

Commerce Commission

Electricity Distribution and Gas Pipeline Businesses

Afternoon sessions

14 March 2014

Presentation to Information Disclosure Workshop



Agenda

Registration and tea/coffee from 9.00am

- 9.30am** Introduction
- 10am** Regulatory Asset Base (RAB) *(with break)*
- 11.30am** Network asset information and classification
- 12pm** **Lunch**
- 1pm** Purpose and benefit of disclosed information
- 1.30pm** Related party transactions
- 2.00pm** Regulatory taxation *(with break)*
- 3.30pm** Compliance overview
- 3.45pm** Conclusion and questions



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Purpose and Benefit of Disclosed Information

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1.1 Why information is disclosed

Purpose of disclosed information is to allow an assessment of suppliers' performance

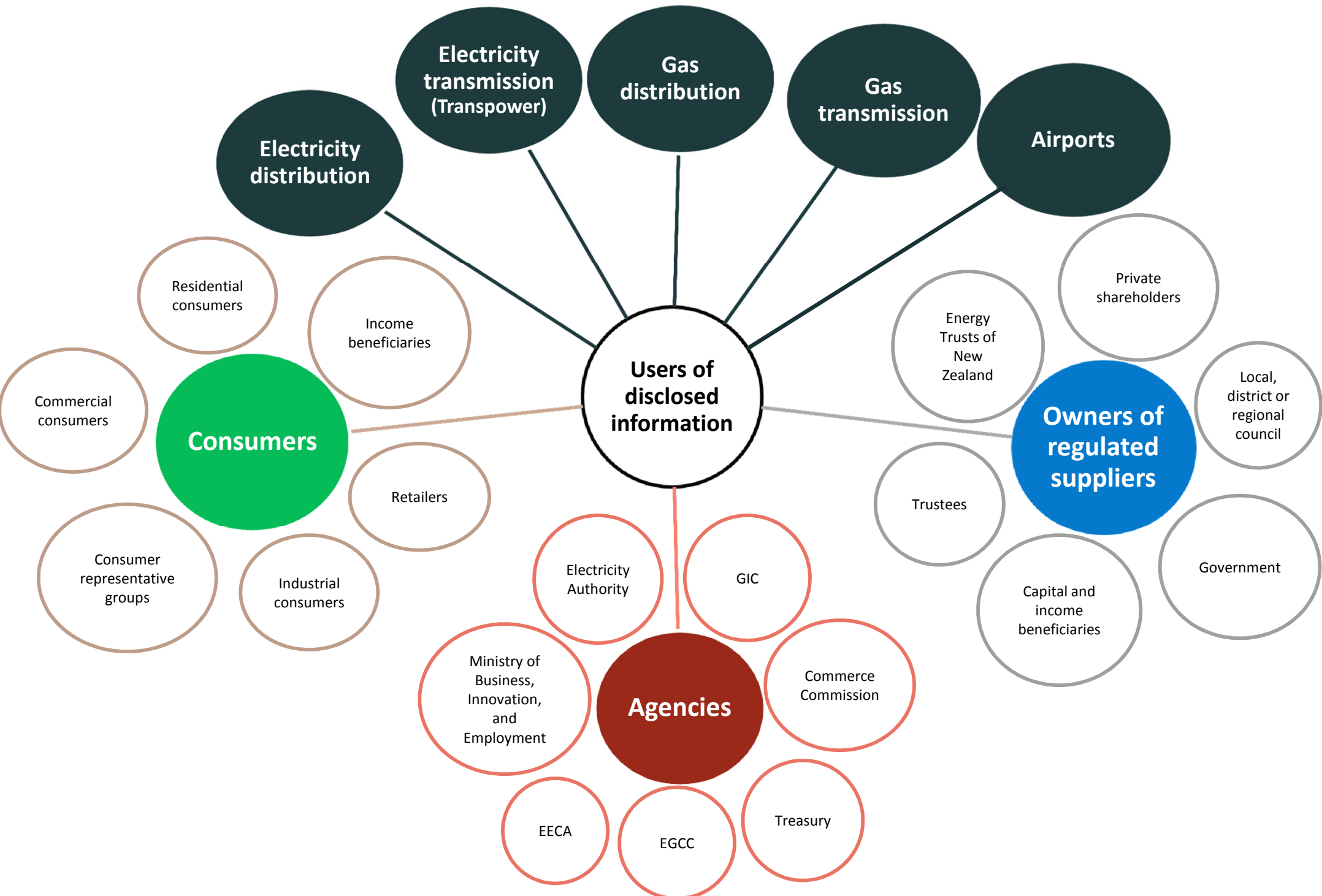
Are suppliers operating in the long term interests of consumers? For example:

- is the supplier providing services at a quality that reflects consumer demands?
- is the supplier earning an appropriate economic return over time?

The only form of regulation for some suppliers

More information on the purpose of disclosed information available at: <http://www.comcom.govt.nz/dmsdocument/9531>





How this information has been used to date



- PwC's 'Information Disclosure Compendium'
- Ownership reviews
 - PwC's review of the Hawkes Bay Power Consumers' Trust ownership of Unison
- Set maximum prices and quality standards for suppliers subject to price-quality regulation
- Summary and analysis to promote understanding of suppliers' performance
 - Electricity distributors' performance from 2008 to 2011
 - How mature are electricity distributors' asset management practices?
 - Initial observations on forecasts disclosed by 29 electricity distributors in March 2013

Purpose and benefit of specific disclosed information



Information disclosure requirements reflect the minimum package of information needed to understand suppliers' performance

Information on...

- network assets help understand historic and planned investment in the network
- the RAB helps understand changes in profitability (ROI)
- information on related party transactions provides reassurance that the ROI reflects the profits of the supplier



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Related Party Transactions

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Contents

1. Recap of IMs and ID requirements
 - a. Definitions
 - b. Why disclose related party transactions?
 - c. Disclosure requirements
 - d. Common transactions
 - e. Valuation options
2. Queries and topics of interest
3. Completing schedule 5b
4. Administration



1.1 Recap: Definitions

1. **Related party** is a defined term in the IMs;
 - a) a person that, in accordance with GAAP, is related to the EDB/GPB (GDB/GTB) in question; or
 - b) any part of the EDB/GPB in question that does not supply electricity distribution services; (or equivalent)

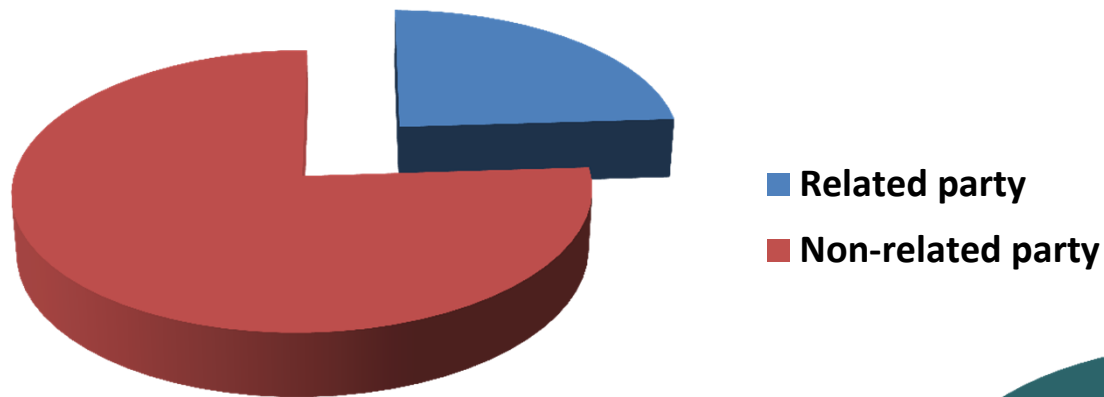
2. **Arm's-length transaction** means a dealing or transaction that does not include terms that parties would usually include or exclude if the parties were acting independently, in their own best interests, or connected only by the transaction in question.

Source: Electricity Distribution Services Input Methodologies Determination 2010, Part 1, General Provisions



1.2 Related party transactions

Operational Expenditure



Capital Expenditure

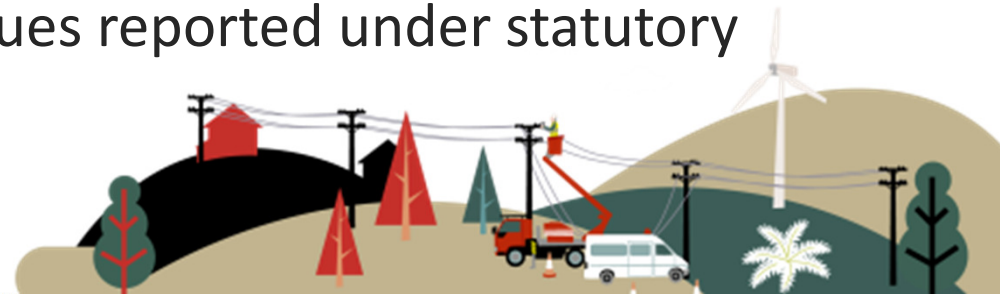


Source: EDBs 2013 information disclosures



1.3 Recap: Why are valuation rules provided for related party transactions?

1. Related parties may have different incentives, when setting the terms and conditions of transactions, from unrelated parties
 - Restructuring arrangements to change transaction values for gain or benefit e.g. RAB
2. Transparency helps interested persons assess performance
3. Value these transactions at prices to reflect the true economic cost
 - The value of these transactions can influence the RAB, regulatory profit and ROI, often for many years
 - Important that values are based on objective criteria, and verifiable information
4. Values may differ from related party values reported under statutory financial reporting



1.4 Recap: Disclosure requirements



1. Disclosure of related party transactions is required under sections 2.3.6 and 2.3.7 of the ID determination.
2. Related party transactions between regulated entities are required to be publicly disclosed by those parties
3. Schedules 5b and 14 (voluntary notes 15) are audited and director certified



1.5 Common related party transactions



Transaction	Choose a valuation option ¹	Schedule 5b(iii) Type	Schedule 5b(i) Summary category ²
1. Purchasing a commissioned asset or component of a commissioned asset e.g. transformers, inventory	IMs clause 2.2.11(5)(a)-(i)	Capex	Capital expenditure
2. Purchasing contracting services to build new network assets e.g. construction services (indirect costs such as labour)	IMs clause 2.2.11(5)(a)-(i)	Capex	Capital expenditure
3. Purchasing managerial or administration services, tree trimming, lines maintenance e.g. vegetation management, management and back office support	ID clause 2.3.6(1)(a)-(g)	Opex	Operational expenditure
4. Sale of a network asset e.g. low voltage lines and cables	ID clause 2.3.7(1)-(2)	Sales	Market value of asset disposals
5. Supply of operational services e.g. lines charges	ID clause 2.3.7(1)-(2)	Sales	Total regulatory income

