COMMERCE COMMISSION
NEW ZEALAND
Te Komihana Tauhokohoko

Initial ID RAB technical working group session

3 March 2022

Workshop Agenda

Time	Agenda
1pm	Welcome, introductions, scope and indicative timeline
1.45pm	Information requirements, assurance and alternative methodologies
2.15pm	Cost allocation
2.45pm	Break
3.00pm	Commission financial loss asset (**FLA**) demonstration model
3.30pm	Questions
4.00pm	Close

Welcome

- Introductions
- How to ask questions and provide feedback during the session
  - Raise hand
  - Use the session chat
- Please note that we will be recording the session and taking notes to ensure that we are able to summarise the key points accurately. We are not going to transcribe or publish the recording but will be publishing the key points
- We will record any specific issues that are not discussed during the session and may publish guidance in the future where appropriate
- We will circulate our notes of the key points to regulated fibre service providers (**regulated providers**) for feedback before publishing the notes on our website

Purpose and scope of the workshop

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- This technical working group session is on the process to determine the value of the initial information disclosure regulatory asset base (**initial ID RAB**) for regulated providers other than Chorus
- It will provide an overview of some of the things we expect that you will need to consider as you gather the relevant information
- We will present our current indicative timeline for the determination of the initial ID RABs
- We will gather information on the status of each regulated provider other than Chorus in terms of progress towards starting to extract information on the initial ID RAB
- We will explain how we currently intend to obtain relevant information that we expect to require to determine the value of other LFCs[1] initial ID RABs

[1] We refer to regulated providers other than Chorus as "other LFCs" in this presentation

Purpose and scope of the workshop - continued

- Any views discussed by Commerce Commission (**Commission**) staff represent preliminary views and are not the views of Commissioners. Any future decision to issue a notice in respect of information relating to a regulated provider's initial ID RAB under s 221 of the Telecommunications Act 2001 (**the Act**) would be made by the Commission and not Commission staff
- If regulated providers have any issues with interpreting or applying the *Fibre Input Methodologies Determination 2020*, as amended on 21 December 2021 (**fibre IMs**), we encourage regulated providers to seek independent legal advice

Indicative process timeline

- Current indicative timeline

- We are also starting to engage with Chorus on the finalisation of its initial price quality RAB (**initial PQ RAB**) and initial ID RAB

- Next step – publish process update paper

Context for the topics covered today

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- Based on our process for determining the value of Chorus' transitional initial PQ RAB, we have identified a number of technical areas that we see value in highlighting
- Understanding these areas and the associated requirements in our fibre IMs will assist the Commission to accurately determine the value of the initial ID RABs for regulated providers other than Chorus
- These technical areas are:
  - Information requirements, assurance and alternative methodologies;
  - Cost allocation; and
  - The Commission financial loss asset demonstration model.
- We invite you to ask questions and provide feedback as we discuss these areas

Information requirements, assurance and alternative methodologies

Information requirements

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- Calculation of financial loss asset in initial ID RAB requires 10 years of historical information (1 December 2011 to 31 December 2021)
  - UFB revenues cash flow (B1.1.2(3)(b):
  - UFB costs cash flow (B1.1.2(3)(a):
    - UFB cost allocation adjustment cash flow;
    - UFB operating expenditure cash flow;
    - UFB tax costs cash flow (matching and allocation of tax assets, with proportionate adjustment to adjusted tax values if sum of adjusted tax values > sum of UFB unallocated opening values);
    - UFB value of net commissioned assets cash flow
      - Arms-length valuation of UFB assets acquired from related party.
- Business changes and retention of historical data
  - Discontinuities of data
  - Reconciliations of fibre business unit information back to Group reporting
- Retrospective allocation of assets and costs

Assurance considerations

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- Initial ID RAB reported under ID is subject to reasonable assurance opinion for first historical disclosures (Cl. 2.5 of Fibre ID Determination)
  - SAE 3100 and ISAE (NZ) 3000
  - "Proper records" opinion
  - Need to engage with auditors re level of work required on initial ID RAB to support reasonable assurance opinion for year-end disclosures
  - Materiality thresholds
- Acceptance of audited financial statements as basis for UFB cash flows
- Additional assurance for information audited to higher materiality or different balance date in group disclosures
- Assurance re transformation of information into model inputs – familiarising staff and auditors with fibre IM requirements
- Visibility of assumptions, calculations and source data, especially to support cost allocations

Alternative Methodologies for determining financial losses (B1.1.14)

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Examples of precedents:

- Capital contributions not matched to individual assets
  - Fibre IMs require capital contributions to be recorded as reduction in asset values rather than as revenue per GAAP
  - Need to identify assets that would have generated capital contributions
- Asset value adjustments
  - UFB value of net commissioned assets cash flow does not allow for adjustments to cost other than capital contributions, depreciation and impairment losses at the commissioning date (no NBV adjustments for leases or transfers between asset classes)
- Value of commissioned assets not recorded as a separate asset
  - expenditure in respect of a UFB asset already commissioned to be treated as relating to a separate UFB asset
- Calculation of UFB cost allocation adjustment cash flow
  - Opening and closing cost allocator values needed to calculate UFB cost allocation adjustment cash flow

