

Airports backward-looking profitability information disclosure amendments

Draft reasons paper

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Commerce Commission
Wellington, New Zealand

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1. Introduction

Purpose of paper

1. This paper sets out the reasons for our proposed amendments to the backward-looking profitability information disclosure (**ID**) requirements applying to suppliers of airport services.
2. We invite your views on the proposed amendments. By providing your views on this paper and the draft ID amendments determination, you will help inform our final decision.

How to provide your views

3. Please email submissions by 4pm, 11 April 2019 and cross-submissions by 4pm, 26 April 2019. We will consider all submissions received by this date in reaching our final decision.
4. Please email your submission to regulation.branch@comcom.govt.nz with 'Airports profitability ID amendment' in the subject line of your email. All submissions will be published on our website.
5. While we discourage requests for non-disclosure of submissions so that all information can be tested in an open and transparent manner, we recognise that there may be cases where parties that make submissions wish to provide information in confidence.¹ We offer the following guidance:
 - 5.1 If it is necessary to include confidential material in a submission, the information should be clearly marked, with reasons why that information is confidential.
 - 5.2 Where commercial sensitivity is asserted, submitters must explain why publication of the information would be likely to unreasonably prejudice their commercial position or that of another person who is the subject of the information.
 - 5.3 Both confidential and public versions of the submission should be provided.
 - 5.4 The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.

¹ Parties can also request that we make orders under section 100 of the Act in respect of information that should not be made public. Any request for a section 100 order must be made when the relevant information is supplied to us, and must identify the reasons why the relevant information should not be made public. We will provide further information on section 100 orders if requested by parties. A key benefit of such orders is to enable confidential information to be shared with specified parties on a restricted basis for the purpose of making submissions. Any section 100 order will apply for a limited time only as specified in the order. Once an order expires, we will follow our usual process in response to any request for information under the Official Information Act 1982.

6. We request that you provide multiple versions of your submission if it contains confidential information or if you wish for the published electronic copies to be 'locked'. This is because we intend to publish all submissions on our website. Where relevant, please provide both an 'unlocked' electronic copy of your submission, and a clearly labelled 'public version'.

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

7. 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.² 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.³
8. Auckland International Airport Limited (**AIAL**), Christchurch International Airport Limited (**CIAL**) and Wellington International Airport Limited (**WIAL**)⁴ are subject to ID regulation under Part 4 of the Act.⁵ 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.

Background to proposed amendments

9. 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

² Commerce Act 1986, s 52.

³ Commerce Commission "Input methodologies review decisions: Framework for the IM review" (20 December 2016).

⁴ In this paper we collectively refer to these companies as "Airports".

⁵ Commerce Act 1986, Subpart 11.

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. 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.¹⁰ In our 2016 IM decision, we indicated that any consequential changes affecting our backward-looking requirements will be subject to a separate consultation process.¹¹
11. For further background on how the approach to assessing profitability has changed see Attachment A: Further background on backward and forward-looking profitability assessment.
12. 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.¹² The conditional exemptions required AIAL and CIAL to disclose backward-looking profitability information consistent with the already amended forward-looking profitability disclosure.

Our amendment process so far

13. 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.¹³
14. 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 have informed our draft decision. Formal views on our draft decision are sought from stakeholders as part of this submission process. The workshop papers and summary of views expressed can be found on our website.¹⁴ We have not specifically addressed all views in this paper though we have addressed some as necessary.
15. After considering views from submissions to our draft reasons paper we intend to publish our final decision by June.

¹⁰ Commerce Commission "Airport Services Information Disclosure Amendments Determination 2016, [2016] NZCC 29" (20 December 2016).

¹¹ Commerce Commission "Input methodologies review decision – Topic paper 5: Airports profitability assessment" (20 December 2016), p 8.

¹² 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), paragraphs 2-4.

¹³ Commerce Commission "Airports backward-looking profitability information disclosure amendments – process paper" (17 January 2019).