1. Electricity Distribution ID and IM Determinations

2. 2. 5b(i) – disclose in summary category ‘Other related party transactions’ when the other summary disclosure categories do not apply

Finding your way around the IM valuation options for capex related party transactions

Clause 2.2.11(5)(a)-(i)

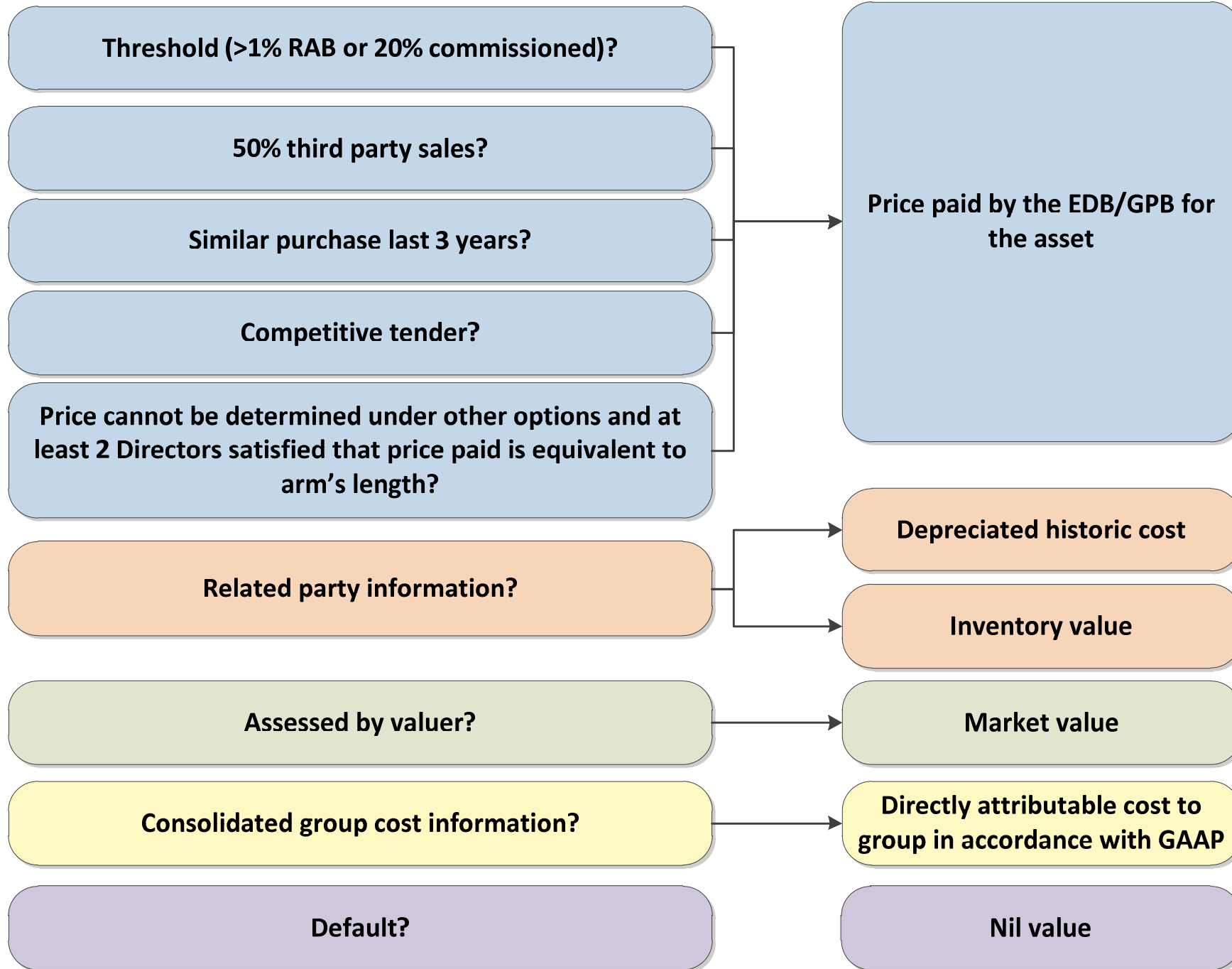


1.6 Recap: Valuation options – Capital expenditure

1. Valuation options are derived from the asset valuation IMs
2. The options:
 - assign a value which is a proxy for arm's length transactions
 - are based on objective and verifiable information
3. The options are linked to:
 - costs incurred by the related party or group to which related party belongs
 - prices paid to an unrelated party
 - tender prices
 - prices that reflect arm's length



1.7 Recap: Valuation options – Capital expenditure

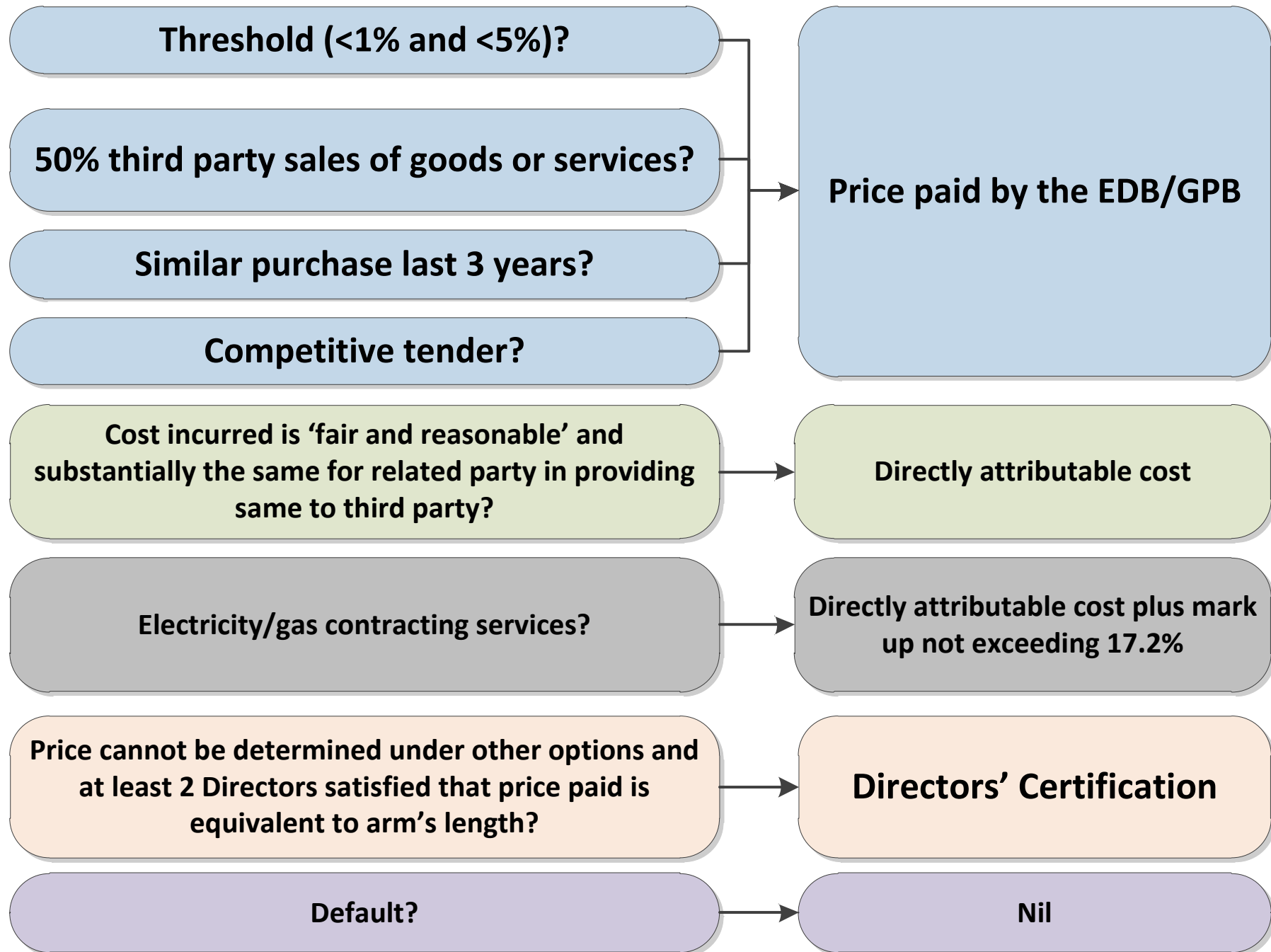


Finding your way around the ID valuation options for opex related party transactions

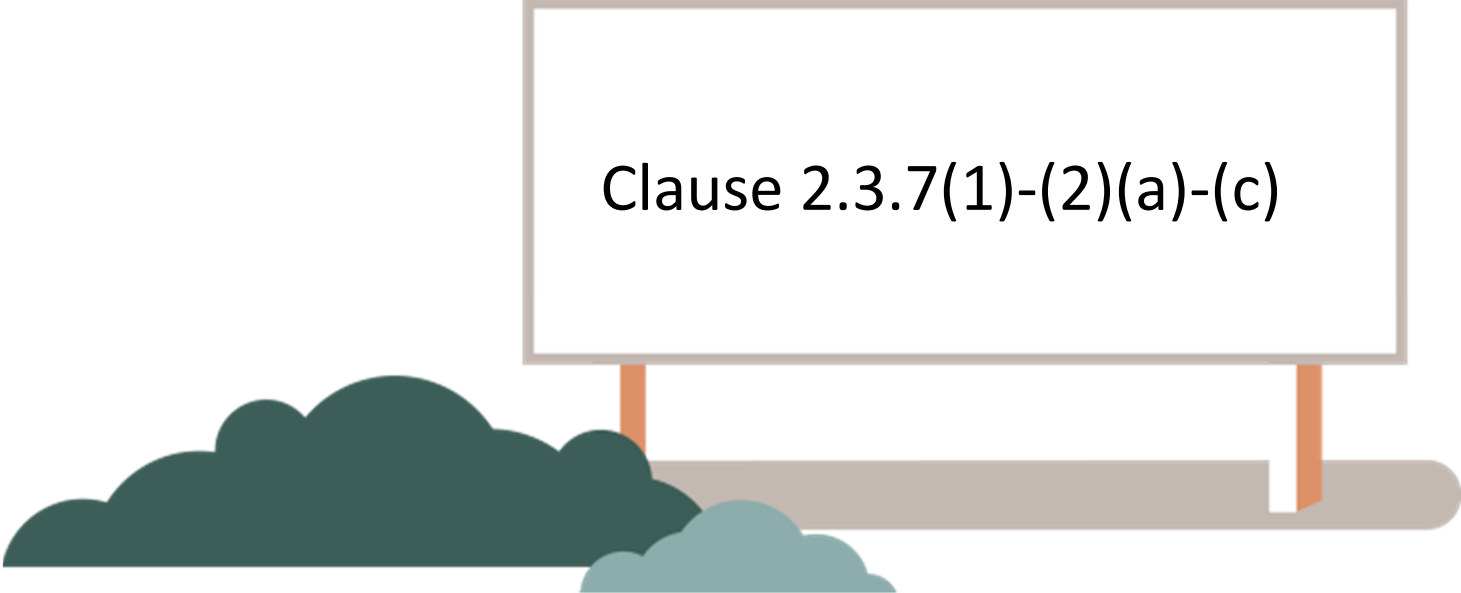
Clause 2.3.6(1)(a)-(g)



