

ELECTRICITY AND GAS INFORMATION DISCLOSURE SEMINAR

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21-22 MARCH, 25-26 MARCH 2013



ASSET VALUATION

Concepts and Practice

Presentation to Information Disclosure Seminar
March 2013



Why have this session?

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- Basic rules are contained in input methodologies (IMs)
- Who has studied the IMs before?
 - Sometimes detailed knowledge missing
 - Sometimes broader view missing
- Different rules existed prior to current information disclosure (ID) requirements
- This session is based on our experience so far ...

What will we cover today?

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- Regulated asset base (RAB)
- Initial asset values
- Interaction with cost allocation
- RAB roll-forward
 - Revaluations
 - Depreciation
 - Asset acquisitions and disposals
- Special cases

Where are asset values used?

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- IMs were required to be set for:
 - “the valuation of assets, including depreciation and the treatment of revaluations” – s 52T(1)(a)(ii) Commerce Act 1986
- Price-monitoring (ID) requires transparency of revenue components, including:
 - Opening RAB (Investment value)
 - Depreciation (Expense)
 - Revaluations (Income)
- Compare this to price-setting which requires a quantification of ‘building blocks’

Where are asset values used in ID?

Schedule 2 of ID determination:

2(ii): Information Supporting the ROI		(\$000)	
24			
25			
26	Total opening RAB value		
27	<i>plus</i> Opening deferred tax		
28	Opening RIV		-
29			
30	Operating surplus / (deficit)		
31	<i>less</i> Regulatory tax allowance		
32	<i>less</i> Assets commissioned		
33	<i>plus</i> Asset disposals		
34	Notional net cash flows		-
35			
36	Total closing RAB value		
37	<i>less</i> Adjustment resulting from asset allocation		
38	<i>less</i> Lost and found assets adjustment		
39	<i>plus</i> Closing deferred tax		
40	Closing RIV		-
41			
42	ROI—comparable to a vanilla WACC		-
43			
44	Leverage (%)		44%
45	Cost of debt assumption (%)		
46	Corporate tax rate (%)		
47			
48	ROI—comparable to a post tax WACC		-

Where are asset values used in ID?

Schedule 3 of ID determination:

	(\$000)
7 3(i): Regulatory Profit	
8 Income	
9 Line charge revenue	-
10 <i>plus</i> Gains / (losses) on asset disposals	-
11 <i>plus</i> Other regulated income (other than gains / (losses) on asset disposals)	-
12	
13 Total regulatory income	-
14 Expenses	
15 <i>less</i> Operational expenditure	-
17 <i>less</i> Pass-through and recoverable costs	-
18	
19 Operating surplus / (deficit)	-
20	
21 <i>less</i> Total depreciation	-
22	
23 <i>plus</i> Total revaluation	-
24	
25 Regulatory profit / (loss) before tax & term credit spread differential allowance	-
26	
27 <i>less</i> Term credit spread differential allowance	-
28	
29 Regulatory profit / (loss) before tax	-
30	
31 <i>less</i> Regulatory tax allowance	-
32	
33 Regulatory profit / (loss)	-

Regulatory Asset Base (RAB)

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- The RAB is a regulatory construct
 - Problem of circularity
 - RAB bears close resemblance to financial reporting
 - Methodology is Indexed Historic Cost (IHC)
- Individual or aggregated assets?
 - IMs require individual assets
 - ID generally requires aggregated

What is an asset exactly?

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- Network and non-network assets
- Intangibles
- Land and easements
- Network spares
- Vested assets
- Works under construction
- Working capital
- Goodwill



What are the initial asset values?

