Business Segments, including:
  - (i) a description of the basis, formula(e) and/or methodology(ies) used in respect of each cost and revenue item;
  - (ii) the reason for choosing the basis, formula(e) or methodology(ies); and
  - (iii) the quantification of any factors applied in allocating unattributable costs or revenues,

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being in each case an allocation methodology that complies with the principles set out in Section 3.4;

- (b) depreciation policies and methodologies for each class of assets (depreciation charges must be calculated based on either the appraisal value or the historical cost of the relevant asset (book value), depending on whether or not those assets have been reappraised, the economic life of that class of assets, and the weighted average remaining life of that class of assets); and
- (c) the transfer pricing policies used for transactions between Business Segments or between a Business Segment and another activity that is conducted by a member of the relevant Electric Power Industry Group (including where such Business Segments and other activities are conducted within a single corporate entity), being policies that are consistent with the requirements of Section 3.6.

An Electric Power Industry Participant must provide the ACAM that is required to be prepared by it in accordance with Section 2.2.1 to the ERC by the later of June 30, 2004 and the date on which these Guidelines apply to that Electric Power Industry Participant.

- 2.2.2 The ERC may, from time to time, require an Electric Power Industry Participant to make such changes to the ACAM prepared by it as the ERC considers appropriate (including replacing that ACAM with one prepared or approved by the ERC) and the Electric Power Industry Participant must thereupon make such changes and provide a copy of them to the ERC.
- 2.2.3 An Electric Power Industry Participant may from time to time change the ACAM prepared by it, in which case it must thereupon provide the ERC with a statement that sets out:
  - (a) the precise details of the proposed change;
  - (b) the reasons for that change; and
  - (c) the effect of that change on the Accounting Separation Statements.

### **2.3 Substance to prevail over legal form**

For the purposes of Section 2.1.1(c), in determining the substance of a transaction or event, all its aspects, including the expectations and motivations for the transaction and/or events, must be considered. Where a group of transactions and/or events is designed to achieve an overall commercial effect, the group of transactions and events must be considered together.<sup>1</sup>

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<sup>1</sup> See also Accounting Standards Council (ASC) of the Philippines, *Framework for the Preparation and Presentation of Financial Statements*, paragraph 35.

**2.4 Materiality**

For the purposes of Section 2.1.1(d), an item is considered material if its omission, misrepresentation or non-disclosure has the potential to prejudice the understanding of the financial position and nature of the business activities of an Electric Power Industry Group, or any member of it, which is gained by reading the relevant Accounting Separation Statements.<sup>2</sup>

**2.5 Information must be verifiable**

An Electric Power Industry Participant must maintain (or ensure the maintenance of) general record keeping and accounting arrangements which enable information provided in the relevant Accounting Separation Statements to be verified.

**2.6 Management Responsibility Statement**

The Accounting Separation Statements prepared by an Electric Power Industry Participant for the purposes of these Guidelines must be accompanied by a statement which evidences the responsibility for the information contained in those Accounting Separation Statements (Management Responsibility Statement) in the form provided in Appendix I. A Management Responsibility Statement:

- (a) must be signed and dated by the chief executive officer of the Electric Power Industry Participant or by such other person who is specifically authorized in writing by the governing body of that Electric Power Industry Participant for that purpose; and
- (b) must be approved by a resolution of the governing body of the Electric Power Industry Participant that is passed not more than 14 days before the date of the Management Responsibility Statement (a certified copy of this resolution must be attached to the Management Responsibility Statement).

**2.7 Records and audit trails supporting Accounting Separation Statements**

2.7.1 An Electric Power Industry Participant must keep (or ensure the keeping of) accounting records that:

- (a) correctly record and explain the events and financial position of each of the relevant Business Segments;
- (b) enable an Auditor to properly form an opinion on the Accounting Separation Statements prepared by it in accordance with the requirements of these Guidelines; and

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<sup>2</sup> See also Accounting Standards Council (ASC) of the Philippines, *Framework for the Preparation and Presentation of Financial Statements*, paragraphs 29 and 30.