1.8 Recap: Valuation options – Operating expenditure



Finding your way around the ID valuation options for sale or supply of related party transactions



Clause 2.3.7(1)-(2)(a)-(c)



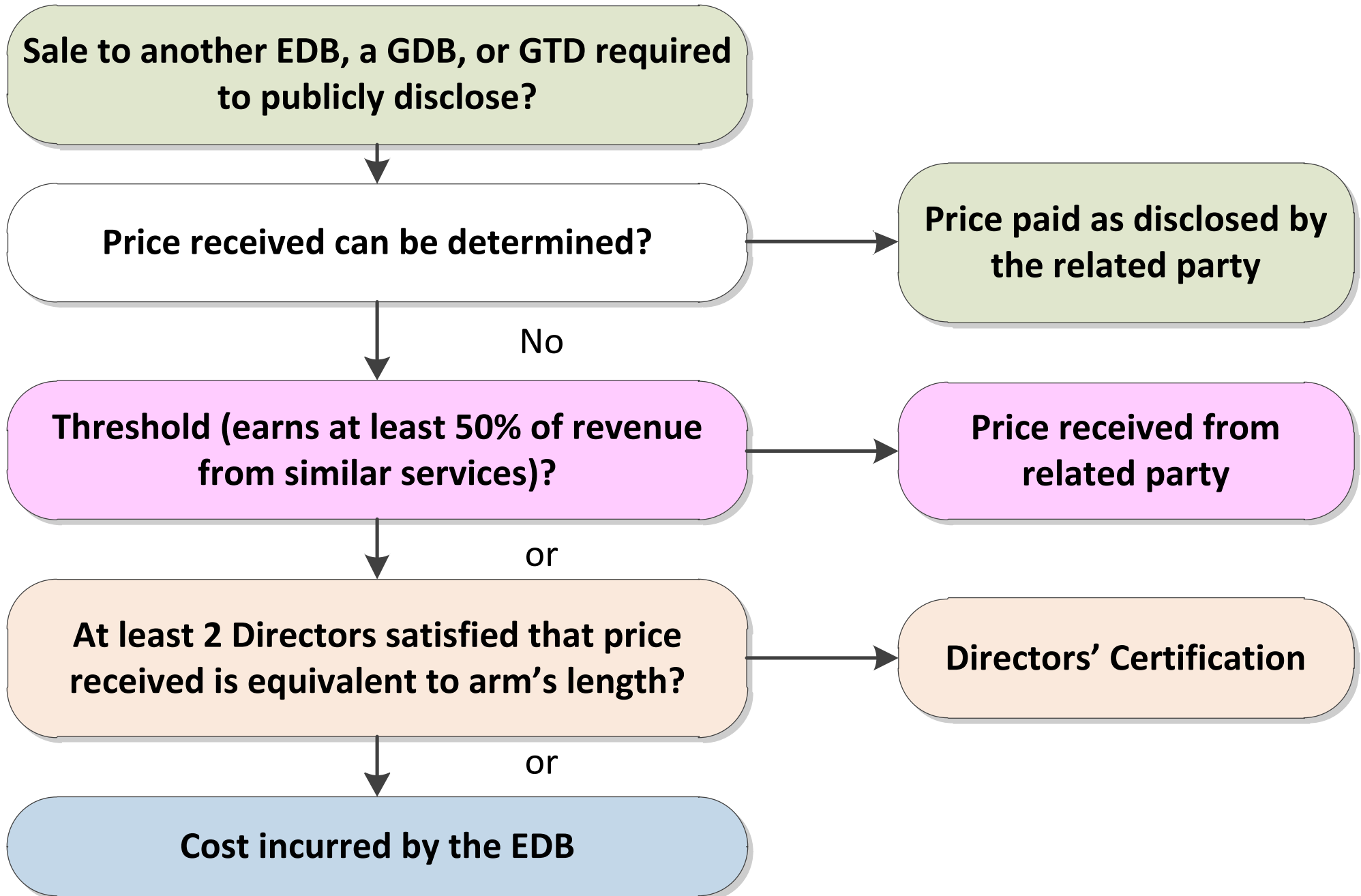
1.9 Recap: Sale or supply to a related party

Default for sales: If the customer is another EDB, GDB, or GTB who must disclose the price paid under ID, **then you must value the sale at the price they disclose**

- This ensures both parties disclose the same price and means the requirements for valuing commissioned assets and expenses are mirrored in valuing sales to related parties
- Draws on IM rules for commissioned assets (must be concluded at current RAB value)
- ID rules for expenditure and sales or supply of services, goods, or assets to a related party



1.10 Recap: Valuation options – Sale or supply



Queries and topics of interest



2.1 Queries and topics of interest

1. When can you use director certification?
2. Who is the regulated supplier?
3. Who is the related party?
4. How to identify the part of a business that does not provide regulated services, ie, the related party within the regulated supplier



2.1 Queries and topics of interest

5. Does a contract make a difference to the valuation options?
6. How to disclose contracting costs – asset/component of an asset or service
7. When can you combine reporting of related party transactions?



2.1 Queries and topics of interest

8. Can you revise previous valuations?
9. Some terms explained –
 - a. network management
 - b. competitive tender process
 - c. directly attributable cost
 - d. cost incurred



2.2 When can you use directors' certification?

1. The option was included as suppliers advised that the other costing options may not always be available
2. In the case of commissioned assets, clause 2.2.11(5)(h) of the IM applies
3. This allows EDBs to use directors' certification where:
“... the price cannot otherwise be determined under paragraphs (a) – (g)”
4. In the case of transactions involving other goods, services, and assets directors' certification is also provided as an option where the price cannot be determined using the alternative options listed in the ID determination



2.2 When can you use directors' certification?

5. Directors' certification is equally available with two other options in the case of the sale or supply of other goods, services to a related party
6. We consider that “cannot otherwise be determined” does not mean absolutely unavailable, but rather means that the other options are not practically available, i.e. where the costs cannot be readily and reasonably ascertained by using one of those options
7. Suppliers must be able to demonstrate that the other options are practically unavailable if they use director certification



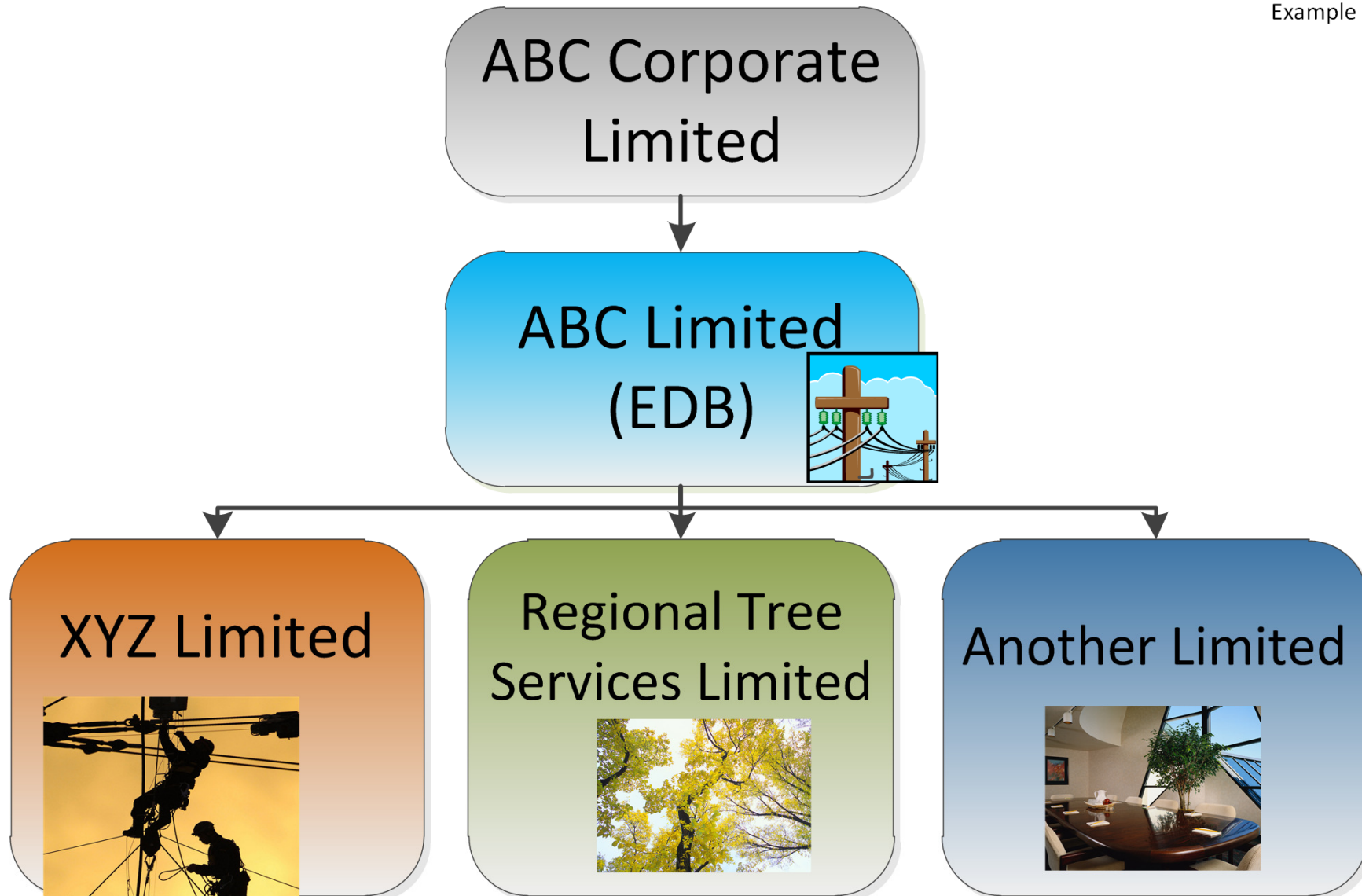
2.2 When can you use directors' certification?