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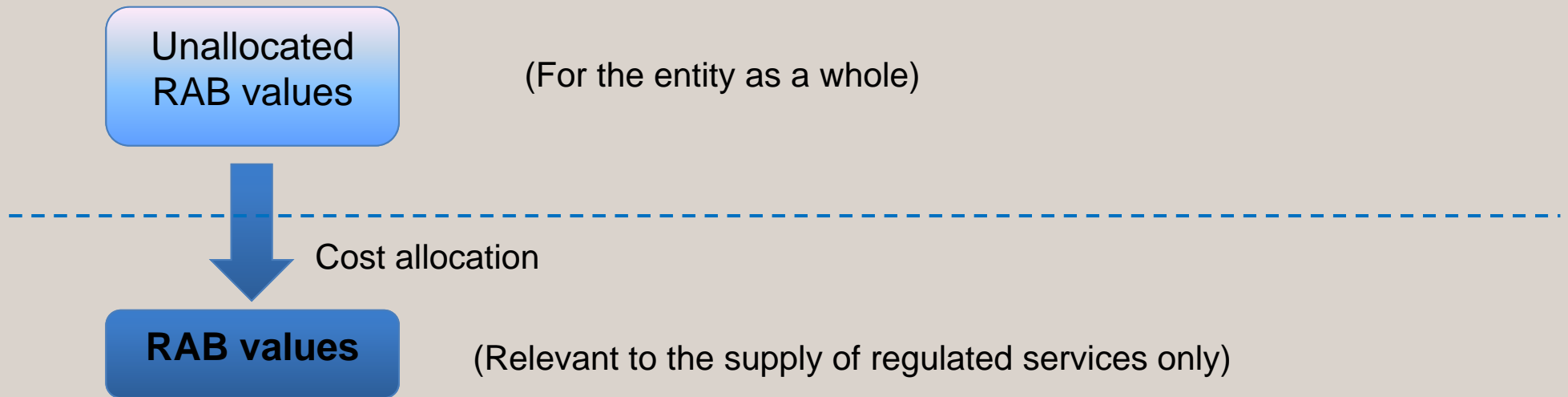
- Take the 1 April 2009 asset values under prior ID
 - This is the deemed historic cost for IHC methodology
 - Note that values based mostly on prior ODV valuations
- For controlled gas companies, add in the Gas Authorisation asset values (updated from 2005)

What are the initial asset values?

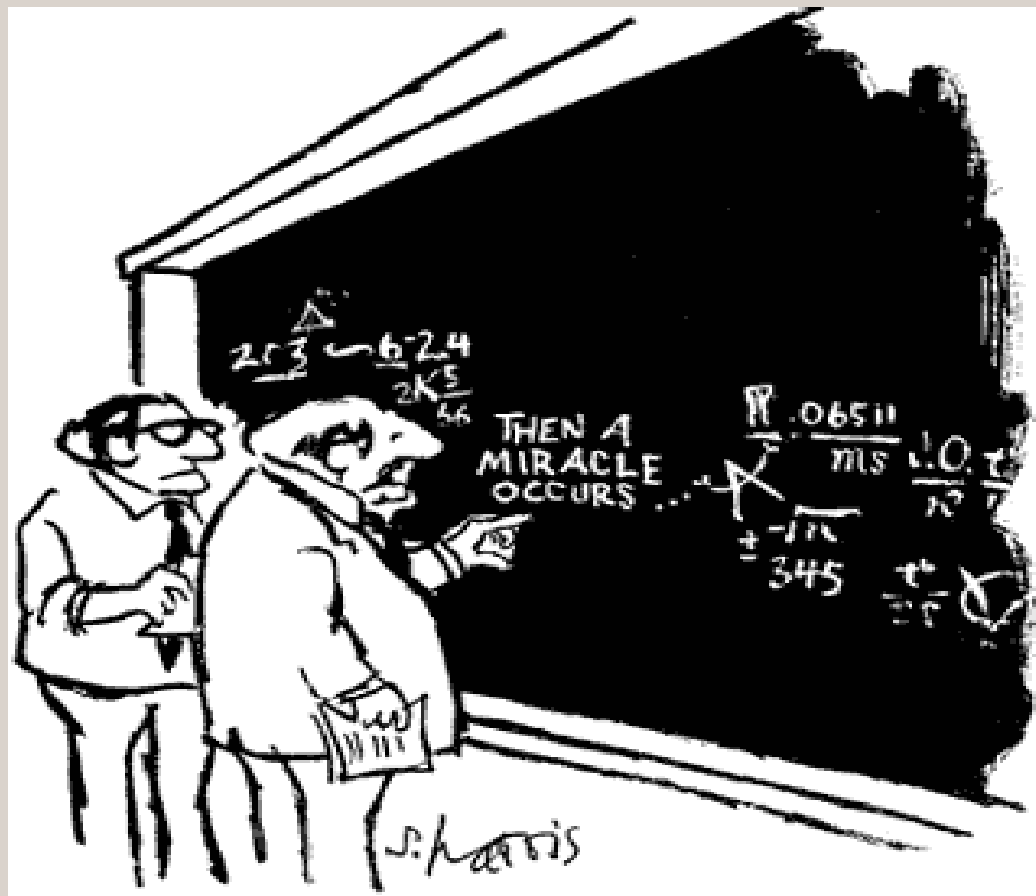
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- Asset adjustment process - one-off election
 - Include certain assets (eg load control relays)
 - Exclude things that are not 'assets' (see prior slide)
 - Correct errors in asset registers
 - Adjust some multipliers and optimisation/EV
- Results in:
 - Included, excluded, and value modified assets