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- (c) provide sufficient information about transactions with and between the relevant Business Segments to allow an Auditor to reach an opinion about compliance with these Guidelines.
- 2.7.2 An Electric Power Industry Participant must maintain (or ensure the maintenance of) an audit trail which includes:
- (a) all information contained in the Accounting Separation Statements prepared by it, including the allocation of costs to Business Segments and information in relation to transactions with related parties; and
  - (b) all relevant records, including but not limited to copies of contracts or engagements between related parties.

### **2.8 Audit requirements**

- 2.8.1 All Accounting Separation Statements prepared for the purposes of these Guidelines must be accompanied by a report prepared, signed and dated by an Auditor (Auditor's Report) that:
- (a) contains the Auditor's opinion on whether the Accounting Separation Statements are presented fairly in accordance with the requirements of this Guideline, clearly identifying any exceptions and the effect of each such exception on the Accounting Separation Statements; and
  - (b) is in the format provided in Appendix J.
- 2.8.2 It is the responsibility of the Auditor to understand the requirements of these Guidelines but the ERC is available to consult with the Auditor if necessary in order to enable the Auditor to obtain sufficient understanding of these Guidelines to prepare the Auditor's Report referred to in Section 2.8.1.
- 2.8.3 An Electric Power Industry Participant must ensure that, under the terms of engagement of the relevant Auditor, that Auditor is obliged (at the ERC's request) to meet with the ERC and provide it with such information regarding the performance of its functions under this Section 2.8 as the ERC requires.
- 2.8.4 The ERC may appoint an Auditor, or require the Auditor engaged to provide the Auditor's Report under Section 2.8.1, to prepare a new or amended report that complies with Section 2.8.1 if:
- (a) the ERC becomes aware that information provided in the Accounting Separation Statements is incorrect or does not comply with the requirements of this Guideline; or
  - (b) in the ERC's opinion, the Auditor's Report prepared under Section 2.8.1 is unsatisfactory or does not comply with the requirements of this Guideline.

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2.8.5 The relevant Electric Power Industry Participant must bear all of the costs associated with any work done by an Auditor under this Section 2.8.

### **2.9 Reporting Cycle**

2.9.1 The reporting period for the Accounting Separation Statements prepared for the purposes of these Guidelines must be the Financial Year of the relevant Electric Power Industry Participant.

2.9.2 Notwithstanding Section 2.9.1, the ERC may require an Electric Power Industry Participant to provide it with such interim or additional accounting information as it specifies from time to time.

### **2.10 General Information Sheet**

2.10.1 All Accounting Separation Statements prepared for the purposes of these Guidelines must be accompanied by a statement (General Information Sheet) that:

- (a) lists the name and company registration number of each member of the relevant Electric Power Industry Group;
- (b) contains an organizational chart showing the ownership relationships between those members; and
- (c) describes the activities undertaken by each of those members.

2.10.2 The General Information Sheet:

- (a) must be signed and dated by the chief executive officer of the relevant Electric Power Industry Participant or by such other person who is specifically authorized in writing by the governing body of that Electric Power Industry Participant for that purpose; and
- (b) must be approved by a resolution of the governing body of that Electric Power Industry Participant, being a resolution that is passed not more than 14 days before the date of the General Information Sheet (a certified copy of this resolution must be attached to the General Information Statement).

### **2.11 Compliance Report**

2.11.1 All Accounting Separation Statements prepared for the purposes of these Guidelines must be accompanied by a certificate (Compliance Report) that:

- (a) the relevant Electric Power Industry Participant has not violated any of the provisions of Article V during the period of the Accounting Separation Statements; or



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- (b) if the relevant Electric Power Industry Participant has violated any of the provisions of Article V during the period of the Accounting Separation Statements, a statement of that fact, together with details of that violation.