8. Suppliers must also be able to substantiate the assertion that the transaction is valued on terms equivalent to those in an arm's length transaction
9. We cannot grant an exemption in the case of Commissioned Assets as we are bound to apply the IMs
10. We will consider exemption applications in the case of other goods, services, and assets where there are no rules in the IMs



2.3 Who is the regulated supplier/related party?

Example only



2.3 Who is the regulated supplier?

1. The ID determinations do not identify specific businesses as **EDBs/GPBs(GTBs/GDBs)** and rely on the definitions in the IMs.
2. A **EDB** means a supplier of **electricity distribution services** and a **GPB** means a supplier **of gas transmission services**
3. These services involve the conveyance of electricity and gas across the relevant networks,
4. We consider that the **EDB** and **GPB** is the person that operates and conveys the electricity or gas across the network
5. This means that the **EPB/GPB** need not be the owner of the network
6. The **EPB/GPB** person may be a legal entity (for example a company) or an association of persons (for example an unincorporated joint venture)



2.4 Who is the related party?

1. Under each of the IM determinations **related party** means:
a person that, in accordance with **GAAP**, is related to the **EDB/GPB**; or
any part of the **EDB/GPB** that does not supply **electricity distribution services, gas transmission services, or gas distribution services**
2. With one exception, the treatment for the reporting of the cost for the acquisition of any service, good or asset by the EDB/GPB is the same under either of the above limbs
3. In the example on slide 23 all of the separate firms are **related parties** of ABC Ltd
4. XYZ Ltd, Regional Tree Services Ltd and Another Ltd would also be **related parties** of ABC Ltd if they carried on the same business activities as separate business divisions within ABC Ltd



2.5 How to identify the part of the business that does not provide regulated services



1. A part of a business will only be a **related party** under the IMs if it does not supply the regulated services
2. Whether part of a **EDB/GPB** is a **related party** depends on the closeness of the connection between the function being performed and the supply of the regulated service (the closer the connection the more likely the function will be considered to be the supply of the regulated service)
3. It may be simpler to identify a **related party** where it is a subsidiary rather than business unit within the **EDB/GTB**
4. The main practical difference is that **related party** transactions must be separately disclosed



2.6 Does a contract make a difference to the valuation options?

1. The ID determinations recognise that some services may be supplied by **related parties** to the **EDB/GPB** through formal contractual relationships
2. Under the ID determinations **electrical contracting services (EDBs)** and **contracting services (GPBs)** mean the following services, when provided under a contract between the **EDB/GPB** and a **related party** -
 - a. construction and maintenance; (only expenses/opex and not assets/capex)
 - b. network management; (system operation and network support)
 - c. connection and disconnection services;
 - d. vegetation management; and
 - e. load control



2.6 Does a contract make a difference to the valuation options?

3. The option of valuing the services at
 - a. the directly attributable cost incurred by the subsidiary
 - b. determined in accordance with the cost allocation process set out in clause 2.1.1 of the applicable IM determination
 - c. plus a mark-up which does not exceed 17.2%

is available if the services provided by the **related party** are **electrical contracting services** or **contracting services**

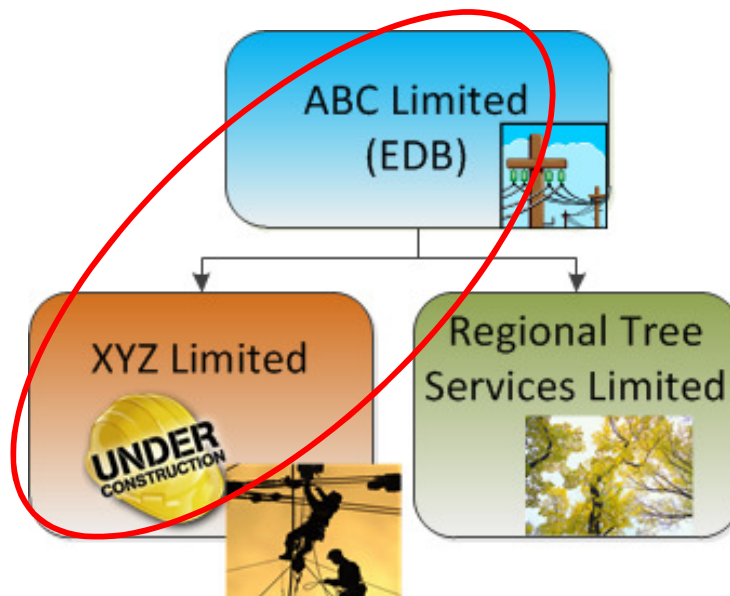
4. This option is not available if the services are supplied by a separate business division within the regulated supplier as a person cannot contract with itself
5. Where the **related party** makes at least 50% of its sales to third parties on similar terms (including price) the supplier may use the actual price paid



2.7 How to disclose contracting costs

Examples:

- a. labour acquired for construction of assets



- b. indirect costs – where the group consolidation option in the IMs is used



2.7 How to disclose contracting costs

1. Contracting costs can either be assets (capex) or other goods and services (opex)
2. They are considered to be costs of assets or components of assets where they are incurred in the construction of an asset and costs of other goods and services in all other cases
3. Where they form part of a Commissioned Asset their cost must be assessed under one of the options in clause 2.2.11(5) of the IMs
4. Where the asset is not yet commissioned the costs must be reported in Works Under Construction, but excluding finance costs
5. Profit and indirect costs (such as pay-roll, HR, health and safety, etc.) are excluded if the costs are valued under clause 2.2.11(5) (g), (ie, at their directly attributable cost as would be incurred by the group, in accordance with **GAAP**, as if the group was the EDB/GPB)



2.7 How to disclose contracting costs

6. We consider that suppliers should be allowed to recover indirect costs under option (g), provided they are no higher than the indirect costs avoided by the supplier purchasing these services from a **related party**
7. As these indirect costs are not allowable asset costs under the group consolidation valuation option under **GAAP** (ie, option g), they should be treated and valued as operational expenditure
8. If this method is adopted, the indirect costs must be certified by directors as being allocated consistent with the IMs and being no higher than those that would have been allocated had the regulated supplier installed the asset itself



2.8 When can you combine reporting of related party transactions?

1. There must be separate disclosures of each:
 - a. related party
 - b. transaction category/type
 - c. valuation method
 - d. material transaction

2. Related party transactions can be combined where they are non-material and involve the same related party, the same type of transaction and the same valuation method



2.9 Can you revise previous valuations?



1. There are no restrictions on applying different valuations in future years where a different option might more accurately approximate an arm's length transaction
2. It is permissible to revalue transactions under a different option available in the IMs and ID determinations
3. Suppliers must be able to substantiate the new valuations and should explain the reasons for any revisions in the explanatory notes to their disclosures



2.10 Some terms explained

1. Network management – this is limited to those services directly attributable to managing the network, such as system operation and network support. It does not include general business support and administration
2. Competitive tender process – this includes both open and closed tenders, and in the case of closed tenders, the proposal and related information need only be provided to a third party who was invited to tender
3. Directly attributable costs
 - a. the term **directly attributable** is defined in the IMs and means, in relation to-

operating costs, wholly and solely incurred by the **EDB/GPB** in or in relation to its **supply** of one **regulated service** which can be completely attributed to production of the specific goods or services; and

regulated service asset values, wholly and solely related to an asset used by the **EDB/GPB** in or in relation to its **supply** of one **regulated service**



2.10 Some terms explained

- b. indirect costs such as depreciation on vehicles and equipment used for manufacturing, administrative overhead expenses and those relating to business support are not considered to be directly attributable
 - c. under GAAP only those costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management can be capitalised
4. Cost incurred by the **EDB/GPB** –
- a. this cost option is available where services, goods or assets are supplied to a **related party** and the price received cannot be determined under sub-clause 1 [EDB and GDB ID determination at clause 2.3.7 (2)(c), GTB ID determination at clause 2.3.8 (2)(c)]
 - b. cost includes both direct and indirect costs (including common costs), but excludes any other profit margin



Administration and record keeping

Schedule 5b: Report on
Related Party Transactions



3.1 Recap: Completing schedule 5b and explanatory notes



Company Name _____
For Year Ended _____

SCHEDULE 5b: REPORT ON RELATED PARTY TRANSACTIONS
This schedule provides information on the valuation of related party transactions, in accordance with section 2.3.6 and 2.3.7 of the ID determination. This information is part of audited disclosure information (as defined in section 1.4 of the ID determination), and so is subject to the assurance report required by section 2.8.

5b(i): Summary—Related Party Transactions (\$000)

Total regulatory income	
Operational expenditure	
Capital expenditure	
Market value of asset disposals	
Other related party transactions	

5b(ii): Entities Involved in Related Party Transactions

Name of related party	Related party relationship

** include additional rows if needed*

5b(iii): Related Party Transactions

Name of related party	Related party transaction type	Description of transaction	Value of transaction (\$000)	Basis for determining value

Complete all required parts of the schedule and explanatory notes

Commerce Commission Information Disclosure Template for EDBs

Company Name _____
For Year Ended _____

Schedule 14 Mandatory Explanatory Notes

(In this Schedule, clause references are to the Electricity Distribution Information Disclosure Determination 2012)

1. This Schedule requires EDBs to provide explanatory notes to information provided in accordance with clauses 2.3.1, 2.4.21, 2.4.22, and 2.5.2.
2. This Schedule is mandatory—EDBs must provide the explanatory comment specified below, in accordance with clause 2.7.1. Information provided in boxes 1 to 12 of this schedule is part of the audited disclosure information, and so is subject to the assurance requirements specified in section 2.8.
3. Schedule 15 (Voluntary Explanatory Notes to Schedules) provides for EDBs to give additional explanation of disclosed information should they elect to do so.