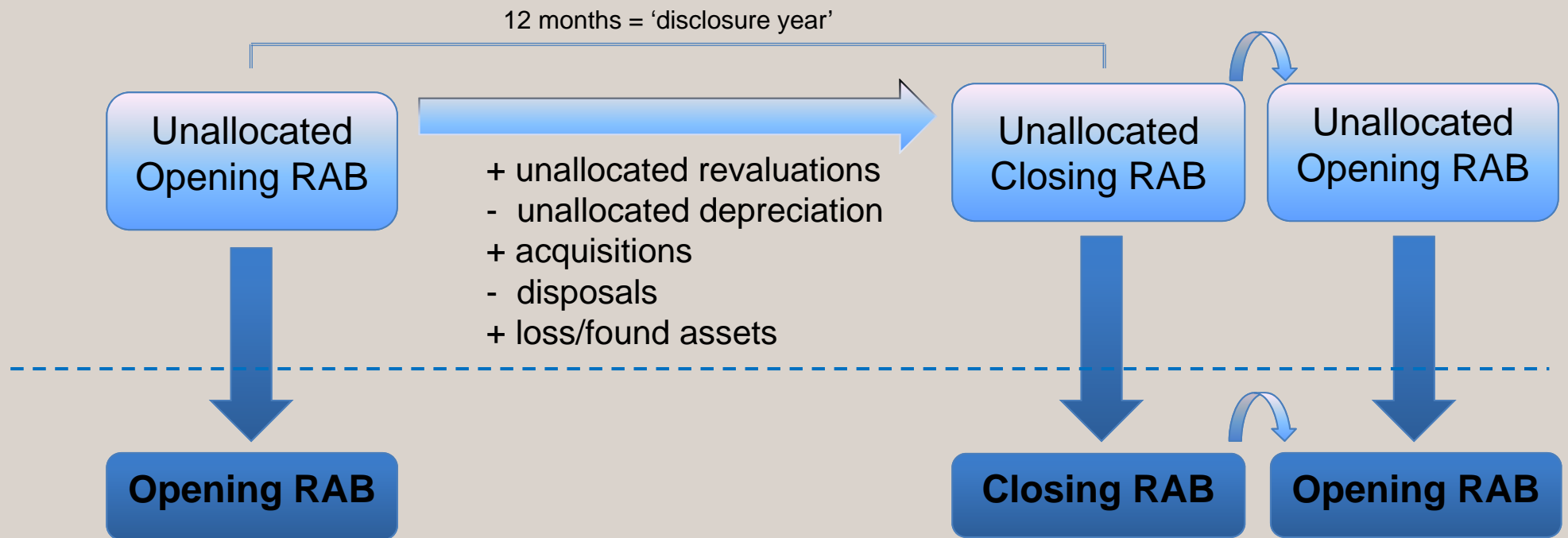
- Relationship with cost allocation



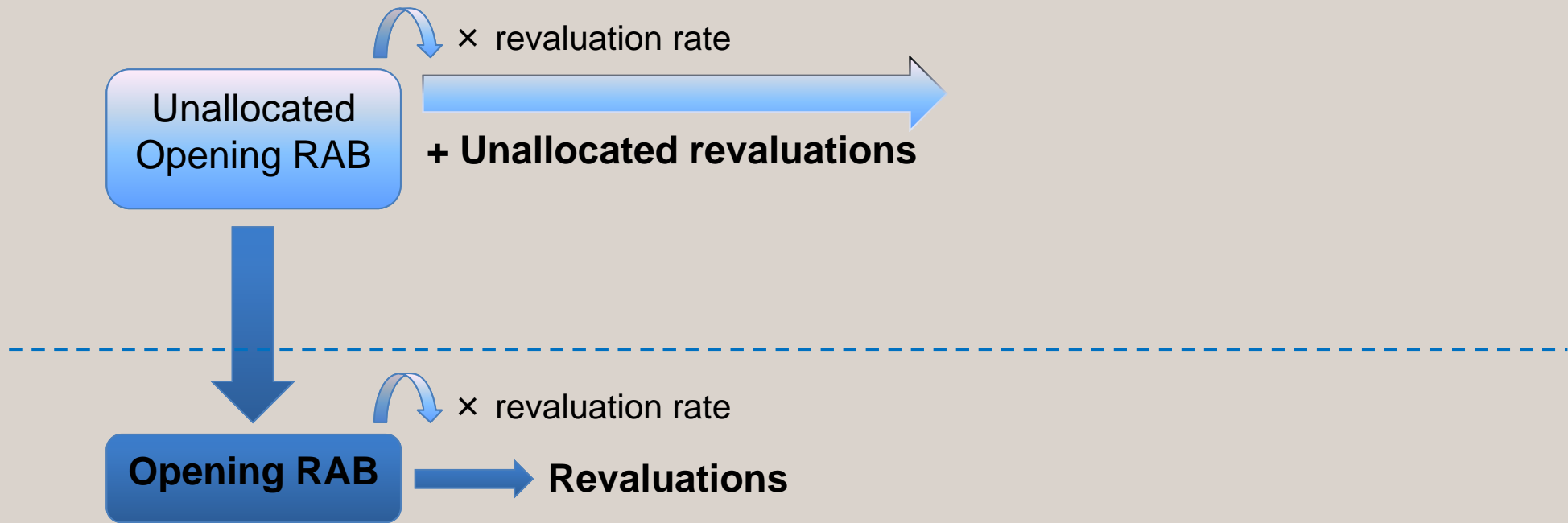
The RAB 'roll forward'



The RAB 'roll forward'