¹⁴ Commerce Commission "Airports Profitability Assessments" (22 February 2019). Commerce Commission, "Airports backward-looking profitability information disclosure amendments - workshop. Summary of views expressed" (7 March 2019). These publications can be found here: <https://comcom.govt.nz/regulated-industries/airports/projects/airports-backward-looking-profitability-id-amendments>.

Scope of the ID amendments

16. In order to promote the Part 4 purpose and the purpose of ID, we have proposed amendments to align our backward-looking profitability ID requirements with our forward-looking profitability ID requirements.
17. We have also proposed minor error correction amendments.

Purpose of the amendments

18. We consider that our proposed amendments would allow for better information to be available for interested persons to 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 proposed amendments would allow interested persons to have sufficient information to assess whether airports are extracting excessive profits, consistent with s 52A(1)(d) of the Act. In each chapter we have explained in greater detail why we consider our proposed amendments will allow for better information for interested persons.

Material published alongside this paper

19. In this paper we outline our reasons for our proposed amendments to the airport services ID determination.
20. In addition, we have published alongside this paper a draft amendment determination and updated excel templates which incorporate the proposed amendments.¹⁵
21. The draft amendments determination identifies amendments as tracked changes and the excel templates note amendments in the “ref” column. The excel templates note:
 - 21.1 “amended” if the row has been amended, which in some instances includes changes in the formula or cell formatting;
 - 21.2 “moved” if the row has been moved to another location in the excel sheet;
 - 21.3 “new” if the row is new; and
 - 21.4 “lines removed” if rows have been removed.

¹⁵ These publications can be found here: <https://comcom.govt.nz/regulated-industries/airports/projects/airports-backward-looking-profitability-id-amendments>

2. Summary of proposed decisions and amendments

Purpose of chapter

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

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

Matter of consideration	Proposed decision	Affected clauses and schedules*
Profitability assessment	Profitability information is disclosed using an internal rate of return (IRR) approach. An IRR that is comparable to a post-tax weighted average cost of capital (WACC) is only 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 or non-pricing assets backward-looking profitability is not required to be disclosed 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 all 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. We propose: <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 to align it with the forward-looking disclosure; and not removing the backward-looking non-standard depreciation 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 our proposed decision is to make it not applicable for WIAL until its new pricing period.	Clause 2.10

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

3. Profitability assessment

Purpose of chapter

24. This chapter outlines our proposed amendments, and the reasons for our proposal to:
- 24.1 implement an IRR approach to assessing backward-looking profitability; and
 - 24.2 require the disclosure of the IRR calculation that is comparable to a post-tax WACC.

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

Matter of consideration	Proposed decision	Affected clauses and schedules*
Profitability assessment	Profitability information is disclosed using an IRR approach. An IRR that is comparable to a post-tax WACC is only to be disclosed.	Schedule 1 and clause 1.4

Problem definition

25. The backward-looking profitability assessment provided for in the current disclosure requirements (Schedule 1: Report on Return on Investment) assesses profitability by:
- 25.1 using a return on investment (**ROI**) calculation; and
 - 25.2 comparing ROI to a post-tax WACC and vanilla WACC.¹⁶
26. Our 2016 IM review resulted in a change to the approach for assessing profitability in our forward-looking ID requirements for airport services.¹⁷ This review resulted in the requirement to disclose forward-looking profitability by:
- 26.1 using an IRR calculation instead of an ROI; and
 - 26.2 only assessing IRR against a post-tax WACC.

¹⁶ Commerce Commission “Airport Services Information Disclosure Amendments Determination 2016, [2016] NZCC 29” (20 December 2016). For reasons for the change in approach from ROI to IRR see Commerce Commission “Input methodologies review decision – Topic paper 5: Airports profitability assessment” (20 December 2016), para 165.

¹⁷ Commerce Commission “Airport Services Information Disclosure Amendments Determination 2017, [2017] NZCC 36” (21 December 2017).