Related party transactions: disclosure of related party transactions (Schedule 5b)

10. In the box below, provide descriptions of related party transactions beyond those disclosed on schedule 5b including identification and descriptions as to the nature of directly attributable costs disclosed under clause 2.3.6(1)(b).

Box 7: Related party transactions
[Insert text here]

Include a full description of the valuation option applied e.g. directly attributable cost, ID clause 2.3.6(1)(a)

4.1 Administration – simple checks

1. Completeness of all required data fields
2. Disclose sufficient information about who, what, and valuation method
3. Disclosed information in schedule 5b(i) and (iii) is consistent
4. Schedule 5b(iii) – Basis for determining value must be one of the valuation options from the ID determination (opex or sales) or the IM (assets)



4.1 Administration – simple checks

5. Consistency of disclosure of related party transactions between regulated businesses
6. Asset disposals to related party – schedules 5b(i) and 4(ii)
7. Directors' certification valuation option applied – certification under schedule 18
8. Record keeping to support objective and verifiable disclosures



4.2 Administration – record keeping

Possible data retention and access needs include:

Valuation Options	Considerations
Price paid	<ul style="list-style-type: none">• Record of related party sales to third parties (if accessible) and terms of sale including price• Records of prices paid for similar services to an unrelated party, preceding 3 years• Tender documents and tenders received• Contract terms and conditions• Evidence of market prices• Price Indices
Directly Attributable Costs	<ul style="list-style-type: none">• Rationale for 'fair and reasonable' and costs incurred by related parties (if accessible) for same type of services provided to third parties• Directly attributable cost for consolidated group
Mark up	<ul style="list-style-type: none">• Directly attributable cost incurred by the related party



4.2 Administration – record keeping

Possible data retention and access needs include:

Valuation Options	Considerations
Depreciated Historic Cost	<ul style="list-style-type: none">• Related party's asset register prepared in accordance with GAAP on the day before the acquisition by regulated business
Inventory Value	<ul style="list-style-type: none">• Related party's inventory value prepared in accordance with GAAP on the day before the acquisition by regulated business
Market Value	<ul style="list-style-type: none">• Independent valuation report as at commissioning date
Directors' certification	<ul style="list-style-type: none">• Supplier must be able to substantiate the assertion that the transaction is valued on terms equivalent to those in an arm's length transaction



4.2 Administration - record keeping

Possible data retention and access needs include:

Valuation Options	Considerations
Price disclosed by related party	<ul style="list-style-type: none">• Price paid or cost incurred by related party
Price received from related party	<ul style="list-style-type: none">• Records of prices for similar services to third parties• Details of terms and conditions for transactions• Rationale for Directors' certification
Cost incurred	<ul style="list-style-type: none">• Cost incurred by regulated business in providing the service, good or asset



4.3 Revised templates

1. Enhanced formatting with increased space within free form fields
2. Related party transaction type – drop down selections
 - Currently Capex, Opex, Sales
 - Better alignment with the summary categories in 5b(i)
3. Revised templates will be available on our website



Questions?



Commerce Commission

Regulatory Tax and Information Disclosure

March 2014

Presentation to Information Disclosure Workshop



Contents

Overview of concepts

1. Deferred tax basics
2. Origin of modified deferred tax methodology
3. Key features of modified deferred tax methodology

Implementation

4. Calculating the regulatory tax allowance - Schedule 5a (i)
5. Maintaining the deferred tax balance - Schedule 5a (vi)
6. Allocation adjustments and tax asset roll-forward
7. Tax consequences of transactions and emerging issues
8. Administration - record-keeping, correction of errors and simple checks
9. Questions and answers

1.1 Deferred tax basics – depreciation temporary differences



- Deferred tax account captures tax effect of temporary differences between regulatory asset base (RAB) and regulatory tax assets.
- Main temporary difference is depreciation
- IRD rules can allow accelerated depreciation on assets using methods and rates different to comparable economic depreciation rates.



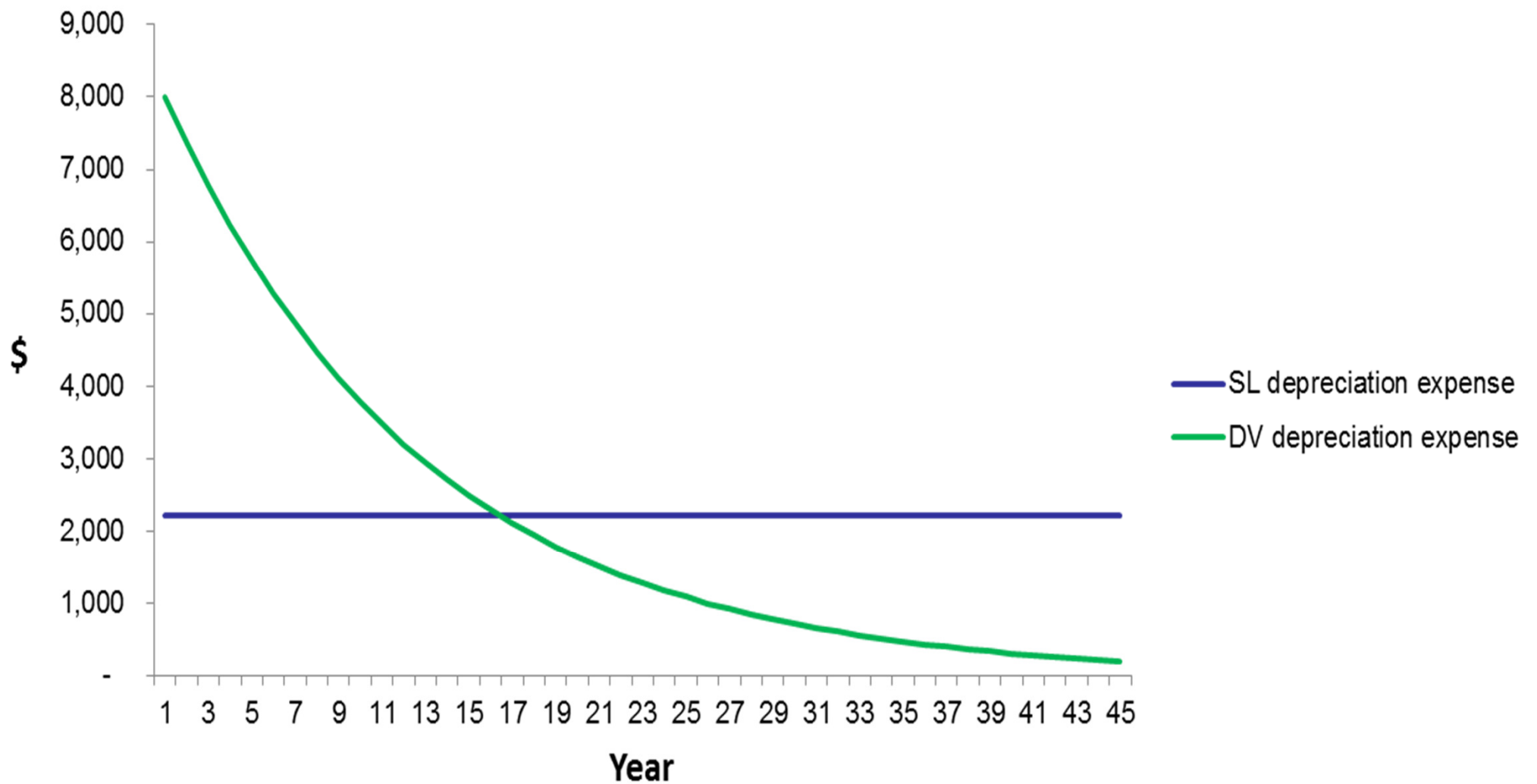
1.1 Deferred tax basics – depreciation temporary differences

Example – Transformers:

- IRD assigns a diminishing value (DV) depreciation rate of 8% or straight line depreciation rate of 6%.
- IM determination (Schedule A) assigns a standard physical asset life of 45 years (equivalent to a straight line depreciation rate of 2.22%).