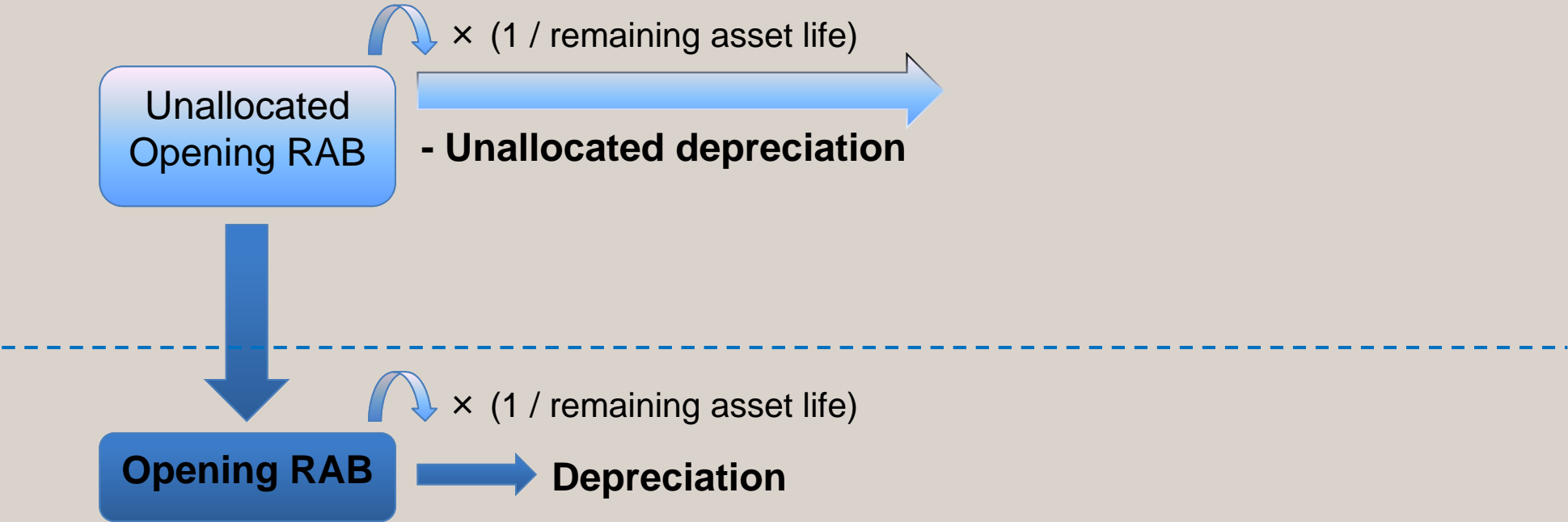


- The 'indexed' part of IHC methodology
- Current value indexed annually by the change in the Consumer Price Index (CPI)
- Multiply opening RAB value by 'revaluation rate'
 - Revaluation rate is change in CPI

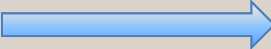


- Revaluation must be treated as income for the purposes of determining profitability (ROI)
- No revaluations for:
 - fully depreciated assets
 - disposed assets
 - lost assets
- No periodic revaluations like GAAP

- Allocation of capitalised costs over time
- ‘Diminution in an asset’s remaining service life potential’
