

Airports backward-looking profitability information disclosure amendments

Reasons paper

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1. Introduction

Purpose of paper

1. This paper sets out the reasons for our amendments to the backward-looking profitability information disclosure (**ID**) requirements applying to suppliers of airport services.

How airports are regulated under Part 4 of the Commerce Act 1986

2. Part 4 of the Commerce Act 1986 (**the Act**) provides for the regulation of the price and quality of goods or services in markets where there is little or no competition and little or no likelihood of a substantial increase in competition.¹ The purpose of Part 4 as set out in s 52A(1) of the Act is to promote the long-term benefit of consumers in regulated markets by promoting outcomes that are consistent with outcomes produced in competitive markets. We promote the interests of consumers of the regulated service by promoting the s 52A(1)(a)-(d) outcomes consistent with what would be produced in workably competitive markets.²
3. Auckland International Airport Limited (**AIAL**), Christchurch International Airport Limited (**CIAL**) and Wellington International Airport Limited (**WIAL**)³ are subject to ID regulation under Part 4 of the Act.⁴ ID regulation has its own specific purpose (s 53A of the Act). The purpose of ID regulation is to ensure that sufficient information is readily available to interested persons to assess whether the purpose of Part 4 of the Act is being met.

Airports profitability assessment process

4. Airports are required to set charges for airport services in accordance with the Airport Authorities Act 1966 (AAA). The AAA requires Airports to consult about charges for airport services when prices are set and within five years of the setting of charges for airport services.
5. As part of the 2016 IM review, we set forward-looking profitability disclosure requirements for the purpose of allowing interested persons to assess Airports targeted profitability that would result from a price setting event.⁵
6. At the end of each disclosure year an Airport is also required to disclose historical financial information that, amongst other things, allows interested persons to assess

¹ Commerce Act 1986, s 52.

² Commerce Commission "Input methodologies review decisions: Framework for the IM review" (20 December 2016).

³ In this paper we collectively refer to these companies as "Airports".

⁴ Commerce Act 1986, Subpart 11.

⁵ Commerce Commission "Input methodologies review decision – Topic paper 5: Airports profitability assessment" (20 December 2016)

actual profitability. In this paper we refer to this as the backward-looking profitability assessment.

Background to proposed amendments

7. The ID requirements for airport services were initially determined in 2010.⁶ Amendments to the ID requirements for airport services were completed in 2012,⁷ and in 2016 as a result of the input methodologies (IM) review.⁸ The airport ID requirements were also further amended alongside other consequential amendments to the electricity distribution business, gas distribution business and gas transmission business ID determinations arising out of the IM review in 2017.⁹
8. The 2016 IM review resulted in a change to the approach for assessing profitability for airport services and we amended our forward-looking ID requirements to reflect this. In our 2016 IM decision, we indicated that any consequential changes affecting our backward-looking requirements will be subject to a separate consultation process.¹⁰
9. For further background on how the approach to assessing profitability has changed see Attachment A: Further background on backward and forward-looking profitability assessment.
10. To allow the disclosure of useful backward-looking information on profitability for interested persons, we granted a conditional exemption for AIAL and CIAL for the 2017/2018 and 2018/2019 disclosure years.¹¹ The conditional exemptions required AIAL and CIAL to disclose backward-looking profitability information consistent with the already amended forward-looking profitability disclosure.
11. The amendments outlined in this paper are intended to align the approach to assessing backward-looking profitability with the approach to assessing forward-looking profitability, which was amended as a result of the 2016 IM review.

⁶ Commerce Commission “Commerce Act (Specified Airport Services Information Disclosure) Determination 2010” (Decision 715, 22 December 2010).

⁷ Commerce Commission “Amendment to Commerce Act (Specified Airport Services Information Disclosure) Determination 2010 [2012] NZCC 5” (10 December 2012).

⁸ Commerce Commission “Airport Services Information Disclosure Amendments Determination 2016, [2016] NZCC 29” (20 December 2016).

⁹ Commerce Commission “Airport Services Information Disclosure Amendments Determination 2017 [2017] NZCC 36” (21 December 2017).

¹⁰ Commerce Commission “Input methodologies review decision – Topic paper 5: Airports profitability assessment” (20 December 2016), p 8.

¹¹ For a detailed explanation, see Commerce Commission “Conditional Exemption for AIAL airport services information disclosures for 2017/2018 and 2018/2019 disclosure years” (19 October 2017), paragraphs 2-4 and Commerce Commission “Conditional Exemption for CIAL airport services information disclosures for 2017/2018 and 2018/2019 disclosure years” (19 October 2017), paras 2-4.

Our amendment process

12. On 17 January 2019 we published a process paper that outlined our intention to align our backward-looking profitability ID requirements with our forward-looking profitability ID requirements.¹²
13. On 22 February 2019 we held a workshop to seek views from interested persons on how the backward-looking profitability disclosure requirements might be amended. Workshop participants' views informed our decision.
14. Views on our draft decision were sought from stakeholders as part of the draft decision submission process.
15. The papers and summary of views expressed at the workshop, the draft decision and submissions on the draft decision can be found on our website.¹³
16. We have considered all views expressed in the consultation when making our final decision.