1.1 Deferred tax basics – depreciation temporary differences

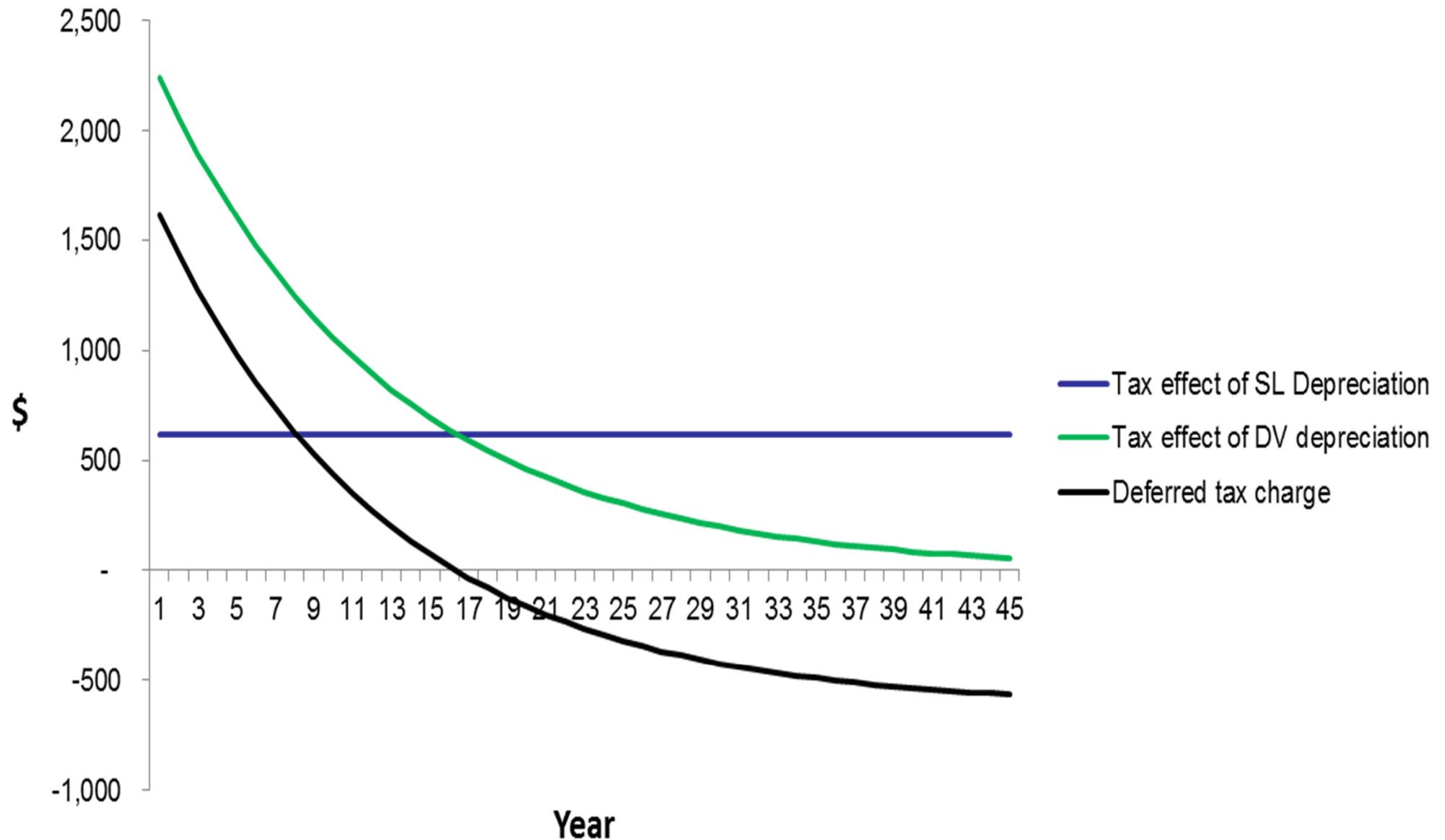


1.1 Deferred tax basics – depreciation temporary differences



Deferred Tax No Revaluations							
Life	Closing	Closing					Closing
45	Regulatory	Regulatory		Depreciation		Deferred tax	Deferred tax
Cost	Asset Base Value	Tax Value	Year	Regulatory (SL)	Tax (DV)	Charge	Balance
1,000,000	977,778	920,000	1	22,222	80,000	(16,178)	(16,178)
	955,556	846,400	2	22,222	73,600	(14,386)	(30,564)
	933,333	778,688	3	22,222	67,712	(12,737)	(43,301)
Regulatory	911,111	716,393	4	22,222	62,295	(11,220)	(54,521)
Dep. Rate	888,889	659,082	5	22,222	57,311	(9,825)	(64,346)
2.22%	866,667	606,355	6	22,222	52,727	(8,541)	(72,887)
	844,444	557,847	7	22,222	48,508	(7,360)	(80,247)
Tax DV Rate	822,222	513,219	8	22,222	44,628	(6,274)	(86,521)
8%	800,000	472,161	9	22,222	41,058	(5,274)	(91,795)
	777,778	434,388	10	22,222	37,773	(4,354)	(96,149)
	755,556	399,637	11	22,222	34,751	(3,508)	(99,657)
	733,333	367,666	12	22,222	31,971	(2,730)	(102,387)
	711,111	338,253	13	22,222	29,413	(2,014)	(104,400)
	688,889	311,193	14	22,222	27,060	(1,355)	(105,755)
	666,667	286,297	15	22,222	24,895	(748)	(106,503)
	644,444	263,394	16	22,222	22,904	(191)	(106,694)
	622,222	242,322	17	22,222	21,071	322	(106,372)
	600,000	222,936	18	22,222	19,386	794	(105,578)
	577,778	205,101	19	22,222	17,835	1,228	(104,349)
	555,556	188,693	20	22,222	16,408	1,628	(102,721)
Asset value difference		366,862					
Tax effect (x 0.28)		102,721					

1.1 Deferred tax basics – depreciation temporary differences



1.2 Deferred tax basics – accounting entries

Per Regulatory Accounts		1	2		
A	Revenue	1000	1000		
B	Total depreciation	50	50		
C	Regulatory taxable profit =A-B	950	950		
D	Regulatory tax expense = C x 0.28	266	266		
E	Regulatory tax depreciation	150	25		
F	Tax payable to IRD =(A-E) x 0.28	238	273		
<i>Regulatory tax depreciation higher than total depreciation</i>					
1	Dr	Tax expense	266		
	Cr	Tax Payable to IRD		238	
	Cr	Deferred tax		28	=(E-B) x 0.28
<i>2 Regulatory tax depreciation lower than total depreciation</i>					
	Dr	Tax expense	266		
	Dr	Deferred tax	7		= -(E-B) x 0.28
	Cr	Tax Payable to IRD		273	

1.3 Deferred tax basics – some other common temporary differences

- Capital contributions (after 20 May 2010 if spread over 10 years for tax purposes)
- Renewals expenditure (deductible for tax purposes but capital under GAAP)
- Disposal of assets (some disposals may be allowed under tax rules but not for regulatory purposes)
- Provisions for employee remuneration, holiday pay
- Doubtful debt provisions
- Equipment leases
- Others?



2.1 Tax methodology – origin of present approach

- To achieve financial capital maintenance (FCM), accounting based approaches for measuring returns must be equivalent over time to economic approaches
- Deferred tax approach under NZ(IAS)12 does not meet FCM
- A variety of modified approaches that are net present value-neutral are potentially feasible
- Alternative deferred tax approaches were proposed by Vector and by CRA (on behalf of Unison).



2.2 Tax methodology – NPV effect of excluding revaluations from tax expense



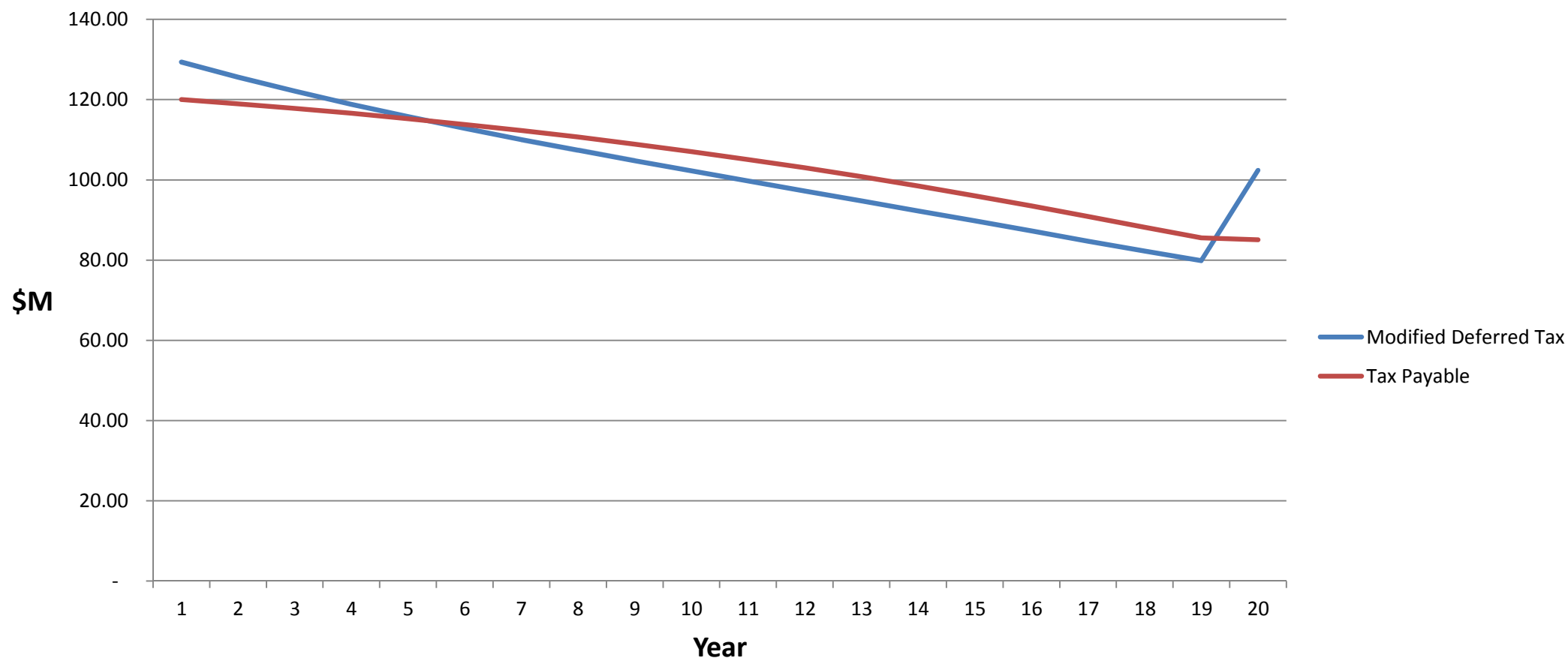
WACC	10%	Tax rate	28%					
Initial Cost of Asset	120	Tax DV	50%					
Operating expenditure	10	Revaluation year 1	20					
Regulatory depreciation	40							
REVALUATIONS IN TAX ALLOWANCE				REVALUATIONS EXCLUDED FROM TAX ALLOWANCE				
Year	1	2	3	Total	1	2	3	Total
Return on capital	12.00	8.88	4.44		12.00	8.88	4.44	
Tax on return on capital	4.67	3.45	1.73		4.67	3.45	1.73	
Revaluations	(27.78)				(27.78)			
Tax on revaluations	7.78				7.78			
Regulatory depreciation	40.00	50.00	50.00		40.00	50.00	50.00	
Operating expenditure	10.00	10.00	10.00		10.00	10.00	10.00	
Revenue	46.67	72.33	66.17		46.67	72.33	66.17	
Less operating expenditure	(10.00)	(10.00)	(10.00)		(10.00)	(10.00)	(10.00)	
Less tax depreciation	(60.00)	(30.00)	(30.00)		(60.00)	(30.00)	(30.00)	
Exclude revaluations					20.00			
Taxable income	(23.33)	32.33	26.17		(3.33)	32.33	26.17	
Tax expense	(6.53)	9.05	7.33		(0.93)	9.05	7.33	
Cash flow	43.20	53.28	48.84		37.60	53.28	48.84	
NPV	39.27	44.03	36.69	120.00	34.18	44.03	36.69	114.91
Opening RAB value	120	100	50		120	100	50	
Depreciation	40	50	50		40	50	50	
Revaluation	20				20			
Closing RAB value	100	50	0		100	50	0	
Opening tax book value	120	60	30		120	60	30	
Tax depreciation	60	30	30		60	30	30	
Closing tax book value	60	30	0		60	30	0	
Opening deferred tax	-	(11)	(6)		-	(11)	(6)	
(= tax effect of difference in asset values)								

2.3 Tax methodology – origin of present approach

- Modified deferred tax approach adopted was developed by PwC (on behalf of the ENA) - supported by the majority of regulated suppliers
- Modified deferred tax approach results in greater up-front cash flows for suppliers than the tax payable approach in respect of new investments.