Proposed airport services ID amendment

27. We propose requiring the disclosure of backward-looking profitability information using an IRR approach. This proposed amendment includes:
 - 27.1 requiring the disclosure of an IRR calculation in the schedule that was previously referred to as Schedule 1: Report on Return on Investment;
 - 27.2 renaming Schedule 1: Report on Return on Investment to Schedule 1: Report on Profitability; and
 - 27.3 removing the references to ROI and regulatory investment value in Schedules 1, 7 and 18.
28. These proposed amendments would allow for interested persons to better assess actual profitability of airport services consistent with the forward-looking profitability approach.
29. We also propose only requiring the disclosure of the IRR calculation that is comparable to a post tax WACC in Schedule 1: Report on Profitability.
30. This approach removes the requirement to disclose profitability that is comparable to a vanilla WACC.
31. Consistent with the forward-looking profitability assessments we do not consider the vanilla WACC comparisons are necessary for interested persons. We note that information required to determine profitability that is comparable to a vanilla WACC is still disclosed and able to be determined.
32. 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.
33. 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 assessments

Purpose of this chapter

34. This chapter outlines our proposed decision and reasons to require only the disclosure of profitability relating to the RAB assets.

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

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

Problem definition

35. The backward-looking profitability assessment provided for in the current disclosure requirements only looks at profitability relating to all RAB assets.
36. 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).
37. 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 assessment.
38. 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.¹⁸

¹⁸ 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.

Proposed decision

39. We propose continuing to require only the disclosure of backward-looking profitability on the RAB assets.
40. We have considered also requiring the disclosure of profitability relating to the pricing assets as is required in the forward-looking profitability assessments.
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.¹⁹
42. Board of Airline Representatives of New Zealand (BARNZ) indicated that they would like the information but also noted the challenges that would be faced in providing the additional information on an annual basis.²⁰ At the workshop BARNZ and Air New Zealand Limited decided to not comment until later in the consultation process on whether the information should be required.
43. 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 draft decision is to not require the information to be disclosed through the ID requirements.
44. 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.
45. If at a later stage it becomes evident that pricing asset profitability information is necessary or it would be more efficient to obtain non-pricing asset information through annual disclosures, we note that we have the ability to:
 - 45.1 amend our ID requirements; or
 - 45.2 require airports to provide the information through a request under s 53ZD of the Act.

¹⁹ Commerce Commission, "Airports backward-looking profitability information disclosure amendments - workshop. Summary of views expressed" (7 March 2019), para 4.3.2.

²⁰ Commerce Commission, "Airports backward-looking profitability information disclosure amendments - workshop. Summary of views expressed" (7 March 2019), para 4.3.1.

5. Comparison to forward-looking profitability assessment

Purpose of this chapter

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

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

Matter of consideration	Proposed decision	Affected clauses and schedules*
Comparison to forward looking profitability assessment	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 assessment 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

47. Current backward and forward-looking profitability disclosure requirements compare profitability to the 5 year WACC.
48. Comparing rates of return on an annual basis with the 5 year WACC can be misleading if airports have decided to smooth their revenue as part of their pricing decision.
49. Revenue smoothing, while providing even revenues across that pricing period, can cause uneven forecast profitability across the pricing period. Assessing profitability against forecast for the whole period, part way through the period can be misleading.
50. Also current backward-looking profitability disclosures have inconsistent approaches regarding the level of explanation that is required for variances. This is demonstrated in:
- 50.1 Schedule 1: Report on Return on Investment which does not have a requirement to explain variances; and
- 50.2 Schedule 4: Report on Regulatory Asset Base Roll Forward which does not have a requirement to explain variances; whereas
- 50.3 Schedule 6: Report on Actual to Forecast Performance requires all variances above 10% to be explained.
51. 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 disclosure (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