Scope of the ID amendments

17. In order to better promote the Part 4 purpose and the purpose of ID, we have made amendments to align our backward-looking profitability ID requirements with our forward-looking profitability ID requirements.
18. We have also made minor error correction amendments. We note that the potential amendment to the definition of 'Interruption' identified by NZ Airports during its submission is more than a minor error correction and therefore beyond the scope of this round of amendments.¹⁴
19. The amendments to the ID requirements are to apply for AIAL and CIAL from publication date, being 13 June 2019. For WIAL the amended forward looking disclosure requirements are applicable to their next forward-looking disclosures and the backward-looking requirements are applicable from the first disclosure year of its next pricing period. Chapter 9 outlines our reasons for these decisions.

Decision making criteria

20. We consider that our amendments allow for information to be made available for interested persons to better assess whether the purpose of Part 4 of the Act is being met, consistent with s 53A of the Act. In particular, we consider that our amendments will allow interested persons to have sufficient information to assess whether Airports are extracting excessive profits, consistent with s 52A(1)(d) of the

¹² Commerce Commission "Airports backward-looking profitability information disclosure amendments – process paper" (17 January 2019).

¹³ These publications can be found here: <https://comcom.govt.nz/regulated-industries/airports/projects/airports-backward-looking-profitability-id-amendments>.

¹⁴ NZ Airports, "Submission" (11 April 2019), para 37.

Act. In each chapter we have explained why we consider our amendments will allow for better information for interested persons.

Material published alongside this paper

21. In this paper we outline our reasons for our amendments to the airport services ID determination.
22. In addition, we have published alongside this paper an amendments determination, consolidated determination and updated excel templates which incorporate the amendments.
23. For ease of reference the amendments determination identifies amendments as tracked changes. The track changes will be accepted in the consolidated ID determination.

2. Summary of decisions and amendments

Purpose of chapter

24. This chapter provides a summary of our decisions and amendments to the airport services ID determination. Further information on each of our decisions and amendments can be found in chapters 3-9.

Table 1: Summary of decisions and amendments to the airport services ID determination

Matter of consideration	Decisions	Affected clauses and schedules*
Profitability assessment	Profitability information is disclosed using an internal rate of return (IRR) approach. Only an IRR that is comparable to a post-tax weighted average cost of capital (WACC) is to be disclosed.	Schedule 1 and clause 1.4
Regulatory asset base (RAB) and pricing asset base profitability assessments	Backward-looking profitability information relating only to all RAB assets is disclosed. Information on pricing and non-pricing assets backward-looking profitability is not required to be disclosed separately at this stage.	n/a
Comparison to forward-looking profitability assessment	Period to date and annual IRRs that are comparable to forecast information are to be disclosed. Explanations of variances to forecast that impact the profitability assessment are to be disclosed including all variances caused by changes in financial accounting treatments.	Schedules 1, 4, 6, 18 and clause 2.3
Cash flow timing – default assumption and assets commissioned	Backward-looking cash flow timing assumptions to be consistent with the forward-looking cash flow timing assumptions except for assets commissioned. Backward-looking profitability assessment to include monthly assets commissioned cash flow timing assumption.	Schedule 1 and clauses 1.4 and 2.3
Carry forward balance	Annual carry forward balances in backward and forward-looking profitability are to be disclosed.	Schedule 1, 18 and clause 1.4
Other disclosure requirements	Backward-looking disclosure requirements amended to align with the forward-looking disclosure requirements, including: <ul style="list-style-type: none"> removing the requirement to disclose offsetting revenue for the works under construction roll forward; amending the backward-looking assets held for future use disclosure and revaluations disclosure to align them with the forward-looking disclosure; and amending the backward-looking non-standard depreciation disclosure to remove a duplication with the forward-looking disclosure. Minor corrections to definitions and excel template formulas.	Schedule 1, 4, 18, 19, 20 and clause 1.4
Transitional provisions	The new provisions are to apply for AIAL and CIAL immediately, but will not be applicable for WIAL until its new pricing period.	Clause 2.10

*Clause and schedule references are to the renumbered clauses and schedules in the amendment determinations

3. Profitability disclosure

Purpose of chapter

25. This chapter outlines our amendments, and the reasons for those amendments, to:
- 25.1 implement an IRR approach to disclosing backward-looking profitability; and
 - 25.2 require the disclosure of only the IRR calculation that is comparable to a post-tax WACC.

Table 2: Summary of amendments to the backward-looking profitability disclosure

Matter of consideration	Decisions	Affected clauses and schedules*
Profitability disclosure	Profitability information is disclosed using an IRR approach. Only an IRR that is comparable to a post-tax WACC is to be disclosed.	Schedule 1 and clause 1.4

Problem definition

26. The backward-looking profitability disclosure provided for in the previous disclosure requirements (Schedule 1: Report on Return on Investment) assesses profitability by:
- 26.1 using a return on investment (**ROI**) calculation; and
 - 26.2 comparing ROI to a post-tax WACC and vanilla WACC.
27. Our 2016 IM review resulted in a change to the approach for assessing profitability in our forward-looking ID requirements for airport services.¹⁵ This review resulted in the requirement to disclose forward-looking profitability by:
- 27.1 using an IRR calculation instead of an ROI; and
 - 27.2 only assessing IRR against a post-tax WACC.

Submitters' views

28. BARNZ and NZ Airports both support the alignment of the approach to assessing backward-looking profitability with the forward-looking approach, including by applying an IRR approach over the previous ROI approach and only assessing the IRR against a post-tax WACC.¹⁶

¹⁵ Commerce Commission "Airport Services Information Disclosure Amendments Determination 2017, [2017] NZCC 36" (21 December 2017).