Cost allocation

Cost allocation

- Cost allocation is relevant for sharing or allocating the value of an asset between services that are provided using that asset, and also for sharing opex incurred in the provision of multiple services
- For other LFCs, cost allocation is an input into determining the initial ID RAB as of the implementation date (1 Jan 2022):
  - for **core fibre assets**, the allocation of **asset values** to ID fibre fixed line access services (**FFLAS**)[2] is relevant
  - for the FLA, the allocation of **asset values** and **operating costs** to UFB FFLAS are relevant
- The rules to be applied for cost allocation for ID are set out in the fibre IMs (Part 2 subpart 1; Schedule B sets out specific rules for the FLA)
- Key high-level issues for regulated providers subject to ID:
  - **directly attributable** costs or asset values
  - **shared** costs or assets and accounting-based allocation approach (**ABAA)**

[2] Specific terms are used in the fibre IMs – for example, UFB FFLAS (FFLAS provided under the UFB initiative) is to be used in the calculation of the FLA, while ID FFLAS is to be used for determining the initial ID RAB as of 1 January 2022 (and for cost allocation post-implementation).

Cost allocation

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Directly attributable

- The fibre IMs (clause 1.1.4(2)) define directly attributable:

  directly attributable means

  (a) in relation to **operating costs**, where a cost is wholly and solely incurred in the provision of a particular service; and

  (b) in relation to **asset values**, where an asset is wholly and solely **employed** by a **regulated provider** in the provision of a particular service.

- Where an operating cost or asset value is directly attributable to FFLAS[3], ie, it is wholly and solely incurred (in the case of an operating cost) or wholly and solely employed (in the case of an asset value) in the provision of FFLAS, then it must be 100% allocated to FFLAS (cl 2.1.2(2); Schedule B1.1.6(1)(a),(2)(b))
  - for example, where a pole carries aerial UFB fibre (and no other cables), it is solely and wholly employed for UFB services → the pole asset value must be 100% allocated to UFB
- Where it is directly attributable to other services (or recovered from a Part 4[4] regulated service), it must be excluded (cl 2.1.2(3))

[3] We use the general term FFLAS for the purposes of this overview. However, specific terms are used in the fibre IMs (see footnote 2 on slide 13),
[4] Part 4 means "Part 4 of the Commerce Act 1986"

Cost allocation

Shared costs or assets and ABAA

- Where an operating cost is incurred (or assets are employed) in the provision of FFLAS and other services, the cost (or asset value) must be proportionally allocated between FFLAS and the other services using the ABAA methodology (cl 2.1.2(4); Schedule B1.1.6(1)(b),(2)(c)):
  - for example, where a pole carries aerial fibre for FFLAS as well as other cables (eg, electricity distribution), the pole value must be allocated between FFLAS and other services, using ABAA
- Other things to note:
  - asset and cost allocators must be based on a **causal relationship** wherever possible (or else a proxy) (cl 1.1.4(2))
    - a 'causal relationship' requires that the circumstance in which the cost driver leads to the operating cost being incurred (or the factor influencing employment of the asset) is "objectively justifiable and demonstrably reasonable". See Chorus transitional initial PQ RAB decision (16/12/2021), paras 5.34, 5.42.
  - allocator values must be periodically **updated** (cl 2.1.3(1)(a); Schedule B1.1.6(3))
  - allocator types must be periodically **reviewed** (cl 2.1.3(1)(b); Schedule B1.1.6(3))
  - allocators must be **applied consistently** across FFLAS classes (cl 2.1.3(1)(c)), and between the FLA and initial ID RAB (cl 2.1.3(3))
  - the cap on shared costs must be met (cl 2.1.3(5),(6); Schedule B1.1.6(4),(5))

Cost allocation

Interactions with Part 4 of the Commerce Act 1986

- There may be interactions with Part 4 if cost allocations of fibre assets are shared with assets regulated under Part 4.

Financial loss asset

- For the calculation of the FLA, the allocator types available to be applied for operating costs and asset values are specified in Schedule B1.1.6(1)(c) of Schedule B of the fibre IMs (for operating costs) and in Schedule B1.1.6(2)(d) of Schedule B of the fibre IMs (for asset values)

Commission financial loss asset demonstration model

Commission demonstration model

- In December 2021, the Commission published a model, Chorus' FLA demonstration model (which we will refer to as the Commission model), along with its decision on Chorus' transitional initial PQ RAB
- This Commission model illustrates the calculation of the FLA for Chorus
- The inputs to this Commission model are details of UFB:
  - Revenues cash flow
  - Commissioned assets cash flow
  - Cost allocation adjustment cash flow
  - Operating expenditure cash flow
  - Depreciation
  - Tax values related to the UFB cash flows
  - Crown financing draw-downs and repayments