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

Proposed airport services ID amendment

53. We propose requiring the disclosure of period to date and annual IRRs that are comparable to forecast information. We propose amending:
 - 53.1 Schedule 1: Report on Profitability to require the disclosure of backward-looking period to date and annual IRRs; and
 - 53.2 Schedule 18: Report on the Forecast Total Asset Base Revenue Requirements to require the disclosure of annual and period to date IRRs.
54. Introducing the requirement to disclose pricing period to date and annual forecast IRRs allows for interested persons to compare backward-looking profitability to forecast part way through the pricing period and therefore better assess whether airports are extracting excessive profits.
55. At the workshop NZ Airports questioned whether annual IRR information was relevant, noting that period to date profitability may be sufficient for interested persons to assess profitability.²²
56. We note that information supporting an annual IRR is required to be disclosed to allow for the calculation of period to date annual IRRs. We have made the period to date IRR the predominant disclosure but have also included the disclosure of annual IRRs.
57. We also propose requiring explanations for variances to forward-looking profitability to be disclosed. This proposal includes amending:

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, lessees' operating leases are referred to as 'right of use' assets and are brought onto the balance sheet 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 Commerce Commission, "Airports backward-looking profitability information disclosure amendments - workshop. Summary of views expressed" (7 March 2019), para 4.2.

- 57.1 Schedule 1: Report on Profitability to require a high-level explanation of variances in the IRR and its key inputs eg, assets commissioned, operational expenditure etc;
 - 57.2 Schedule 4: Report on Regulatory Asset Base Roll Forward to require explanations for variances to forecast RAB roll forward information; and
 - 57.3 Schedule 6: Report on Actual to Forecast Performance to remove the 10% threshold for the disclosure of variance.
- 58. We also propose removing the 10% threshold in Schedule 6: Report on Actual Forecast Performance in order to have a consistent approach to requiring variance explanations across our profitability requirements.
 - 59. We also propose amending clause 2.3 to require an explanation for the impact on the backward-looking disclosure of any changes in an airport's accounting treatments from those adopted when preparing the forward-looking disclosure.
 - 60. Explanations of variances to forward-looking profitability is important information for interested persons to understand why profitability might be different to targeted profitability. This would allow interested person to assess whether the purpose of Part 4 is being met.

6. Cash flow timing

Purpose of this chapter

61. This chapter describes our proposed amendments, and the reasons for our proposed amendments for specifying cash flow timing assumptions for the backward-looking profitability disclosures.

Table 5: Summary of proposed amendments for specifying cash flow timing assumptions for the backward-looking profitability disclosures

Matter of consideration	Proposed 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 assessment to include monthly assets commissioned cash flow timing assumption.	Schedule 1 and clauses 1.4 and 2.3

Problem definition

62. There is currently no requirement for airports to use a consistent cash flow timing assumption in the disclosure of backward and forward-looking profitability disclosures. This is inconsistent with other aspects of the calculation that requires a consistent approach for the forward and backward-looking disclosures.²³
63. Our forward-looking profitability disclosure requirements include default cash flow timing assumptions with the ability for airports to apply alternative assumptions.²⁴
64. The default cash flow timing assumption for assets commissioned in the forward-looking profitability assessment assumes average mid-year timing. Although this is likely to be appropriate for forecasting, it may not be appropriate for backward-looking profitability.

Proposed airport services ID amendment

65. We propose amending 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. We consider that this will provide more comparable information for interested persons to assess whether airports are extracting excessive profits consistent with s 52(1)(d) of the Act.

²³ Airport Services Input Methodologies Determination 2010 – consolidated as of 20 December 2016, clauses 3.13, 3.4(5)(c) & 3.7(6).

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

66. We also propose continuing to require the backward-looking profitability assessment to assume monthly assets commissioning cash flow timing assumptions. For Schedule 1: Report on Profitability, this proposed approach requires:
- 66.1 asset commissioning to be disclosed monthly; and
 - 66.2 the IRR calculations are to assume monthly asset commissioning.
67. Although requiring assets commissioned to have monthly cash flow timing is not consistent with the forward-looking profitability it will allow interested persons to make more accurate assessments of backward-looking profitability.
68. 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.²⁵ However, actual outcomes can be different, especially where there are large one-off assets being capitalised, as is the case with airports. Accordingly, given the potential impact on the profitability assessment we consider it is appropriate for interested persons to have profitability information disclosed that takes into account when assets are commissioned.
69. We also note that requiring a more accurate reflection of asset commissioning during the year aligns more closely with the capitalised interest requirements which requires capitalisation up to the commissioning date.²⁶ If there is an inconsistency between the assets commissioned cash flow timing assumption and the capitalised interest requirements there is the potential for time use of money to be double counted or not considered in profitability assessments.