¹⁶ BARNZ, "Submission Airports Information Disclosure Requirements" (9 April 2019), para 5.

Airport services ID amendment

29. We have decided the backward-looking profitability information should be disclosed using an IRR approach. This amendment includes:
 - 29.1 requiring the disclosure of an IRR calculation in the schedule that was previously referred to as Schedule 1: Report on Return on Investment;
 - 29.2 renaming Schedule 1: Report on Return on Investment to Schedule 1: Report on Profitability; and
 - 29.3 removing the references to ROI and regulatory investment value in Schedules 1, 7 and 18.
30. These amendments allow interested persons to better assess actual profitability of airport services consistent with the forward-looking profitability approach.
31. We also only require the disclosure of the IRR calculation that is comparable to a post-tax WACC in Schedule 1: Report on Profitability.
32. This approach removes the requirement to disclose profitability that is comparable to a vanilla WACC.
33. Consistent with the forward-looking profitability disclosures we do not consider the vanilla WACC comparisons are necessary for interested persons. We note that all information required to determine profitability that is comparable to a vanilla WACC is still disclosed and therefore can be separately determined.
34. To allow for the disclosure of only the IRR that is comparable to the post-tax WACC we have added to Schedule 3: Report on Regulatory Tax Allowance the determination of 'Unlevered tax' which is in addition to the 'Regulatory tax allowance'. The amendment includes moving the 'Deductible interest and Interest tax shield' calculation from the previous Schedule 1 to Schedule 3.
35. In Schedule 6: Report on Actual to Forecast Expenditure we have replaced regulatory investment value with RAB value so that interested persons can continue to assess the relative profitability of the segments.

4. RAB and pricing asset base profitability disclosures

Purpose of this chapter

36. This chapter outlines our decision and reasons to require only the disclosure of profitability relating to the RAB assets in the backward-looking disclosure requirements.

Table 3: Summary of decision in relation to RAB and pricing asset base profitability disclosures

Matter of consideration	Decision	Affected clauses and schedules*
RAB and pricing asset base profitability disclosures	Backward-looking profitability information relating only to all RAB assets is required to be disclosed. Information on pricing and non-pricing assets backward-looking profitability is not required to be disclosed at this stage.	n/a

Problem definition

37. The backward-looking profitability disclosure provided for in the previous disclosure requirements only looks at profitability relating to all RAB assets.
38. The forward-looking profitability disclosure allows for the evaluation of projected profitability of all RAB assets and the subset of assets that the pricing decision applies to (pricing assets).
39. Information on the profitability of pricing assets may be important for interested persons if they want to make assessments against the Airports' pricing assets forward-looking profitability disclosure.
40. Our assessment of AIAL and CIAL forward-looking profitability focused on the profitability of the pricing assets. We indicated in the AIAL and CIAL pricing decisions that non-pricing assets, being the subset of the RAB that are not pricing assets, can be better assessed over a longer timeframe than a single pricing period that the pricing decision allows for.¹⁷

¹⁷ Commerce Commission "Review of Auckland International Airport's pricing decisions and expected performance (July 2017 – June 2022) Final report – Summary and analysis under section 53B(2) of the Commerce Act 1986" (1 November 2018), p 40. Commerce Commission "Review of Christchurch International Airport's pricing decisions and expected performance (July 2017 – June 2022) Final report – Summary and analysis under section 53B(2) of the Commerce Act 1986" (1 November 2018), p 38. In the AIAL and CIAL pricing decisions 'non-pricing assets' are referred to as 'other regulated assets'.

Submitters' views

41. Airports are of the view that the cost of disclosing backward-looking profitability on pricing assets would be resource intensive and outweigh the benefit the disclosure would provide.¹⁸
42. BARNZ agreed that Airports should continue to only disclose backward-looking profitability for all RAB assets at his stage. BARNZ suggested we consider the ongoing disclosure requirements for non-standard price services relative to the other regulated airport services as part of any review on other regulated services/non-pricing assets.¹⁹
43. NZ Airports noted their appreciation for the recognition of the additional layer of complexity that would be required if separate information disclosures were required for the pricing assets. NZ Airports also recognises that this approach may require the Commission to seek further information from the Airports for any future review of financial outcomes from non-pricing assets.²⁰

ID Amendment

44. Our decision is to continue to require only the disclosure of backward-looking profitability on all RAB assets.
45. We have considered also requiring the disclosure of profitability relating to the pricing assets as is required in the forward-looking profitability disclosures.
46. At this point it is not clear that requiring the disclosure of pricing assets backward-looking profitability would be useful for interested persons. Accordingly, our decision is to not require the information to be disclosed through the ID requirements.
47. We have also considered requiring information to be disclosed annually through the disclosure requirements that would allow an assessment of non-pricing assets profitability over a longer time frame than a single pricing period. At this point we consider, given the nature of the likely assessment and that it would be applied over an extended timeframe, that it may be more efficient to use our information gathering powers through s 53ZD of the Act.
48. If at a later stage it becomes evident that pricing asset profitability information is necessary or it would be useful to obtain non-pricing asset information through annual disclosures, we note that we have the ability to:
 - 48.1 amend our ID requirements; or
 - 48.2 require Airports to provide the information through a request under s 53ZD of the Act.

¹⁹ BARNZ, "Submission Airports Information Disclosure Requirements" (9 April 2019), para 6-8.

²⁰ NZ Airports, "Submission" (11 April 2019), para 15 and 16.