- Somewhat similar to GAAP and tax concepts
- Straight line methodology:
 - Remaining asset life
 - Opening RAB value
- IHC results in a constant real charge over asset lifetime
- Nil depreciation for land, easements, network spares



Depreciation asset lives

- Initial assets = prior ID regime
- Assets after 2009 

SCHEDULE A STANDARD PHYSICAL ASSET LIVES

Standard Physical Asset Lives for EDBs

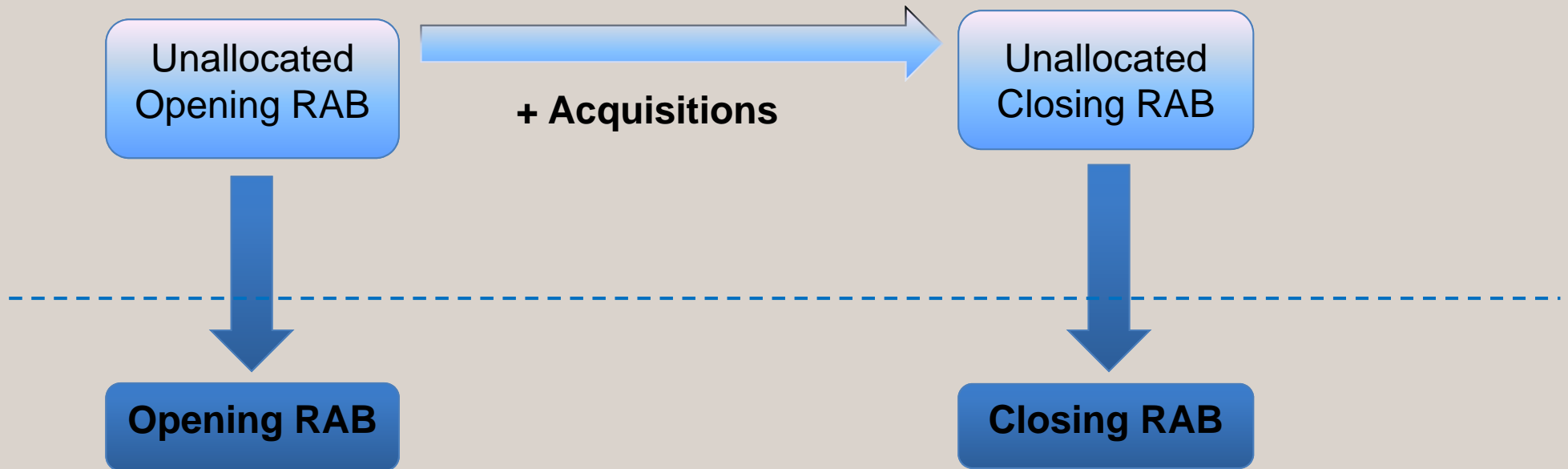
ASSET DESCRIPTION	STANDARD PHYSICAL ASSET LIFE (YEARS)
SUBTRANSMISSION	
<i>66kV, 50kV and 33 kV Lines:</i>	
Concrete pole	60
Wood pole	45