2.4 Tax methodology – origin of present approach – comparison of cash flows



	1	2	3	4	5	6	7	8	9	10
Mod. deferred tax	129.34	125.58	122.09	118.83	115.75	112.84	110.05	107.37	104.77	102.22
Tax payable	120.00	118.95	117.81	116.58	115.26	113.83	112.30	110.66	108.91	107.06
Difference	9.34	6.63	4.28	2.24	0.50	(0.99)	(2.25)	(3.29)	(4.15)	(4.83)

2.5 Modified deferred tax approach – accounting for revaluations

Deferred Tax With Revaluations						
Closing Regulatory Asset Base Value	Reval rate 2% Reval	Year	Depreciation Regulatory (SL)	Tax (DV)	Deferred tax Charge	Amortisation of Revaluations
997,778	20,000	1	22,222	80,000	(16,178)	
995,057	19,956	2	22,677	73,600	(14,386)	455
991,817	19,901	3	23,141	67,712	(12,737)	919
988,038	19,836	4	23,615	62,295	(11,220)	1,392
983,701	19,761	5	24,098	57,311	(9,825)	1,876
978,782	19,674	6	24,593	52,727	(8,541)	2,370
973,261	19,576	7	25,097	48,508	(7,360)	2,875
967,114	19,465	8	25,612	44,628	(6,274)	3,390
960,318	19,342	9	26,138	41,058	(5,274)	3,916
952,849	19,206	10	26,676	37,773	(4,354)	4,453
944,682	19,057	11	27,224	34,751	(3,508)	5,002
935,791	18,894	12	27,785	31,971	(2,730)	5,563
926,149	18,716	13	28,357	29,413	(2,014)	6,135
915,730	18,523	14	28,942	27,060	(1,355)	6,720
904,505	18,315	15	29,540	24,895	(748)	7,317
892,445	18,090	16	30,150	22,904	(191)	7,928
879,520	17,849	17	30,774	21,071	322	8,552
865,699	17,590	18	31,411	19,386	794	9,189
850,950	17,314	19	32,063	17,835	1,228	9,841
835,240	17,019	20	32,729	16,408	1,628	10,507
Total	378,084				(102,721)	98,399
Tax Effect	105,863					27,552
Asset value difference			835,240			
			(188,693)	646,547		
Tax effect (x 0.28)				181,033		
Made up of:						
Tax effect of revaluations				105,863		
Tax effect of depreciation of revals				(27,552)		
Depreciation timing differences				102,721		
				181,033		

2.6 Modified deferred tax approach – sum of amortisations equals sum of revaluations

Deferred Tax With Revaluations						
Closing Regulatory Asset Base Value	Reval rate 2%	Year	Regulatory (SL)	Depreciation Tax (DV)	Deferred tax Charge	Amortisation of Revaluations
970,000	20,000	1	50,000	80,000	(8,400)	
938,347	19,400	2	51,053	73,600	(6,608)	1,053
904,984	18,767	3	52,130	67,712	(4,959)	2,130
869,849	18,100	4	53,234	62,295	(3,443)	3,234
832,881	17,397	5	54,366	57,311	(2,047)	4,366
794,013	16,658	6	55,525	52,727	(763)	5,525
753,178	15,880	7	56,715	48,508	418	6,715
710,305	15,064	8	57,937	44,628	1,504	7,937
665,319	14,206	9	59,192	41,058	2,504	9,192
618,142	13,306	10	60,484	37,773	3,424	10,484
568,690	12,363	11	61,814	34,751	4,270	11,814
516,876	11,374	12	63,188	31,971	5,048	13,188
462,604	10,338	13	64,610	29,413	5,764	14,610
405,770	9,252	14	66,086	27,060	6,423	16,086
346,257	8,115	15	67,628	24,895	7,029	17,628
283,931	6,925	16	69,251	22,904	7,587	19,251
218,627	5,679	17	70,983	21,071	8,100	20,983
150,124	4,373	18	72,876	19,386	8,572	22,876
78,064	3,002	19	75,062	17,835	9,006	25,062
-		20	78,064	16,408	9,406	28,064
Total	240,198				52,834	240,198
Tax Effect	67,255					67,255
Asset value difference			-			
			(188,693)	(188,693)		
Tax effect (x 0.28)				(52,834)		
Made up of:						
Tax effect of revaluations				67,255		
Tax effect of depreciation of revals				(67,255)		
Depreciation timing differences				(52,834)		
				(52,834)		

3.1 Key features of regulatory tax methodology



- Notional tax charge - “ring-fencing” of regulated services, including tax losses
- Notional interest, not actual costs
- Regulatory investment value used for assessing profitability under ID regulation is the RAB value plus the deferred tax balance
- Amortisation of the difference between the initial RAB and the initial regulatory tax asset value over the residual lifetime of the assets



3.1 Key features of regulatory tax methodology

- Unallocated regulatory tax asset values allocated between regulated and non-regulated services
- Amortisation of indexed revaluations over the residual lifetime of the assets
- Deferred tax balance and unamortised balance of differences in asset values existing at 31 March 2009 for sold assets must be transferred
- Separate line item disclosure of discretionary discounts and consumer rebates
- No current tax payable



4.1 The regulatory tax allowance – Schedule 5a(i) (Year 2 of Tax Calcs Worksheet)



5a(i): Regulatory Tax Allowance

		(\$000)	
	Regulatory profit / (loss) before tax		116.09
<i>plus</i>	Income not included in regulatory profit / (loss) before tax but taxable	-	*
	Expenditure or loss in regulatory profit / (loss) before tax but not deductible	-	*
	Amortisation of initial differences in asset values	16.67	
	Amortisation of revaluations	1.05	
			17.72
<i>less</i>	Income included in regulatory profit / (loss) before tax but not taxable	20.95	*
	Discretionary discounts and consumer rebates	-	
	Expenditure or loss deductible but not in regulatory profit / (loss) before tax**	-	*
	Notional deductible interest	31.98	
			52.93
	Regulatory taxable income		80.88
<i>less</i>	Utilised tax losses	-	
	Regulatory net taxable income		80.88
	Corporate tax rate (%)	28%	
	Regulatory tax allowance		22.65

* Workings to be provided in Schedule 14

** Excluding discretionary discounts and consumer rebates

4.2 The regulatory tax allowance – permanent differences and capital contributions

- **Positive permanent differences** excludes any amounts that are-
 - (a) amortisation of initial differences in asset values; or
 - (b) amortisation of revaluations.
- **Negative permanent differences** excludes amounts that are-
 - (a) discretionary discounts and consumer rebates
- **Capital contributions:**
 - Election for tax purposes to spread income over 10 years or to treat as reduction in cost of asset – depreciated over remaining useful life
 - Temporary difference under spreading option



4.3 The regulatory tax allowance – regulatory tax adjustments

- **Amortisation of initial differences in asset values**
 - Initial differences in asset values \$333.33 per example
 - Divide by weighted average remaining useful life of relevant assets, i.e. assets in initial regulatory asset base at 31 March 2009
 - Adjustment required to unamortised balance for assets sold
- **Amortisation (depreciation) of revaluations**
 - Total depreciation - adjusted depreciation
- **Notional deductible interest**
 - Allocation of debt costs is not covered by the cost allocation IM
 - Instead, a prescriptive formula based on assumed debt costs and an assumed leverage is used



4.4 Schedules 5a(iii) and 5a(iv)

5a(iii): Amortisation of Initial Difference in Asset Values

(\$000)

Opening unamortised initial differences in asset values	316.67	
Amortisation of initial differences in asset values	16.67	
Adjustment for unamortised initial differences in assets acquired	-	
Adjustment for unamortised initial differences in assets disposed	-	
Closing unamortised initial differences in asset values		300.00
Opening weighted average remaining asset life (years)		19.00

5a(iv): Amortisation of Revaluations

(\$000)

Opening Sum of RAB values without revaluations	1,027.60	
Adjusted depreciation	54.08	
Total depreciation	55.14	
Amortisation of revaluations		1.05

5.1 Maintaining the deferred tax balance

All changes in tax asset values versus regulatory asset values except revaluations should give rise to a deferred tax entry

- Roll-forward formula:
 - opening deferred tax*
 - + tax effect of temporary differences*
 - tax effect of amortisation of initial difference in asset values*
 - + deferred tax balance relating to assets acquired in the disclosure year in question*
 - + cost allocation adjustment.*
- Calculation of deferred tax balance relating to assets acquired
- Cost allocation adjustment – specific tax rules



5.1 Schedule 5a(vi)

5a(vi): Calculation of Deferred Tax Balance

(\$000)

Opening deferred tax		(9.34)
<i>plus</i> Tax effect of adjusted depreciation		15.14
<i>less</i> Tax effect of total tax depreciation		18.15
<i>plus</i> Tax effect of other temporary differences*		-
<i>less</i> Tax effect of amortisation of initial differences in asset values		4.67
<i>plus</i> Deferred tax balance relating to assets acquired in the disclosure year		-
<i>less</i> Deferred tax balance relating to assets disposed in the disclosure year		-
<i>plus</i> Deferred tax cost allocation adjustment		6.69
Closing deferred tax		(10.32)

6. Tax asset roll-forward

Tax asset allocation must change if:

- a matching regulatory asset allocation changes; or
- there is a change in usage of an unmatched tax asset.