5. Comparison to forward-looking profitability disclosure

Purpose of this chapter

49. This chapter describes our amendments and the reasons for those amendments to require comparison of backward-looking profitability with forward-looking profitability.

Table 4: Summary of amendments to require comparison of backward-looking profitability with forward-looking profitability

Matter of consideration	Decision	Affected clauses and schedules*
Comparison to forward looking profitability disclosure	Period to date and annual IRRs that are comparable to forecast information are to be disclosed. Explanations of all variances to forecast that impact the profitability disclosure are to be disclosed including all variances caused by changes in financial accounting treatments.	Schedules 1, 4, 6, 18 and clause 2.3

Problem definition

50. Previous annual backward and forward-looking profitability disclosure requirements compared profitability to the 5 year WACC, which was a reflection of the target profitability for the whole pricing period.
51. Assessing profitability part way through the period against forecast values for the whole period can be misleading. This can be because revenue smoothing, while providing even revenues across that pricing period, can cause uneven forecast profitability (from year-to-year) during the pricing period.
52. Previous backward-looking profitability disclosures also had inconsistent approaches regarding the level of explanation that was required for variances.
53. In addition, there is currently no requirement to disclose the impact of changes in accounting treatments. Changes in accounting treatments might cause a variance between forward-looking disclosures (which Airports might disclose before the new accounting treatment comes into effect) and backward-looking disclosure (which Airports might make after the new accounting treatment comes into effect).²¹

²¹ For example, in 2018 the International Accounting Standards Board (**IASB**) issued a new accounting standard updating the principles relating to the treatment of leases. IFRS16 replaces IAS17 and comes into effect for annual reporting periods beginning on or after 1 January 2019. Under the new accounting standard, operating leases are referred to as 'right of use' assets and are brought onto the balance sheet

54. Disclosure of explanations for variances to forward-looking profitability is important information for interested persons to understand why actual profitability is different to forecast profitability and will assist them in assessing whether Airports are targeting excessive profits.

Submitters' views

55. BARNZ noted the importance of having explanations of variances from forecast profitability values. While it agreed in principle to removing the previous 10% threshold, to leave some discretion for Airports and consolidate the explanations in Schedules 1 and 6 only, it noted that the approach needed to be kept under review to make sure the important variances are all explained sufficiently.²²
56. NZ Airports also supported the proposed approach to seek 'reasonable' explanation of variances but questioned our draft decision to require variance explanations of every variance in Schedules 1, 2, 4 and 6. They considered that the overlapping nature of the explanations would create additional work and had the potential to confuse readers. As a result of this feedback we have reduced the number of places variance explanations are required.
57. In response to our draft decision, NZ Airports also questioned whether annual IRR information was relevant, noting that period to date profitability may be enough for interested persons to assess profitability.²³ We agree that period to date IRR information is more relevant than annual IRR and have structured Schedule 1 and the variance explanation requirements to reflect this. We have however continued to include the annual IRR disclosures for the reasons outlined in paragraph 61.

Period to date profitability amendments

58. We have decided to require the disclosure of period to date and annual IRRs that are comparable to forecast information. To apply this decision, we have amended:
- 58.1 Schedule 1: Report on Profitability to require the disclosure of backward-looking pricing period to date and annual IRRs; and
- 58.2 Schedule 18: Report on the Forecast Total Asset Base Revenue Requirements to require the disclosure of pricing period to date and annual IRRs.
59. Introducing the requirement to disclose pricing period to date IRRs allows for interested persons to compare backward-looking profitability to forecast part way

for financial reporting purposes. This means that most leases will have a treatment equivalent to capital expenditure for finance reporting. Under the previous standard these leases were not recorded on the balance sheet and the lease rentals were treated as operating expenditure. This new accounting treatment might cause a variance between forward-looking disclosure and the backward-looking disclosure. Commerce Commission, "Transpower's individual price-quality path for the next regulatory control period – Issues paper" (7 February 2019), p 118.

²² BARNZ, "Submission Airports Information Disclosure Requirements" (9 April 2019), p. 2 and 3.

²³ Commerce Commission, "Airports backward-looking profitability information disclosure amendments - workshop. Summary of views expressed" (7 March 2019), para 4.2.

through the pricing period and therefore better assess whether Airports are extracting excessive profits, rather than having to wait until the end of the pricing period.

60. We have focused the new Schedule 1 on the period to date IRR rather than the annual IRR as it is the most relevant information to allow an assessment of profitability. This has been achieved by presenting the period to date IRR at the top of the schedule and making the variance explanation centred on the period to date rather than annual IRR (as explained below).
61. We have also included the disclosure of an annual IRR so interested persons can understand the impact of the latest disclosure year on profitability. Other schedules also include annual information as it is either required for the roll forward of annual balances (RAB and carry-forward balances) or is required to determine the period to date IRRs.

Explanation of variances amendments

62. We have decided to require explanations for variances from forward-looking profitability to be disclosed. This has been provided for by:
 - 62.1 requiring explanations for variances from forward-looking profitability through new clauses 2.3(9) and 2.3(10); and
 - 62.2 including in Schedule 1: Report on Profitability a text box for the explanations;
63. The key requirement of the new clause 2.3(9) is an explanation of the difference between actual period to date IRR and forecast period to date IRR.
64. The explanation must include an explanation of:
 - 64.1 any variances disclosed in the Report on Profitability set out in Schedule 1, the Report on Regulatory Profit set out in Schedule 2 or the Report on Regulatory Asset Base Roll Forward set out in Schedule 4 that have a material impact on the period to date IRR variance; and
 - 64.2 any percentage variances in the Report on Actual to Forecast Performance set out in Schedule 6 that have a material impact on the period to date IRR variance.
65. We do not expect every variance of the subcomponents to be explained, rather only those that have had a material impact on the period to date IRR variance.
66. Airports are required to explain all material positive and negative impacts on profitability, not just those that explain the net effect.
67. Consistent with the materiality concept, Airports will need to consider whether the information would influence the users of the information in their decision-making processes.