Commission demonstration model - continued

It should be noted that some aspects of the Commission model published in December 2021 are not relevant for the other LFCs initial ID RAB calculation

In particular note that for the other LFCs initial ID RABs:

- The sum of UFB opening asset values as of 1 December 2011 are assumed to be nil
- The UFB cost allocation adjustment cash flow was separately calculated by Chorus in their own modelling and relied on the use of the "alternative methodologies for determining financial losses" provision
  - We expect that other LFCs can apply the fibre IMs as set out in Schedule B1.1.2(4), but we note that alternative methodologies may be applied
- The calculation of the components (debt and equity) of the Crown financing draw-downs in the model are not those applicable for other LFCs

Financial losses calculation

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Schedule B1.1.2(2) Financial losses' for a regulated provider are calculated in accordance with the formula:

present value of total net cash flows + UFB asset base closing value at implementation date + present value benefit of Crown financing

Looking at the first part of this calculation:

'*present value of total net cash flows*' = the sum of the 'present value of annual net cash flows' for each financial loss year (with any positive values arising for financial loss years offset against negative values)

'*present value of annual net cash flows*' = present value of UFB revenues cash flows – present value of UFB costs cash flows

Cash flow inputs - UFB revenues cash flows

For each financial loss year between 1 Dec 2011 and 31 Dec 2021 other LFCs need to provide, based on historical information, revenue cash flow data

Schedule B1.1.2(3)(b) The UFB revenues cash flow means revenues derived by a regulated provider from the provision of UFB FFLAS for the financial loss year in question, excluding any capital contributions to the extent they were accounted for as revenue under GAAP

Schedule B1.1.2(7)(b) For a particular financial loss year, the present value (PV) at implementation date of the UFB revenue cash flow is obtained by multiplying the UFB revenues cash flow by the relevant revenue date compounding factor. The model contains the relevant PV multiplier (revenue date compounding factor)

Cash flow inputs - UFB costs cash flow

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Similarly for each financial loss year between 1 Dec 2011 and 31 Dec 2021 other LFCs need to provide, based on historical information, cost cash flow data

Schedule B1.1.2(3)(a) The UFB costs cash flow means costs incurred by a regulated provider under the UFB initiative for the financial loss year in question and is the sum of:

- UFB cost allocation adjustment cash flow;
- UFB operating expenditure cash flow;
- UFB tax costs cash flow;
- UFB value of net commissioned assets cash flow

Schedule B1.1.2(7)(a) For a particular financial loss year, the present value (PV) at implementation date of the UFB costs cash flow is obtained by multiplying the sum of the UFB costs cash flows by the relevant mid-year compounding factor. The model contains the relevant PV multiplier (mid-year compounding factor)

UFB asset base closing value at implementation date

Schedule B1.1.2(2)(b) *UFB asset base closing value at implementation date* - means the sum of UFB closing asset values in respect of financial loss year 2022. This is calculated via the UFB ID RAB being rolled forward over the pre-implementation period

While we are only concerned with the UFB asset base for the pre-implementation period in the calculation of the financial loss asset, any core fibre assets that were not UFB assets will enter the asset base at 1 January 2022 (2.2.3)

Question *– do regulated providers other than Chorus have core fibre assets that were employed in the provision of ID FFLAS on 1 January 2022 that were not UFB assets during the financial loss period?*

Present value benefit of Crown financing

Schedule B1.1.2(2) *Present value benefit of Crown financing* - means the present value benefit of the avoided cost of Crown financing drawn down during the financial loss period

Schedule B1.1.2(6) – sets out the calculation in respect of a regulated provider subject only to ID regulation

Note: The calculation in the model is that for Chorus (as set out in Schedule B1.1.2(5)) and is not applicable to other entities

Tax inputs

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- The UFB revenues and UFB costs cash flows are calculated to meet the fibre IM requirements by extracting relevant UFB amounts from the entity's GAAP accounts as per the fibre IMs
- To determine the associated tax values, the relevant tax adjustments applied to the GAAP accounts need to be applied to the extracted UFB amounts, including
  - Adjustments to account for the impact of permanent and temporary differences between UFB and Tax accounts are made consistent with those made to the general GAAP accounts to derive the Tax accounts
  - Tax depreciation is applied to the regulatory tax asset value of UFB assets
  - Notional deductible interest is calculated as illustrated in the Commission model
  - Calculation of regulatory tax asset values Schedule B1.1.8(1), with proportionate adjustment to adjusted tax values if sum of adjusted tax values > sum of UFB unallocated opening asset values
- Tax calculations will relate to the specific tax situation of each entity

Questions and next steps

Next steps – initial ID RAB

- The Commission will release a process update paper
- We expect to provide a draft of a section 221 notice to each of the other LFCs in March/April

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End of session

Thank you


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Cafe
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SPECIALS
SPECIALS
SPECIALS
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Closing Down Sale
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