### 2.11.2 The Compliance Report:

- (a) must be signed and dated by the chief executive officer of the relevant Electric Power Industry Participant or by such other person who is specifically authorized in writing by the governing body of that Electric Power Industry Participant for that purpose; and
- (b) must be approved by a resolution of the governing body of that Electric Power Industry Participant, being a resolution that is passed not more than 14 days before the date of the Compliance Report (a certified copy of this resolution must be attached to the Compliance Report).

### 2.12 Documents to be delivered to the ERC

Within 5 months of the end of the Financial Year of an Electric Power Industry Participant, that Electric Power Industry Participant must deliver to the ERC:

- (a) the Accounting Separation Statements prepared by it for that period, being statements which are prepared in accordance with these Guidelines;
- (b) the Management Responsibility Statement that is required to accompany those Accounting Separation Statements in accordance with Section 2.6;
- (c) the Auditor's Report on those Accounting Separation Statements prepared in accordance with Section 2.8;
- (d) the General Information Sheet that is required to accompany those Accounting Separation Statements in accordance with Section 2.10;
- (e) the Compliance Report that is required to accompany those Accounting Separation Statements in accordance with Section 2.11; and
- (f) a consolidated copy of the relevant Electric Power Industry Participant's ACAM, where such ACAM has been amended so that it does not correspond with the consolidated copy of the ACAM that has previously been provided to the ERC for the purposes of these Guidelines.

### 2.13 Additional Information

An Electric Power Industry Participant must also provide to the ERC such additional information as the ERC may require to supplement the reporting requirements set out in these Guidelines, including:

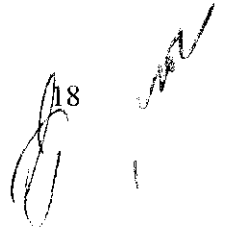
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- (a) additional accounting, financial and/or non-financial information necessary for the determination of regulated rates under the EPIRA; and
- (b) other information that the ERC requires from time to time to enable it to fulfill its functions under the EPIRA effectively.

### **2.14 Confidentiality**

All Accounting Separation Statements which are delivered to the ERC under Section 2.12 will be treated as confidential and may not be used or disclosed by the ERC except to the extent such use or disclosure (including use by or disclosure to external consultants engaged by the ERC) is necessary to enable the ERC to fulfill its functions under the EPIRA or these Guidelines (including where such use or disclosure is necessary for monitoring compliance with, or for the enforcement of, the EPIRA or these Guidelines, whether by the ERC or by any court).



**ARTICLE III  
INFORMATION REQUIREMENTS FOR ACCOUNTING  
SEPARATION**

**3.1 Financial statements**

- 3.1.1 An Electric Power Industry Participant must maintain (or ensure the maintenance of) separate accounts for each Business Segment.
- 3.1.2 The accounts maintained under Section 3.1.1 must be maintained for each Business Segment as if that Business Segment were carried on by a separate company so that the revenues, costs, assets, liabilities, reserves and provisions of, or reasonably allocable to, each Business Segment are separately identifiable in the books of the members of the relevant Electric Power Industry Group.
- 3.1.3 An Electric Power Industry Participant must prepare and submit to the ERC, in accordance with these Guidelines, the following Accounting Separation Statements:
- (a) statement of income for each Business Segment;
  - (b) statement of assets and liabilities for each Business Segment;
  - (c) cash flow statement for each Business Segment;
  - (d) a total statement of income that aggregates all of the Business Segment statements of income into a single statement of income and that is reconciled to the statement(s) of income contained in the General Purpose Financial Statements that pertain to the Electric Power Industry Group of which the Electric Power Industry Participant is a member (for these purposes the reconciliation must clearly set out the adjustments that are made to each item in this total statement of income to reach the items shown in such statement(s) of income contained in the General Purpose Financial Statements); and
  - (e) a total statement of assets and liabilities that aggregates all of the Business Segment statements of assets and liabilities into a single statement of assets and liabilities and that is reconciled to the balance sheet(s) contained in the General Purpose Financial Statements that pertain to the Electric Power Industry Group of which the Electric Power Industry Participant is a member (for these purposes the reconciliation must clearly set out the adjustments that are made to each item in this total statement of assets and liabilities to reach the items shown in such balance sheet(s) contained in the General Purpose Financial Statements),

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which in each case include information on Inter-segmental Transactions as required under Section 3.6.