68. The new clause 2.3(10) requires an explanation of the impact on the backward-looking disclosure of any changes in an Airport's accounting treatments from those adopted when preparing the relevant forward-looking disclosure.
69. The required explanations will provide information for interested persons to understand the difference in profitability between forecast and actual and therefore assist them to better assess whether the purpose of Part 4 is being met.
70. We have also amended Schedule 6: Actual to Forecast Performance by removing the requirement for Airports to explain all variances that are greater than 10% and instead only requiring explanations of items that are material to the Schedule 6 disclosure.

6. Cash flow timing

Purpose of this chapter

71. This chapter describes our decision and the reasons for specifying the cash flow timing assumptions in the backward-looking profitability disclosures.

Table 5: Summary of amendment to specify cash flow timing assumptions for the backward-looking profitability disclosures

Matter of consideration	Decision	Affected clauses and schedules*
Cash flow timing – default assumption and assets commissioned	Backward-looking cash flow timing assumptions to be consistent with the forward-looking cash flow timing assumptions except for assets commissioned. Backward-looking profitability disclosure to include monthly assets commissioned cash flow timing assumption.	Schedule 1 and clauses 1.4 and 2.3

Problem definition

72. There was no requirement for Airports to use a consistent cash flow timing assumption in the disclosure of backward and forward-looking profitability disclosures. This was inconsistent with other aspects of the calculation that required a consistent approach for the forward and backward-looking disclosures.²⁴
73. Our forward-looking profitability disclosure requirements include default cash flow timing assumptions with the ability for Airports to apply alternative assumptions.²⁵
74. The default cash flow timing assumption for assets commissioned in the forward-looking profitability disclosure assumes average mid-year timing. This is likely to be appropriate for forward-looking profitability disclosures when the precise date of commissioning is unknown. However, it is less appropriate for backward-looking profitability disclosures for the reasons outlined in paragraphs 81 and 82.

Submitters' views

75. BARNZ supported the consistent use of timing assumptions between backward and forward-looking disclosures and the recording of timing of major asset commissioning. BARNZ noted that if the commissioning date of a new asset creates a

²⁴ Airport Services Input Methodologies Determination 2010 – consolidated as of 20 December 2016, clauses 3.13, 3.4(5)(c) & 3.7(6).

²⁵ Airport Services Input Methodologies Determination 2010 – consolidated as of 20 December 2016, clauses 3.13, 3.4(5)(c) & 3.7(6).

variance between forecast and actual profitability, this can be explained by the Airport.²⁶

76. NZ Airports raised a concern that the more detailed disclosure of asset commissioning timing was not necessary to evaluate whether Airports are earning excessive profits, instead suggesting the variance analysis and other disclosures would provide sufficient information to interested persons without the need to amend the IRR calculation.²⁷
77. NZ Airports also identified that our monthly cashflow timing assumptions in the draft decision were end of month timing assumptions rather than mid-month, which has been corrected in our final decision.²⁸

ID amendment

78. We have amended ID clause 2.3 to require the backward-looking cash flow timing assumptions to be consistent with the forward-looking cash flow timing assumptions applied during the price setting event, except for the asset commissioning timing assumption.
79. Having consistent timing assumptions for revenues and operating expenses will provide comparable information between the forward-looking and backward-looking profitability disclosures.
80. We have decided to continue to require the backward-looking profitability disclosure to assume monthly asset commissioning cash flow timing.
81. The forward-looking profitability disclosure assumes assets are commissioned evenly over the year through the use of a mid-year timing assumption. This is a reasonable assumption when forecasting, which can be up to 7 years into the future.²⁹ However, actual outcomes can be different, especially where there are large one-off assets being capitalised, as is often the case with Airports. Accordingly, given the potential impact on the profitability disclosure we consider it is appropriate for Airports to disclose profitability information that takes into account when assets were commissioned.
82. A more accurate reflection of asset commissioning during the year also aligns more closely with the capitalised interest requirements which require capitalisation up to the commissioning date.³⁰ If there is an inconsistency between the assets commissioned cash flow timing assumption and the capitalised interest

²⁶ BARNZ, "Submission Airports Information Disclosure Requirements" (9 April 2019), p. 3.

²⁷ NZ Airports, "Submission" (11 April 2019), paras 30 to 31

²⁸ NZ Airports, "Submission" (11 April 2019), paras 32 to 34.

²⁹ Airports typically start their price setting process 2 years before they set their prices and typically forecast profitability for a 5 year period.

³⁰ Airport Services Input Methodologies Determination 2010 – consolidated as of 20 December 2016, clause 3.9(3).

requirements there is the potential for time use of money to be double counted or not considered in the profitability disclosures, which would be inconsistent with the FCM principle.³¹

83. The decision to require monthly asset commissioning timing assumptions requires the following to be included in Schedule 1: Report on Profitability:

83.1 asset commissioning disclosed monthly; and

83.2 the IRR calculations assume monthly asset commissioning.