- Extended and reduced lives
- Composite assets, dedicated assets, fixed life easements
- Independent engineer’s reports
- Found assets

- CPP modifications to methodology
- Unallocated depreciation constraint over lifetime

- More prescriptive than prior ID regime
- ‘Commissioning’: used by a supplier to provide services
- GAAP cost applies generally
 - ‘location and condition’
 - foreign currency
 - cost of financing
- Relationship with tax cost covered in tax presentation
- Nil value for intangibles, easement land, unnecessary/expensed spares
- Limited values for easements, prior regulated assets, related party acquisitions

- Where do they fit in?



- Is limited to post-tax cost of capital
 - Prescribed for EDBs/GPBs (published WACC)
 - Estimated by exempt EDBs
- Start and stop dates
 - Consistent with NZ IAS 23 (Borrowing costs)

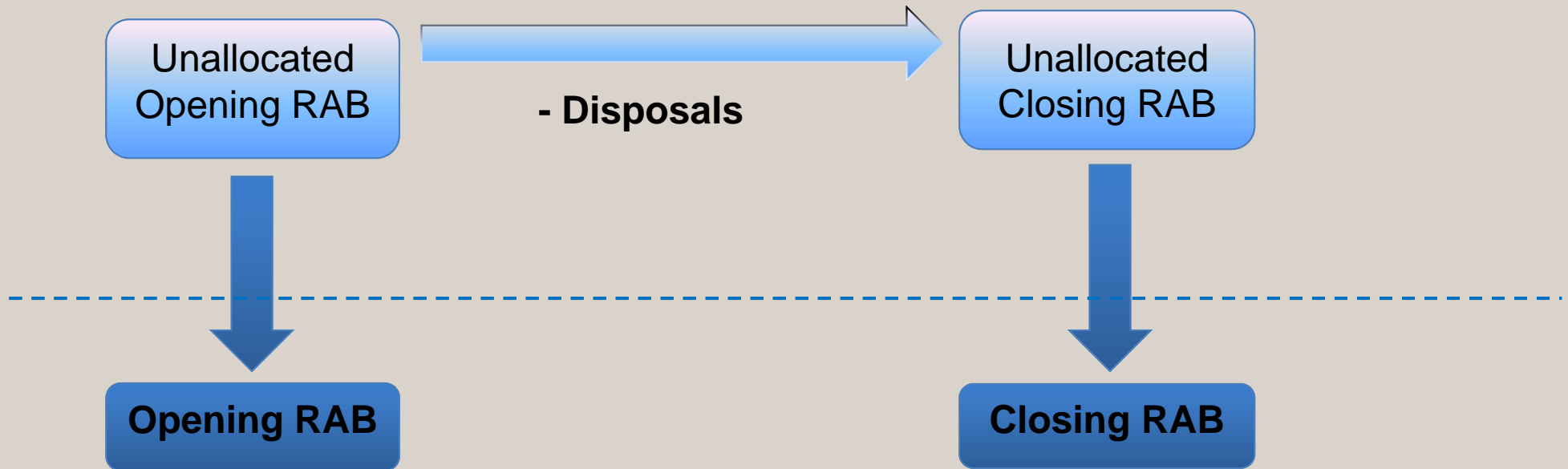
- Principle: where the amount is material then must be at 'arm's length'
- Materiality: safe harbour where total of related party acquisitions are:
 - Less than 1% of opening RAB; or
 - Less than 20% of commissioned assets in that disclosure year
- Use actual purchase price if:
 - 50% or more related party sales; or
 - Substantially similar supplier in the last 3 years; or
 - Competitive tender; or
 - Certified by directors as at arm's length

- Otherwise:
 - Depreciated historic cost; or
 - Inventory value under GAAP; or
 - Directly attributable cost for group transactions; or
 - Market value determined by an independent valuer; or
 - Nil (default option)