3.1.4 The Accounting Separation Statements must be prepared on the basis that:

- (a) items that are directly attributable to a Business Segment are allocated accordingly;
- (b) items that are indirectly attributable to a Business Segment are allocated using an appropriate allocation method; and
- (c) items that are unattributable to a Business Segment are allocated using a fair and reasonable method,

in accordance with the principles set out in Section 3.4.

### **3.2 Format and content of Accounting Separation Statements**

Except to the extent that the ERC otherwise approves, the format and content of the Accounting Separation Statements must be consistent with the requirements provided in Appendices B (total statement of income and total statement of assets and liabilities, with reconciliation to General Purpose Financial Statements), C (Accounting Separation Statements specific to Generation Business Segments), D (Accounting Separation Statements specific to Transmission and Related Activities Business Segments), E (Accounting Separation Statements specific to Distribution and Related Activities Business Segments), F (Accounting Separation Statements specific to Supply Business Segments), and G (Accounting Separation Statements specific to Wholesale Aggregation, as applicable.

### **3.3 Cost basis and cost allocation standard**

3.3.1 The Accounting Separation Statements must be prepared on an historical cost accounting basis, except to the extent any relevant assets have been reappraised (in which case the Accounting Separation Statements must be prepared using the appraisal value of those assets).

3.3.2 A fully distributed cost allocation standard must be applied in the preparation of the Accounting Separation Statements so that all costs (including corporate overhead costs) are apportioned among Business Segments in accordance with the principles set out in Section 3.4.

### **3.4 Principles of revenue and cost allocation**

#### ***Allocation based on causation***

3.4.1 To the extent possible, revenues and costs must be allocated to Business Segments on the basis of *causation* - that is, each cost or revenue must be allocated to the activity that caused the cost or revenue to arise.

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- 3.4.2 In practice, *causation* is determined by identifying one of the following relationships:
- (a) a directly traceable cause and effect relationship between the revenue or cost and the carrying out of an activity or provision of a service or product; or
  - (b) a verifiable relationship between the revenue or cost and the carrying out of an activity or provision of a service or product; or
  - (c) a direct causal relationship between a pool of common costs or revenues and the carrying out of an activity or provision of a service or product, such that allocation of the pool of common costs or revenues can be made using a relevant, reliable and verifiable factor, such as relative use.

### ***Allocation of direct, indirectly attributable and unattributable costs and revenues***

- 3.4.3 Direct costs (or revenues) are costs (or revenues) that are solely incurred (or generated) in the undertaking or provision of a particular activity or service or product, regardless of whether such costs (or revenues) are recorded in the accounts against the relevant item. Direct costs must be allocated to the relevant Business Segment based on this direct causal relationship.
- 3.4.4 Indirectly attributable costs (or revenues) are costs (or revenues) that are part of a common pool of costs (or revenues) but which can be attributed to a particular activity, service or product through a non-arbitrary, commercially sustainable and verifiable cause and effect relationship. Indirectly attributable costs (or revenues) must be allocated to the relevant Business Segment using an activity-based approach where possible.
- 3.4.5 Unattributable costs (or revenues) are costs (or revenues) that are part of a common pool of costs (or revenues) and which cannot be attributed to a particular activity, service or product through a non-arbitrary, commercially sustainable and verifiable cause and effect relationship. Unattributable costs (or revenues) must be allocated on a fair and reasonable basis which must be documented in the relevant ACAM.
- 3.4.6 If a causal relationship cannot be established for a particular cost (or revenue) without undue cost and effort, the cost (or revenue) may be allocated on a fair, reasonable and defensible basis which must be documented in the relevant ACAM.