³¹ Commerce Commission, "Input methodologies review decisions Topic paper 5: Airport profitability assessments" (20 December 2016), para 166.

7. Carry forward balance disclosure

Purpose of this chapter

84. This chapter describes our amendments and the reasons for our amendments for the disclosure of the carry forward balance in the profitability disclosures.

Table 6: Summary of amendments for the disclosure of the carry forward balance in the profitability disclosures

Matter of consideration	Decisions	Affected clauses and schedules*
Carry forward balance	Annual carry forward balances in backward and forward-looking profitability are to be disclosed.	Schedule 1, 18 and clause 1.4

Problem definition

85. Previous forward-looking disclosure requirements, while requiring the disclosure of an opening and closing pricing period carry forward balance, did not require the disclosure of annual carry forward balances.
86. As discussed in Chapter 5, we have amended the requirements to provide for the disclosure of period to date and annual IRRs that are comparable to forecast information. Period to date and annual IRR calculations are dependent on annual carry forward balances.

Submitters' views

87. BARNZ agreed with our proposal to disclose the annual backward-looking and annual forward-looking carry forward balances.³²
88. NZ Airports did not comment on the requirement to disclose carry-forward balances but:
- 88.1 suggested the disclosure of the carry-forward balance would be clearer if it was depicted as an addition to the RAB rather than deducted as it currently is; and
- 88.2 questioned why the term 'other carry-forward adjustment – not forecast' was required.³³

³² BARNZ, "Submission Airports Information Disclosure Requirements" (9 April 2019), p. 3.

³³ NZ Airports, "Submission" (11 April 2019), p. 7.

ID amendment

89. We have introduced a requirement to disclose annual carry forward balances in backward and forward-looking profitability disclosures. This approach includes amending:
 - 89.1 Schedule 1: Report on Profitability to have a requirement to disclose the actual roll forward of the carry forward balance; and
 - 89.2 Schedule 18: Report on the Forecast Total Asset Base Revenue Requirements to disclose annual forecast carry forward balances.
90. Disclosing a carry forward balance is necessary for interested persons to determine backward-looking and forward-looking annual and period to date profitability. This will provide information for interested persons to assess annually whether Airports are extracting excessive profits consistent with s 52(1)(d) of the Act rather than having to wait until the end of the pricing period (refer chapter 5 for further discussion on the importance of this).
91. We have decided to leave the carry-forward balance as a deduction from the RAB value. AIAL and CIAL have prepared disclosures in accordance with the current approach and interested persons have reviewed those disclosures. Interested persons have not raised any concerns and we would be concerned that any change may create unintended confusion.
92. We have included the item 'other carry-forward adjustment – not forecast' to allow Airports to include in the carry-forward any amounts that they have not planned to include in the carry-forward adjustment. Disclosing planned and non-planned adjustments separately allows interested persons to understand which adjustments are an outcome from pricing decisions and those that were made outside the pricing decision process.

8. Other disclosure amendments and decisions

Purpose of this chapter

93. This chapter describes our other amendments and decisions to the backward-looking profitability disclosure requirements and our reasons for these amendments and decisions.

Table 7: Summary of other amendments

Matter of consideration	Amendments	Affected clauses and schedules*
Other disclosure requirements	Backward-looking disclosure requirements amended to align with the forward-looking disclosure requirements, including: <ul style="list-style-type: none"> • removing the requirement to disclose offsetting revenue for the works under construction roll forward; • amending the backward-looking assets held for future use disclosure and revaluations disclosure to align them with the forward-looking disclosure; and • amending the backward-looking non-standard depreciation disclosure to remove a duplication with the forward-looking disclosure. Minor corrections to definitions and excel template formulas.	Schedule 1, 4, 18 19, 20 and clause 1.4

Problem definition

94. Previously Schedule 4: Report on the Regulatory Asset Base Roll Forward required the disclosure of:
- 94.1 offsetting revenue under Schedule 4b(v): Works under construction;
 - 94.2 assets held for future use information under Schedule 4(b)(viii) that was not comparable to the forward-looking profitability disclosure;
 - 94.3 revaluation information under Schedule 4(b)(iv) that was not consistent with the IM revaluation requirements; and
 - 94.4 non-standard depreciation information under Schedule 4(b)(iii) that is a duplication of the forward-looking disclosure requirement.
95. The offsetting revenue disclosure is not required to be forecast and has never been disclosed in backward-looking profitability disclosures.

96. The backward-looking assets held for future use disclosure is not consistent with the forward-looking disclosure following our amendments made as a result of the 2016 IM review.³⁴
97. The backward-looking revaluations disclosure was not consistent with the revised IM requirements or therefore consistent with the forward-looking disclosure requirement either. This is a result of the IMs and forward-looking revaluations disclosure being updated as part of the IM Review.
98. The backward-looking depreciation disclosure includes information that is required to be disclosed as part of the forward-looking depreciation disclosure requirement. As part of the IM Review the forward-looking disclosure requirements were amended to include information about the justification and extent of customer agreement with non-standard depreciation decisions.
99. Minor issues were also identified in the excel template used for the disclosure of pricing information. These issues included:
 - 99.1 inconsistent presentation of terms in Schedule 18: Report on the Forecast Total Asset Base Revenue Requirements and Schedule 19: Report on the Forecast Pricing Asset Base Revenue Requirements with the terms defined in the determination;
 - 99.2 formulas errors in Schedule 19: Report on the Forecast Pricing Asset Base Revenue Requirements; and
 - 99.3 a formatting error in Schedule 20: Report on Demand Forecast which does not allow for the input of decimal points.
100. We also identified some definitions that were not removed as a result of past amendments to the requirements.

