



AUSTRALIAN
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Profitability measures for electricity and gas network businesses

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Overview

- Aim of the review
- Key issues raised in submissions
- Proposed measures
- Reporting on profitability
- Next steps

Aim of the Review

“to identify suitable profitability measures and their associated data requirements that would allow us to report and compare the returns of electricity and gas service providers.”

Increased transparency

- Primary purpose is to increase the transparency of service provider's profitability.
- Transparency around returns and drivers will assist in achieving NEO and NGO:
- Increased transparency should:
 - assist stakeholders in making submissions on regulatory proposals
 - provide an additional source of information to assess effectiveness of the regulatory regime.

Comparisons

We are seeking to identify profitability measures that will allow comparison of:

1. A service provider's expected returns to its actual returns;
2. Returns of service providers in the same sector;
3. Returns of service providers and businesses in other regulated/unregulated industries.

Multiple vs single measure

- Submissions differed on this issue.
- Our draft position is to report on a suite of measures:
 - recognises there is no single perfect measure;
 - highlights different aspects of a SP's profits and allows a more fuller assessment of drivers;
 - supports overall aim of increasing transparency.
- Proposed measures use a range of inputs:
 - EBIT, NPAT, asset value, equity, customer numbers and enterprise values.

Regulatory v statutory reporting

- A key objective is to identify measures that allow comparison of SPs with other businesses.
- Submissions noted that stat and reg accounting frameworks differ (adjustments required).
- McGrathNicol's view was these adjustments would be complex and still open to criticism:
 - It suggested we apply some measures using stat info (avoids adjustments and improves comparability).
- We consider that this approach is preferable to making adjustments to regulatory information.

Allocation issues

- Issues raised with NPAT measures, particularly where the SP part of a consolidated corporation:
 - tax and financing managed at corporate level;
 - allocations considered to be difficult/arbitrary.
- McGrathNicol advised that if guidance is put in place allocations could be made to the SP level.
 - It acknowledged there would be an initial cost.
- Our draft position is to require businesses to make allocations to the SP level (guidance to be provided).

Proposed measures and required data

1. Return on Assets (EBIT) = $\text{EBIT} / \text{RAB (reg)}$
2. Return on Assets EBIT / Total Assets (stat)
3. Return on Equity = $\text{NPAT} / \text{total equity (stat)}$
4. Return on Regulated Equity = $\text{NPAT} / [\text{RAB} \times 0.4]$
5. Earnings per customer = $\text{EBIT} / \text{customer no. (reg)}$
6. RAB multiples = $\text{Market value} / \text{RAB}$

Reporting

- NEL/NGL provides for the AER to report on financial performance (including profitability);
- Future AER performance reporting to include analysis and commentary on profitability;
- Data collected through annual reporting instruments:
 - Annual reporting instruments to be amended or developed where they do not exist.
 - Income statement and balance sheet included.
- Assurance requirements will apply.

Information on actual returns

- We had intended to publish some actual returns as part of the draft position paper;
- Annual Reporting RINs for distributors include an income statement;
- Based on feedback we have come to the view that the data is not currently fit for purpose.
 - Some issues identified around EBIT/NPAT
 - Highlighted need to provide detailed guidance on completing the statements.

Proposed process to gather data

- We are proposing the following approach to gather data:
 1. Work with SPs to publish RoA measure over the next month.
 2. Post-final position request SPs to voluntarily provide data (based on final measures)
 - including some historical data.
 3. Amend/develop annual reporting instruments to collect required data on an ongoing basis.

Next steps

- Position paper:
 - Submissions close 30 May
 - Publish final position end of August.