²⁵ Airports typically start their price setting process 2 years before they set their prices and typically forecast profitability for a 5 year period.

²⁶ Airport Services Input Methodologies Determination 2010 – consolidated as of 20 December 2016, clause 3.9(3).

7. Carry forward balance disclosure

Purpose of this chapter

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

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

Matter of consideration	Proposed decision	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

71. Current forward-looking disclosure requirements, while requiring the disclosure of an opening and closing pricing period carry forward balance, do not require the disclosure of annual carry forward balances.
72. As discussed in Chapter 5, we propose amending 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.

Proposed airport services ID amendment

73. We propose introducing a requirement to disclose annual carry forward balances in backward and forward-looking profitability disclosure requirements. This approach includes amending:
- 73.1 Schedule 1: Report on Profitability to have a requirement to disclose the actual roll forward of the carry forward balance; and
- 73.2 Schedule 18: Report on the Forecast Total Asset Base Revenue Requirements to include a requirement to disclose annual forecast carry forward balances.
74. 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 more sufficient information for interested persons to assess whether airports are extracting excessive profits consistent with s 52(1)(d) of the Act.

8. Other disclosure amendments and decisions

Purpose of this chapter

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

Table 7: Summary of proposed other amendments

Matter of consideration	Proposed decision	Affected clauses and schedules*
Other disclosure requirements	Backward-looking disclosure requirements amended to align with the forward-looking disclosure requirements. We propose: <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 to align it with the forward-looking disclosure; and • not removing the backward-looking non-standard depreciation disclosure. Minor corrections to definitions and excel template formulas.	Schedule 1, 4, 18 19, 20 and clause 1.4

Problem definition

76. Currently Schedule 4: Report on the Regulatory Asset Base Roll Forward requires the disclosure of:
- 76.1 offsetting revenue under Schedule 4b(v): Works under construction;
 - 76.2 assets held for future use information under Schedule 4(b)(viii); and
 - 76.3 non-standard depreciation information under Schedule 4(b)(ii)-(iii).
77. The offsetting revenue disclosure is not required to be forecast and has never been disclosed in backward-looking profitability disclosures.
78. 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.²⁷
79. As a result of the 2016 IM review, we amended the airports IM and ID determinations to include a set of principles that airports must apply when disclosing

²⁷ Commerce Commission “Input mythologies review decisions – Topic paper 5: Airports profitability assessment” (20 December 2016), p. 130.

non-standard depreciation profits. This also included the requirement to disclose information in the forward-looking profitability templates.²⁸ The backward-looking non-standard depreciation disclosure may not be necessary now that the forward-looking profitability disclosure requirements require the disclosure of non-standard depreciation information. The approach to depreciation needs to be consistent between backward and forward-looking profitability disclosures.²⁹

80. Minor issues have been identified in the excel template used for the disclosure of pricing information. These issues include:
 - 80.1 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;
 - 80.2 formulas errors in Schedule 19: Report on the Forecast Pricing Asset Base Revenue Requirements; and
 - 80.3 a formatting error in Schedule 20: Report on Demand Forecast which does not allow for the input of decimal points.
81. We have also identified some definitions that were not removed as a result of past amendments to the requirements.

Proposed airport services ID amendment

82. We propose amending 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.³⁰
83. We also propose amending 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. The forward-looking disclosure was updated as a result of the 2016 IM review.³¹
84. We propose not amending the backward-looking non-standard disclosure in Schedule 4: Report on the Regulatory Asset Base Roll Forward. At the workshop, NZ Airports suggested that non-standard depreciation is no longer necessary on a

²⁸ Commerce Commission “Input methodologies review decision – Topic paper 5: Airports profitability assessment” (20 December 2016), para 274.

²⁹ Airport Services Input Methodologies Determination 2010 – consolidated as of 20 December 2016, clauses 3.4(5)(c).