Submitters' views

101. BARNZ agreed with our proposed amendments as outlined in our draft decision.³⁵
102. NZ Airports identified in their submission on our draft decision that the backward-looking revaluation disclosure had not been aligned to the IM requirements.³⁶ Our final amendments determination has addressed this.

³⁴ Commerce Commission "Input methodologies review decisions – Topic paper 5: Airports profitability assessment" (20 December 2016), p. 130.

³⁵ Our draft decision did not include the amendment to the revaluation disclosure and removal of Schedule 4(b)(iii). These amendments were however included in NZ Airports submission and were not questioned in BARNZ's cross submission.

³⁶ NZ Airports, "Submission" (11 April 2019), p. 10.

103. NZ Airports also suggested that the whole non-standard depreciation disclosure (4b(ii) and (iii)) were no longer necessary on a backward-looking basis as it is disclosed as part of Airports' price setting (forward-looking) disclosures.³⁷ As noted below, we have removed the backward-looking non-standard depreciation disclosure in Schedule 4b(iii) to exclude information that was a duplicate of information included in the forward-looking disclosure requirement. We have also decided to continue to require the 4b(ii) disclosure for the reasons set out at paragraph 109 below.
104. NZ Airports also made us aware of inconsistencies in our draft decision around the use of terms relating to the carry forward balance and assets held for future use disclosures.³⁸ We have updated the relevant amendments to address these issues other than NZ Airports suggestion to include distinct definitions for terms used in the forecast and actual variants of asset held for future use.³⁹

ID amendment

105. We have amended Schedule 4: Report on the Regulatory Asset Base Roll Forward to remove offsetting revenue under Schedule 4b(v): Works under construction. Airports have informed us that they do not have offsetting revenue for works under construction.⁴⁰
106. We have also amended Schedule 4: Report on the Regulatory Asset Base Roll Forward to align the assets held for future use disclosure under Schedule 4(b)(viii) with the approach adopted for forward-looking disclosures.
107. We amended Schedule 4: Report on Regulatory Asset Base Roll Forward to allow for revaluation disclosures that are consistent with the IMs. This amendment aligns the disclosure with the forward-looking requirements.
108. We have removed the backward-looking non-standard depreciation disclosure in Schedule 4b(iii) to exclude information that was a duplicate of information included in the forward-looking disclosure requirement.
109. We have decided to continue to require the Schedule 4b(ii) non-standard depreciation disclosure which outlines the actual impact of applying non-standard depreciation. This disclosure is important information that allows interested persons to understand the actual impact of the decision to use non-standard depreciation. Actual impacts may be different to forecast disclosures because of other forecast assumptions.

³⁷ Commerce Commission, "Airports backward-looking profitability information disclosure amendments - workshop. Summary of views expressed" (7 March 2019), para 8.3.

³⁸ NZ Airports, "Submission" (11 April 2019), p. 7.

³⁹ Typically, we only include distinct definitions if the forecast disclosure is required to be determined on a basis that is different to the actual disclosure. It is assumed that by including forecast before the defined term is enough for a preparer or reader of the document to understand its meaning.

⁴⁰ Commerce Commission, "Airports backward-looking profitability information disclosure amendments - workshop. Summary of views expressed" (7 March 2019), para 8.2.

110. We also corrected the following issues:
- 110.1 updating formulas in Schedule 18 and 19 to align the presentation of disclosures with the definitions;
 - 110.2 correcting the formulas in Schedule 19: Report on the Forecast Pricing Asset Base Revenue Requirements;
 - 110.3 correcting the formatting issue in Schedule 20: Report on Demand Forecasts which does not allow for the input of decimal points; and
 - 110.4 removing some definitions that were not removed as a result of past amendments to the requirements.

9. Transitional provisions

Purpose of this chapter

112. This chapter describes the provisions necessary to transition Airports on to the amended requirements, and our reasons for these transitional provisions.

Table 8: Summary of transitional provisions

Matter of consideration	Decision	Affected clauses and schedules*
Transitional provisions	The new provisions are to apply for AIAL and CIAL immediately but will not be applicable for WIAL until its new pricing period.	Clause 2.10

Problem definition

113. WIAL's current prices were set when the previous forward-looking disclosure requirements were in place. Until WIAL disclose pricing information under the amended forward-looking disclosure requirements, there is little to no value for interested parties to have backward-looking information aligned to our new approach to assessing profitability.
114. AIAL and CIAL have disclosed their current price setting decisions under the 2016 IM review amended forward-looking profitability disclosure requirements. Therefore, disclosure of backward-looking profitability information consistent with the revised approach to assessing profitability is of value to interested persons.
115. However, AIAL and CIAL will not have some forward-looking profitability information disclosed in the format that we require in these amendments, as they have already made their forward-looking disclosures for their current pricing periods.
116. The ID determination also had transitional provisions which no longer apply because the applicable time period has passed.

