

Commission note:

After this document was provided, PwC agreed that the document could be published for consultation purposes. Please note PwC's restrictions in Appendix A.



Strictly confidential

Sarah Oldershaw
Regulatory Programme Manager
Chorus Limited
1 Willis Street
CBD
Wellington

26 March 2021

Initial asset value – input methodology verification

Dear Sarah,

1. You requested that PricewaterhouseCoopers Consulting (New Zealand) LP (PwC) assist Chorus Limited (Chorus) by undertaking an independent verification of the Initial Asset Value (IAV) model (the Model) for the regulated fibre fixed line access service (FFLAS) assets of Chorus.
2. The purpose of the verification is to assess and report on whether the IAV has been compiled consistent with the Input Methodologies (IMs).
3. Our review has been undertaken with reference to the following IM determinations issued by the Commerce Commission in October and November 2020:
 - 2020 NZCC 21 Fibre input methodologies Determination 2020 - 13 October 2020
 - 2020 NZCC 24 Fibre input methodologies (initial value of financial loss asset) Amendment Determination 2020 - 3 November 2020.
4. This report has been provided in accordance with the terms of our statement of work dated 26 May 2020 and the overriding engagement letter dated 20 February 2012, and is subject to the restrictions set out in Appendix A.

Scope

5. Our verification role has comprised the following key tasks:
 - Gaining an understanding of the Model
 - Understanding the methods and assumptions used to derive the IAV of the:
 - core fibre assets
 - financial loss asset at implementation date.
 - Assessment of compliance with the IMs, including:
 - identifying where judgements have been made, and assessing whether those judgements are consistent with the IMs
 - identifying potential errors or ambiguities in the IMs, and the approach adopted in the Model.

Approach



6. Our IM verification of the Model focusses on the core fibre assets and the financial loss asset to implementation date, with reference to the IM determinations.
7. Our assessment of the IM compliance of the core fibre asset modelling has considered:
 - Asset categorisation for:
 - FFLAS and non FFLAS assets
 - geographic areas
 - directly attributable and non-directly attributable assets
 - asset depreciation class
 - Application of the cost allocation IM to assets and capex, including asset allocators
 - Commissioning, depreciation and disposals assumptions and methods
 - Where regulatory methods diverge from generally accepted accounting principles (GAAP) (eg: capital contributions)
 - Alignment between fixed asset register (FAR) information and forecast commissioning and roll forward methods to implementation date.
8. Our assessment of the IM compliance of the financial loss asset modelling has considered:
 - Asset categorisation for:
 - Ultra-Fast Broadband (UFB) and non UFB assets
 - directly attributable and non-directly attributable assets
 - asset depreciation class
 - Application of the cost allocation IM to UFB assets, commissioned assets and opex, including opex and asset allocators
 - Commissioning, depreciation and disposals assumptions and methods for UFB assets and tax assets
 - Derivation of UFB cash flows, including opex, tax and commissioned assets
 - Cost of capital parameters, cost of debt and discounting
 - Benefit of Crown financing.
9. Our verification does not include inspection or assurance over the integrity of the Model or underlying source information.

Verification process

10. In July 2020, we completed a preliminary IM review of the Model with reference to the November 2019 draft IM determination. The purpose of this review was to assess the extent to which the Model was compliant with the draft IMs.
11. In March 2021, we completed a final IM review of the Model with reference to the October and November 2020 final IM determinations.
12. Our final verification was undertaken on the Model provided to us on 24 March 2021.



Our analysis

13. Our analysis involved preparation of:

- schedules of each IM reference and our assessment of whether and how compliance is demonstrated, and a description of any issues identified
- model maps to identify discrete sections of logic, intermediate calculations, and to ensure our verification process covered all sections of the Model
- documentation of the cost allocation and asset allocation process logic in the Model
- documentation of the tax logic in the Model.

14. During our initial review of compliance with the draft IMs we identified some areas of non-compliance, and other areas where we required further clarification, or provided suggestions for improved compliance. Chorus responded to our queries and we reviewed these responses and subsequent amendments to the Model.

15. Following this initial feedback, and the final IM determination, Chorus provided us with an updated Model. We identified some further areas of non-compliance. Chorus responded to our queries and we reviewed these responses and subsequent amendments to the Model.

16. We also identified areas where the Model uses an alternative method with equivalent effect to the IMs and where the IMs contain errors or ambiguities.

Findings

17. We identified the following areas where the IMs contain errors or inconsistencies which impact the modelling. These relate to the financial loss asset, as follows:

- Clause B1.1.2 (4) – UFB cost allocation adjustment cash flow
- Clause B1.1.2 (5) – Present value benefit of Crown financing.

18. We identified the following components of the Model where an alternative approach with equivalent affect to the IMs has been adopted:

- Clause B1.1.2 (4) – UFB cost allocation adjustment cash flow
- Clause B1.1.2 (5) – Present value benefit of Crown financing
- Clause B1.1.2 (9) – UFB opening asset value.

Conclusion

19. We have applied best endeavours to verify that the IAV Model is compliant with the IMs. We have provided written feedback to Chorus on earlier versions of the Model. All issues identified during our verification process have been resolved or recorded above.

Limitations

20. Our work does not include inspection or assurance over the integrity of the Model or underlying source information.

21. We provide no opinion over the IAV value which may be generated from the Model and our advice should not be construed as such. Our work does not include any work in the nature of a financial audit and we have not verified any of the inputs involved or the valuation outcomes.

22. As the verification procedures do not constitute either an audit in accordance with New Zealand generally accepted auditing standards or a review in accordance with review engagement standards in New Zealand, we do not express any assurance on the Model.

23. We understand that a copy of our report may be provided to the Commerce Commission. PricewaterhouseCoopers, its partners and employees accept no liability or duty of care to any



party other than Chorus in relation to the contents of our report. Our liability in relation to our report is owed solely to Chorus in accordance with our terms of engagement with you.

Use of our report

This verification report dated 26 March 2021 is solely for the purpose set out above and is not to be used for any other purpose.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Lynne Taylor'.

Lynne Taylor
Executive Director
PwC Consulting
lynne.taylor@pwc.com
021 779 088

A handwritten signature in black ink, appearing to read 'Craig Rice'.

Craig Rice
Partner
PwC Consulting
craig.rice@pwc.com
021 624 462



Appendix A – Restrictions

This report has been prepared solely for the purpose of assisting Chorus with verification of IM compliance of the IAV model. This report has been prepared solely for this purpose and should not be relied upon for any other purpose. We accept no liability to any party should it be used for any purpose other than that for which it was prepared.

This report has been prepared solely for use by Chorus and may not be copied or distributed to third parties without our prior written consent. We consent to a copy being provided to the Commerce Commission.

To the fullest extent permitted by law, PwC accepts no duty of care to any third party in connection with the provision of this report and/or any related information or explanation (together, the “Information”). Accordingly, regardless of the form of action, whether in contract, tort (including without limitation, negligence) or otherwise, and to the extent permitted by applicable law, PwC accepts no liability of any kind to any third party and disclaims all responsibility for the consequences of any third party acting or refraining to act in reliance on the Information.

We have not independently verified the accuracy of information provided to us or retrieved from public sources and have not conducted any form of audit in respect of Chorus. Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise. The statements and opinions expressed in this report are based on information available as at the date of the report.

We reserve the right, but will be under no obligation, to review or amend our report, if any additional information, which was in existence on the date of this report, was not brought to our attention, or subsequently comes to light.

This report is issued pursuant to the terms and conditions set out in our statement of work dated 26 May 2020 and the overriding terms of engagement letter dated 20 February 2012.