Value (where initial tax values have not been capped):

- *Tax asset value x result of asset allocation ratio.*

Where tax asset value = adjusted tax value (i.e. under IRD rules)



6.1 Tax asset roll-forward – allocation adjustments



Applies to businesses that cost allocate assets:

		Period 2		Adjusted Deprec.	Tax Asset Value	<i>x result of Asset Allocation Ratio</i>
		Unallocated	RAB Allocated			
Opening asset allocation ratio	0.90					
Opening values		1,164.00	1,047.60		719.98	647.98
Depreciation		61.26	55.14	54.08	72.02	64.82
Revaluations		23.28	20.95		-	-
Unallocated closing values		1,126.02	1,013.42		647.96	583.16
Closing asset allocated value			957.11			550.77
Adjustment from application of 2.1.1			(56.30)			(32.40)
Closing asset allocation ratio	0.85					
Difference			23.90			
Cost allocation adjustment			6.69			

6.2 Schedule 5a(viii)

5a(viii): Regulatory Tax Asset Base Roll-Forward

		(\$000)
Opening sum of regulatory tax asset values	647.98	
<i>less</i> Tax depreciation	64.82	
<i>plus</i> Regulatory tax asset value of assets commissioned	-	
<i>less</i> Regulatory tax asset value of asset disposals	-	
<i>plus</i> Lost and found assets adjustment	-	
<i>plus</i> Other adjustments to the RAB tax value	(32.40)	
Closing sum of regulatory tax asset values		550.77

7.1 Tax consequences of transactions

- Tax value of commissioned assets
 - Capital contributions and election to spread for tax purposes
 - Acquisition price in excess of regulatory asset value
- Calculation of tax depreciation on assets acquired and sold
- Value of deferred tax balance acquired from another regulated supplier



7.1 Tax consequences of transactions – example



- Purchase asset for \$10m, regulatory asset value \$8m, deferred tax balance beginning of disclosure year \$500k
- Regulatory tax asset value?
 - related party \$8m
 - other regulated supplier \$10m
- Value of deferred tax balance?
 - Transpower or gas transmission business \$0
 - Other regulated supplier – probably \$500k



7.2 Emerging issues

- Regulatory tax asset value of disposals
- Appropriate disclosure of permanent and temporary differences
- Correction of errors – deduction of revaluations from regulatory profit/(loss) before tax – restate comparative ROI for 2014



7.3 Look out for!

- Consultation on IM amendments
 - Think about tax consequences of changes!



8.1 Administration – record-keeping

Some record-keeping matters to consider:

- Possible value differences between IRD value of tax assets and regulatory tax value
- Identification of assets (and their remaining asset lives) contributing to initial differences in asset values
- Depreciation on assets in absence of revaluations since initial valuation date (adjusted depreciation)
- Analysis of deferred tax balance to process entries for disposed assets
- Matching of regulatory tax assets to regulatory assets for purpose of calculating asset allocation ratio



8.1 Administration – simple checks

- **Opening balances = closing balances**
 - Deferred tax balance
 - Sum of regulatory tax assets
 - Unamortised differences in asset values
- **Revaluations deducted in calculation of regulatory tax allowance**
- **Amortisation of initial differences**
 - Same unless assets existing at 31 March 2009 acquired or sold
 - Adjustment for assets acquired – positive
 - Adjustment for assets disposed – negative
 - Opening weighted average remaining life also adjusted but reduces by 1 year each year



8.1 Administration – simple checks

- Total depreciation in schedule 5a(iv) agrees with Schedule 3: Report on regulatory Profit
- Tax effect of total tax depreciation (Schedule 5a(v)) agrees with tax depreciation (Schedule 5a(viii))
- Tax depreciation appears reasonable as percentage of opening regulatory tax asset values
- Cost allocation adjustment and adjustment to tax asset values recorded for any changes in asset allocations
- Complementary changes in deferred tax balance and regulatory tax asset base roll-forward for assets commissioned and disposed



9. Questions?



Commerce Commission

Compliance Overview

March 2014

Presentation to Information Disclosure Workshop



Contents

1. Monitoring compliance
2. General compliance observations
3. Next steps



1. Monitoring compliance



Our focus in 2013

1.1 Why monitor compliance with ID?



- Non-compliance is a breach of a regulated supplier's statutory obligations
- Under the Commerce Act 1986, the Commission may monitor and analyse all information disclosed under ID
- Interested persons need assurance that disclosed information has been prepared in accordance with the determination
 - Directors' Certification
 - Independent audit assurance
 - Compliance monitoring



1.2 Compliance in 2013 – our focus



- Monitoring timeliness of public disclosure, general completeness of disclosures, and some specific areas
 - e.g. initial RAB adjustment for EDBs
- Identifying areas to provide further support to suppliers
- Providing general feedback about compliance
- Addressing specific compliance issues directly with suppliers



2. General compliance observations

2013 disclosure year



What we observed

2.1 General compliance observations



What went well

- Substantial effort by suppliers in completing 2013 disclosures
- Good overall level of compliance with public disclosure timeframes
- Suppliers continued to use the ID Issues Register to raise queries and seek clarification
- Early engagement by some suppliers to manage anticipated problems in complying with the requirements



2.2 General compliance observations



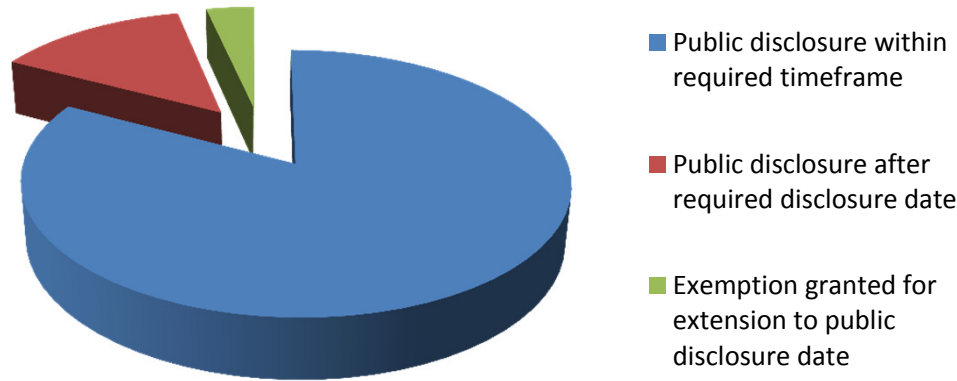
Areas for improvement

- Managing public disclosure due dates
 - Exemption requests
 - Late disclosures

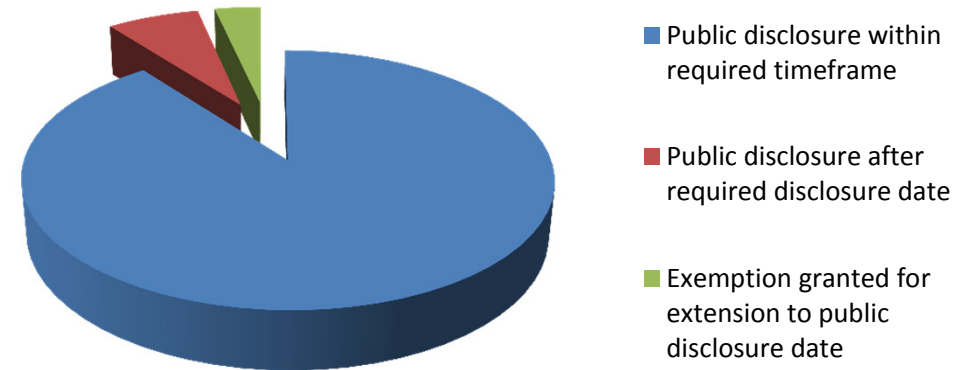


EDBs Compliance with public disclosure timing requirements - 2013

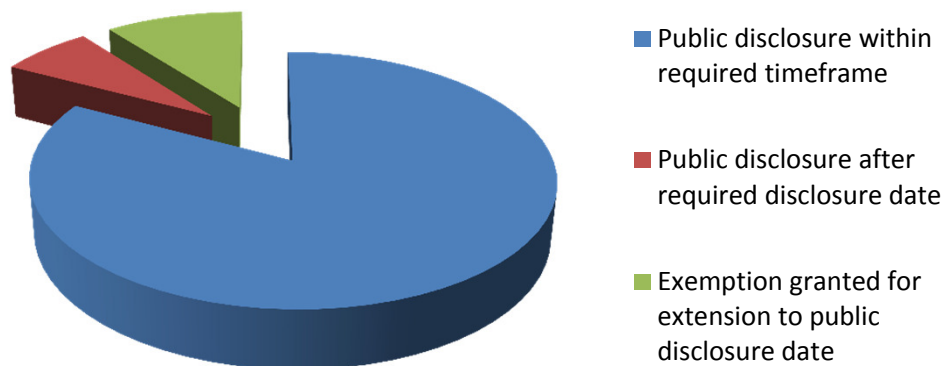
AMP and forecast information



Pricing methodologies



Historical financial and network asset information



2.2 General compliance observations

continued



Areas for improvement (continued)

- Completeness of disclosed information
- Quality and consistency
- Governance responsibilities



2.3 Non-compliance with ID

- Suppliers should contact the Commission if:
 - Errors are discovered in previously disclosed information
 - Suppliers anticipate future non-compliance
- We will work with suppliers in addressing non-compliance
 - Specific areas of non-compliance are being addressed with suppliers



3. Next steps



What we expect

3.1 What are the next steps?

- Continuing our focus on compliance education
- Expecting a greater level of compliance in 2014
- Compliance monitoring becomes more targeted as suppliers better understand the requirements



3.2 What is different in 2014?

Disclosure year 2013

Transitional financial	<i>5h</i>
Initial RAB adjustment	<i>5i</i>
Mandatory notes – transitional	<i>14b</i>
Directors' certificate	<i>19</i>

Historical financial	<i>1-5g, 6a-8</i>
Network assets	<i>9a-10</i>
AMP and forecasts	<i>11-13</i>
Mandatory notes	<i>14, 14a,</i>
Voluntary notes	<i>15</i>
Directors' certificate	<i>17, 18</i>

Disclosure year 2014



3.3 Publications & key dates



- On our website:
 - General Observations and Comments about EDBs 2013 disclosures
 - Updated ID Issues Register
 - Revised ID templates v3.0 for EDBs (schedules 11a-13)
- Available soon:
 - Revised ID templates v3.0 for GPBs
 - Revised ID templates v3.0 for EDBs (schedules 1-10)
 - Regulatory Calendar summarising public disclosure dates



Questions?



Information Disclosure Workshop



These slides formed the basis of the ID presentations to suppliers and auditors by Commission staff in March 2014. These slides are not meant to be definitive and should not be used instead of legal advice. They do not replace or summarise the information disclosure determinations themselves. 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.



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