³⁰ Commerce Commission, “Airports backward-looking profitability information disclosure amendments - workshop. Summary of views expressed” (7 March 2019), para 8.2.

³¹ Commerce Commission “Input methodologies review decision – Topic paper 5: Airports profitability assessment” (20 December 2016), p 130.

backward-looking basis as it is disclosed as part of airports' price setting (forward-looking) disclosures.³² Airports must use a consistent methodology for calculating non-standard depreciation for the backward and forward-looking disclosures.³³

85. We consider that continuing to require the non-standard disclosure in Schedule 4(b)(ii)-(iii) will allow for interested persons to understand the actual impact of the non-standard depreciation approach. Actual impacts may be different to forecast disclosures because of other forecast assumptions.
86. We also propose correcting the following issues:
 - 86.1 updating formulas in Schedule 18 and 19 to align the presentation of disclosures with the definitions;
 - 86.2 correcting the formulas in Schedule 19: Report on the Forecast Pricing Asset Base Revenue Requirements;
 - 86.3 correcting the formatting issue in Schedule 20: Report on Demand Forecasts which does not allow for the input of decimal points; and
 - 86.4 removing some definitions that were not removed as a result of past amendments to the requirements.

³² Commerce Commission, "Airports backward-looking profitability information disclosure amendments - workshop. Summary of views expressed" (7 March 2019), para 8.3.

³³ Airport Services Input Methodologies Determination 2010 – consolidated as of 20 December 2016, clauses 3.4(5)(c).

9. Transitional provisions

Purpose of this chapter

87. This chapter describes our proposed provisions to transition airports on to the amended requirements, and our reasons for these proposed transitional provisions.

Table 8: Summary of proposed transitional provisions

Matter of consideration	Proposed decision	Affected clauses and schedules*
Transitional provisions	The new provisions are to apply for AIAL and CIAL immediately, but our proposed decision is to make it not applicable for WIAL until its new pricing period.	Clause 2.10

Problem definition

88. WIAL's current prices were set when the previous forward-looking disclosures 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 proposed new approach to assessing profitability.
89. 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.
90. However, AIAL and CIAL will not have some forward-looking profitability information disclosed in the format that we propose in these amendments, as they have already made their forward-looking disclosures for their current price periods.
91. The ID determination also has transitional provisions which no longer apply because the applicable time period has passed.

Proposed airport services ID amendment

92. We propose amending ID clause 2.10 to reflect that:
- 92.1 amendments to Schedules 1 and 4 are not applicable for WIAL until the new pricing period; and
- 92.2 AIAL and CIAL are required to disclose forward-looking annual IRR and supporting information in the backward-looking profitability disclosures as if it had been prepared consistent with the revised Schedule 18.
93. 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 sufficient information to assess profitability.

94. We also propose removing 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 Schedule 24. We consider that this transitional requirement is no longer relevant as the applicable time period has passed.
95. We also propose removing the following transitional templates from the airports excel templates:
 - 95.1 Schedule 9 Asset Allocation (2009); and
 - 95.2 Schedule 9 Asset Allocation (2010).

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

96. 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.
97. 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.
98. 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.
99. Therefore, we introduced the requirement that airports must disclose a forward-looking profitability indicator that reflected the airports decision on targeted returns.
100. 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:
 - 100.1 airports can set prices as they see fit;
 - 100.2 airports are not required to apply the Airport IMs Determination in setting prices and making their forward-looking pricing disclosures;
 - 100.3 airports do not have to apply our forecast of cost of capital when setting prices; and
 - 100.4 airports may target a return that is different from an airport's estimate of cost of capital.³⁴
101. 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.
102. 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.³⁵ This did not include an

³⁴ Commerce Commission "Input methodologies review decision – Topic paper 5: Airports profitability assessment" (20 December 2016), p 29.

³⁵ 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 proposed 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.³⁶

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).

³⁶ Commerce Commission "Profitability of Electricity Distributors Following First Adjustments to Revenue Limits" (8 June 2016).