- Subsequent work on an asset is capitalised as a separate asset
- Capital contributions
 - Reduces the cost of an asset
- Vested assets
 - Recorded at the value of the net cost of the regulated supplier
 - Most often nil value
- Revenue derived during construction reduces an asset's cost if:
 - Hasn't been reported as income under ID
 - Hasn't already reduced the asset's cost under GAAP

- 'Sold or transferred'
- 'Irrevocably removed without consent'
- Exits the RAB at the opening RAB value

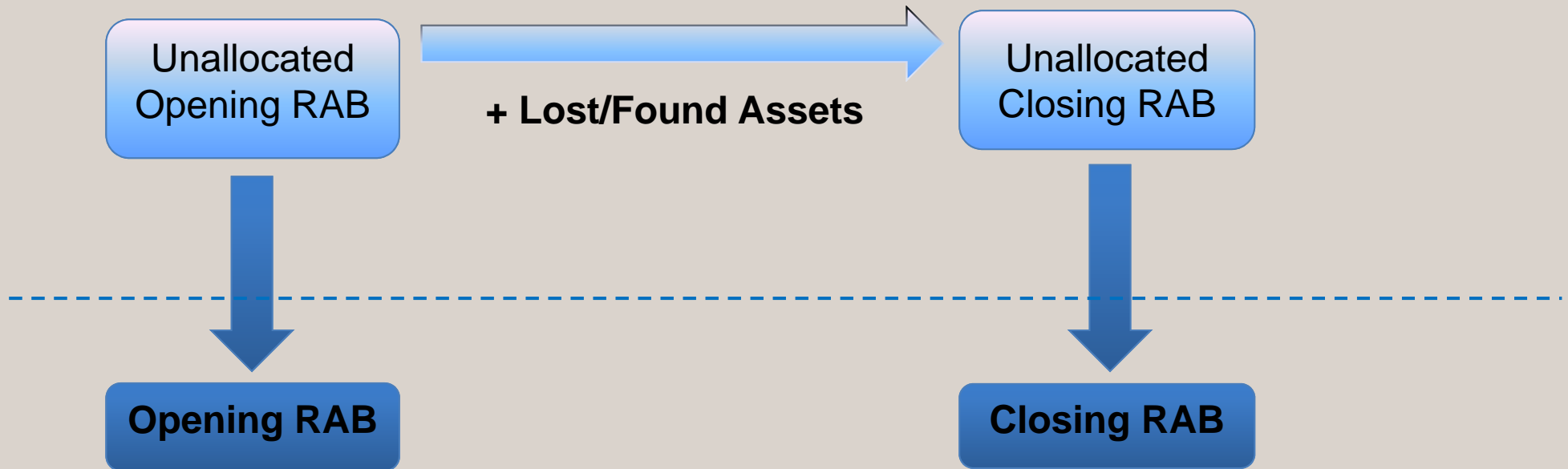
- Where do they fit in?



- What about:
 - Decommissioned assets
 - Redundant assets
 - Stranded assets
 - Value impairments required under GAAP
- Treatment of gain/loss on sale not in IMs

- Lost and found assets
 - Since 2009 only!
 - Should be relatively rare
- At what value do found assets enter the RAB?
 - GAAP value or find a similar asset
 - Market value otherwise
- Lost assets are treated as disposals for no consideration

- Where do they fit in?



Just to recap ...



- Flexibility in tracking regulatory values (vs GAAP or tax)
- Determined by own governance processes and assurance requirements
- Could adapt prior regulatory records
- Could make the case for a parallel system

These slides formed the basis of the seminar presented to suppliers and auditors by Commission staff in March 2013. They are intended to be used as general guidance only, and do not replace or summarise the information disclosure determinations themselves. In order to comply fully with the requirements of the determinations, suppliers and auditors should read the EDB, GDB and GTB determinations published on 1 October 2012. These documents can be found at:

- <http://www.comcom.govt.nz/current-electricity-information-disclosure-requirements/> for EDBs; and
- <http://www.comcom.govt.nz/gas-information-disclosure/> for GPBs.

www.comcom.govt.nz

CONTACT

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CALL the Contact Centre on 0800 943 600

WRITE to Contact Centre, PO Box 2351, Wellington

EMAIL contact@comcom.govt.nz