Submitters' views

117. NZ Airports and BARNZ both raised concerns in their submissions about whether the proposed requirements would appropriately accommodate the next WIAL price setting event.
118. We note that WIAL, in agreement with airlines, has deferred its next price setting event to April 2020. This is beyond the end of the pricing period that aligns with their latest price setting event.
119. BARNZ has suggested that WIAL's next price setting event will include a wash-up that would roll the effective date of the decision back to 1 April 2019, being the day after

the last pricing period. BARNZ therefore considers that the disclosure requirements should assume WIAL's new pricing period begins on 1 April 2019.⁴¹

120. NZ Airports note that there may be some confusion by BARNZ on how the wash-up may operate.⁴²
121. BARNZ has suggested the amended disclosure requirements should apply to Wellington for the full FY20 disclosure year.⁴³

ID amendment

122. We have decided to apply all amendments to AIAL and CIAL as at the date of the amendment determination. We have included a transition provision in clause 2.10 for AIAL and CIAL to disclose comparable forward-looking period to date, annual IRR and supporting information. This allows for the disclosure of forward-looking information that is comparable to the period to date and annual IRR information now required in the backward-looking disclosures.
123. For WIAL we have decided that:
 - 123.1 the amended forward looking disclosure requirements should apply to their next forward-looking profitability disclosure. Therefore, they will come into effect for WIAL from the date of the amendment determination; and
 - 123.2 the amended backward-looking disclosure requirements will be applicable to WIAL for their disclosure year ended 31 March 2020 but not the disclosure year ended 31 March 2019. This provides for the year ended 31 March 2020 disclosures to be prepared consistent with the forward-looking disclosures for that year⁴⁴ and the year ended 31 March 2019 disclosures to be made under the old requirements which do not have forward-looking information disclosures consistent with the IM Review revised requirements.⁴⁵
124. With regards to the suggested WIAL wash-up, we are unable to comment on how this may impact the determination of a pricing period or affect the disclosure in other way until we know how it is determined and applied to prices.
125. Requiring Airports to disclose profitability information that is most consistent with the forward-looking information disclosed at the time they set prices allows interested persons to have access to consistent information to assess profitability.
126. We have also removed the transitional provisions in ID clause 2.10(1) which require AIAL and CIAL to complete the Transitional Report on Regulatory Asset Base Value in

⁴¹ BARNZ, "Submission Airports Information Disclosure Requirements" (9 April 2019), p. 4.

⁴² NZ Airports, "Cross Submission" (3 May 2019), para 19-25.

⁴³ BARNZ, "Submission Airports Information Disclosure Requirements" (9 April 2019), p. 4.

⁴⁴ ID clause 2.5 requires an airport to disclose information relating to its forecast total revenue requirement within five consecutive years of the previous disclosure under that clause, if a disclosure has not been made following a price setting event.

⁴⁵ We have enacted this requirement through the commencement clause 1.2.

Schedule 24. We consider that this transitional requirement is no longer relevant as the applicable time period has passed.

127. We have also removed the following transitional templates from the Airports excel templates:

127.1 Schedule 9 Asset Allocation (2009); and

127.2 Schedule 9 Asset Allocation (2010).

Attachment A: Further background on backward and forward-looking profitability assessment

128. To assess whether Airports are limited in their ability to extract excessive profits, we compare the effective rate of return targeted by an Airport against our mid-point estimate of the cost of capital. As a result of our 2016 IM review we introduced the forward-looking profitability indicator to better assess the extent of, and rationale for any variance.
129. Prior to the 2016 IM review, to assess whether Airports were limited in their ability to extract excessive profits, we compared the effective rate of return targeted by an Airport against our mid-point estimate of the cost of capital.
130. However, when an Airport targeted a return that was different from our mid-point estimate of the cost of capital, we were unable to understand the extent of, and rationale for any variance.
131. Therefore, we introduced the requirement that Airports must disclose a forward-looking profitability indicator that reflected the Airports decision on targeted returns.
132. To facilitate this analysis, we need transparent disclosures of targeted returns and underlying assumptions. Prior to the 2016 IM review, this transparency was made difficult by the fact that Airports:
 - 132.1 can set prices as they see fit;
 - 132.2 are not required to apply the Airport IMs Determination in setting prices and making their forward-looking pricing disclosures;
 - 132.3 do not have to apply our forecast of cost of capital when setting prices; and
 - 132.4 may target a return that is different from an Airport's estimate of cost of capital.⁴⁶
133. Our proposal to introduce the backward-looking profitability requirement will allow for interested persons to better assess the extent of, and rationale for any variance with an Airports forward-looking disclosure.
134. In 2018 we completed an assessment of AIAL and CIAL's pricing decisions and expected performance for July 2017 – June 2022, which included an analysis of AIAL and CIAL's forward-looking profitability disclosures.⁴⁷ This did not include an

⁴⁶ Commerce Commission "Input methodologies review decision – Topic paper 5: Airports profitability assessment" (20 December 2016), p 29.

⁴⁷ Commerce Commission "Review of Auckland International Airport's pricing decisions and expected performance (July 2017 – June 2022) Final report – Summary and analysis under section 53B(2) of the Commerce Act 1986" (1 November 2018). Commerce Commission "Review of Christchurch International

assessment of Airports backward-looking profitability since the amendments are being made through this process. For an example of how we might assess backward and forward-looking profitability for airport services see our report on electricity distributors probability.⁴⁸

Airport's pricing decisions and expected performance (July 2017 – June 2022) Final report – Summary and analysis under section 53B(2) of the Commerce Act 1986" (1 November 2018).

⁴⁸ Commerce Commission "Profitability of Electricity Distributors Following First Adjustments to Revenue Limits" (8 June 2016).