### ***Disclosure of costs and revenue***

- 3.4.7 The Accounting Separation Statements must include a note that separately discloses for each cost and revenue heading in the statements of income for each Business Segment:

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- (a) the amount of direct costs or revenue;
- (b) the amount of indirectly attributable costs or revenue allocated to that Business Segment; and
- (c) the amount of unattributable costs or revenue allocated to that Business Segment.

### ***Depreciation***

- 3.4.8 The categories of depreciation must be the same as for depreciable assets.
- 3.4.9 A depreciation charge must be allocated to the Business Segment to which the asset that gives rise to the relevant depreciation charge is attributed, and in the same proportion as that asset is so attributed.

### ***Extraordinary items***

- 3.4.10 Where they arise, extraordinary items must be allocated to Business Segments on the basis of causation consistent with the methodologies used for other items. Such extraordinary items which are excluded from the segment reporting under paragraph 6 of SFAS31 (or IAS<sup>3</sup>14) should be included in the statement of income for the relevant Business Segment for the purposes of these Guidelines (refer to the Statement of Income contained in Appendices C to G).

### ***Interest and dividends payable and receivable***

- 3.4.11 Interest payable, interest receivable, dividends payable and dividends receivable must be included in the reconciliation of the total statement of income and/or total statement of assets and liabilities to the General Purpose Financial Statements that pertain to the Electric Power Industry Group of which the relevant Electric Power Industry Participant is a member. These items must not be allocated to individual Business Segments.

### ***Fixed assets***

- 3.4.12 Fixed assets must be allocated to the Business Segments in which they are utilized, in proportion to the usage attributable to that Business Segment. Where usage is not a reasonable allocation factor, allocation should occur on a rated capacity, power (MW), energy (kWh) or other basis which is reasonable for the activity undertaken. Such allocation methodology must be clearly described in the Electric Power Industry Participant's ACAM.

### ***Liabilities***

- 3.4.13 Liabilities must be allocated to the Business Segment that gives rise to the liability wherever possible. Liabilities, such as long term borrowings, that relate to the business as a whole should be excluded from individual Business Segment

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<sup>3</sup> International Accounting Standard.



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statements of assets and liabilities. These unallocated items should be included in the reconciliation of the total statement of assets and liabilities to the General Purpose Financial Statements that pertain to the Electric Power Industry Group of which the relevant Electric Power Industry Participant is a member.

### ***Income tax***

- 3.4.14 Income tax on operating profit must not be allocated to individual Business Segments. Income tax and related provisions should be included in the reconciliation of the total statement of income and total statement of assets and liabilities to the General Purpose Financial Statements that pertain to the Electric Power Industry Group of which the relevant Electric Power Industry Participant is a member.

### **3.5 Capitalization policy**

The capitalization of expenditure for the purposes of the preparation of the Accounting Separation Statements must be in accordance with the General Purpose Financial Statements that pertain to the Electric Power Industry Group of which the relevant Electric Power Industry Participant is a member, and such expenditure must:

- (a) relate to the purchase, development or construction of a new asset<sup>4</sup>; or
- (b) increase the capacity or functionality or quality of output of an existing asset; or
- (c) significantly reduce the ongoing maintenance of an existing asset; or
- (d) extend the service life of an existing asset beyond what was expected when the asset was originally installed.

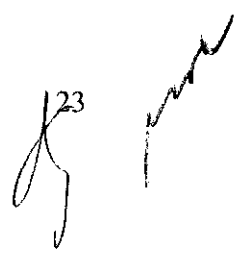

### **3.6 Inter-segmental Transactions and transfer pricing principles**

#### ***Inter-segmental Transactions must be disclosed***

- 3.6.1 For each Business Segment, the Electric Power Industry Participant must disclose, by way of a note in the Accounting Separation Statements, the total value of Inter-segmental Transactions in respect of each of the other Business Segments within, and each of the other activities conducted by, the Electric Power Industry Group of which it is a member, being Inter-segmental Transactions that occur (in whole or in part) during the Financial Year for which the Accounting Separation Statements are prepared.
- 3.6.2 For each Significant Inter-segmental Transaction that occurs (in whole or in part) during the Financial Year for which the relevant Accounting Separation

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<sup>4</sup> The borrowing costs which relate to a new asset prior to its commissioning and inclusion in the asset base can be capitalized using the provisions of paragraphs 4.5 and 11 of IAS23.



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Statements are prepared, the Electric Power Industry Participant must disclose, by way of a note in those Accounting Separation Statements, the costs and revenues that arise from that Significant Inter-segmental Transaction and a transfer journal that follows the principles of double entry bookkeeping and provides descriptions of:

- (a) the item;
- (b) the balancing accounting entry; and
- (c) the Business Segment(s), or other activities, in whose statement of income the balancing entry or entries arise.

3.6.3 For the purposes of Sections 3.6.1 and 3.6.2, the relevant values, costs and revenues are to be calculated in accordance with Sections 3.6.4 and 3.6.5.

### ***Transfer pricing for Inter-segmental Transactions***

3.6.4 A transfer price for a product, service or capital asset is the cost of that product, service or capital asset as recorded by the Business Segment that acquires that product, service or capital asset from another Business Segment or from another business conducted by a member of the relevant Electric Power Industry Group (irrespective of whether the two Business Segments, or the Business Segment and the other business, are within, or conducted by, a single member of the Electric Power Industry Group or are within, or conducted by, different members of the Electric Power Industry Group).

3.6.5 A transfer price must be the same as the price paid by an unrelated entity that acquires the same product, service or capital asset in an arms-length transaction. For these purposes:

- (a) one or more of the acceptable transfer pricing methods described in Appendix H; or
- (b) another transfer pricing method approved by the ERC,

may be used.



**ARTICLE IV**  
**BUSINESS SEGMENTS**

**4.1 Introduction**

The Business Segments for the purposes of these Guidelines are as set out in this Article IV, each such Business Segment being illustrated diagrammatically in Appendix A (a single Business Segment may include activities that are conducted by more than one corporate entity).

**4.2 Generation Business Segments**

4.2.1 The Generation Business Segments are described below.

***Generation of Electricity and Provision of Ancillary Services Business Segment***

4.2.2 This segment comprises the generation of electricity (ie. the production of electricity, including through the use of a co-generation facility and embedded generators) and the provision of Ancillary Services (using generation assets).

4.2.3 The assets included in this Business Segment are all facilities and assets (including support plant) used for the generation of electricity or the provision of Ancillary Services referred to in Section 4.2.2. The liabilities included in this Business Segment are all the liabilities incurred directly, or a relevant share of the shared liabilities which are incurred, to provide the services or undertake the activities referred to in Section 4.2.2.

4.2.4 Revenues include all revenues derived from the sale of electricity or the provision of Ancillary Services referred to in Section 4.2.2, as well as revenues derived from the sale of related facilities, plant or assets.

4.2.5 Costs include all operating and maintenance costs of assets associated with the generation of electricity or the provision of Ancillary Services referred to in Section 4.2.2, and the depreciation of the assets referred to in Section 4.2.3.

***Supply Services Business Segment***

4.2.6 This segment comprises the sale of electricity by a generating company, licensed as RES, to end-users in the contestable market. It includes the:

- (a) billing, collection and the provision of customer services to such end-users in their capacity as electricity consumers or to such other customers in their capacity as purchasers of electricity;
- (b) energy trading (including the purchase of electricity and hedging activities) undertaken in connection with the sale of electricity to end-users who are included in the contestable market or to other customers who are not end-users; and
- (c) the sale of electricity to end-users who are included in the contestable market or to other customers who are not end-users.