

The Auditor-General
Audit Report No.36 2006–07
Performance Audit

Management of the Higher Bandwidth Incentive Scheme and Broadband Connect Stage 1

**Department of Communications, Information
Technology and the Arts**

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of Australia 2007

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Canberra ACT
16 May 2007

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Department of Communications, Information Technology and the Arts in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *Management of the Higher Bandwidth Incentive Scheme and Broadband Connect Stage 1*.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name.

Ian McPhee
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

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Abbreviations and Acronyms

ADSL	Asymmetric Digital Subscriber Line
AFP	Australian Federal Police
ANAO	Australian National Audit Office
BC	Broadband Connect
BC-related programs	the BC Stage 1, BC Stage 2, BC Infrastructure and Australian Broadband Guarantee programs
BCOMS	Broadband Connect Online Management System
CDPP	Commonwealth Director of Public Prosecutions
Committee	DCITA's Audit, Risk and Evaluation Committee
CRU	Communications Research Unit (within DCITA)
DCITA	Department of Communications, Information Technology and the Arts
HiBIS	Higher Bandwidth Incentive Scheme
HOMS	HiBIS Online Management System
ISDN	Integrated Services Digital Network
kbps	kilo bits per second
MB	mega-bytes
MEA	Metropolitan Exclusion Area
NTN	Networking the Nation
RTI	Regional Telecommunications Inquiry
TIO	Telecommunications Industry Ombudsman
TEZSS	Telstra Extended Zone Satellite Service

Glossary

2005 Review	The mid-term review of the HiBIS program undertaken in 2005. A final report was not completed as it was overtaken by the development of a submission to the Government to extend the HiBIS program (into what later became BC)
Added Value Services	Metro-comparable services under the HiBIS and BC Stage 1 programs in excess of the minimum functionality requirements for Threshold Services
allowable costs	Specific types of costs incurred by providers in providing HiBIS/BC Stage 1 services that can be offset against the incentives providers receive. Over the life of HiBIS/BC Stage 1, providers' allowable costs must not exceed the incentives they receive
Asymmetric Digital Subscriber Line (ADSL)	Broadband services provided over the standard telephone line
attestation	A series of questions asked of a customer by a provider leading to a declaration by the customer that they are eligible for a HiBIS/BC service
customer premises equipment	Hardware associated with the installation of broadband services at a customer's premises
funding cap	The amount of funding that any one provider can receive is limited to 60 per cent of total program funds in any financial year and for the programs overall. DCITA may vary the funding cap under certain circumstances
pair gains	A method of providing land-line telephone services that impedes customers' access to ADSL broadband services

incentives or incentive payment(s)	Payments made to registered internet service providers to provide metro-comparable services at metro-comparable prices to eligible HiBIS/BC customers
metro-comparable prices	Prices for metro-comparable services that are equivalent to prices in metropolitan areas
metro-comparable services	Broadband services that are equivalent to the functionality of those in metropolitan areas. Defined as having a peak data download/upload speed of at least 256/64 kbps and 500 MB per month usage allowance
Metropolitan Exclusion Area (MEA)	All State/Territory capital cities and the adjacent high population centres of Wollongong (NSW), the Central Coast of NSW, Newcastle (NSW), Geelong (Vic), Gold Coast/Tweed Heads (Qld/NSW), and Palmerston (NT)
migrating customers	Customers already receiving broadband services at the start of HiBIS that were not up to the standard of metro-comparable services. In most instances, they had the required data speeds, but had lower usage allowances, commonly 200 MB per month
pre-existing customers	Customers already receiving metro-comparable services at the start of the HiBIS program but not at metro-comparable prices
providers	Generally refers to internet service providers that have registered with DCITA to provide HiBIS/BC services
terrestrial broadband services	Broadband services provided by all technologies except satellite
Threshold Services	Broadband services under the HiBIS and BC Stage 1 programs at a peak data download/upload speed of at least 256/64 kbps and 500 MB per month usage allowance

Summary and Recommendations

Summary

Background and context

1. In 2002, the Government commissioned the Regional Telecommunications Inquiry (RTI) to independently assess the adequacy of telecommunications services in regional, rural and remote Australia. A specific term of reference was to assess barriers to accessing higher bandwidth (broadband) services.

2. In response to the RTI, the Government established the \$107.8 million Higher Bandwidth Incentive Scheme (HiBIS) in June 2003. The HiBIS program was to cover the four-year period from 2003–04 to 2006–07. The program provided registered internet service providers with incentive payments for supplying broadband services in regional, rural and remote areas at prices comparable to those available in metropolitan areas. Over 1.3 million dwellings were eligible to receive HiBIS broadband services. The minimum requirements for HiBIS broadband services were a peak download/upload speed of 256/64 kilo bits per second and usage allowance of 500 mega-bytes per month. The Department of Communications, Information Technology and the Arts (DCITA) administered the HiBIS program.

3. In response to the greater than expected demand for HiBIS services, the Government:

- allocated a further \$50 million to the program in June 2005 and reduced the program's timeframe to December 2005; and
- established the \$878 million Broadband Connect (BC) program in August 2005, which effectively extended the HiBIS incentives for a further three and a half years to 2008–09. The first stage of BC ran from January to June 2006 and the second stage from July 2006 to March 2007.

4. DCITA paid claims totalling over \$272 million to 51 service providers for approximately 160 000 HiBIS and BC Stage 1 customers connected between the start of HiBIS on 8 April 2004 and the end of BC Stage 1 on 30 June 2006.

5. In response to the risks identified by DCITA and others in mid-2006 that the BC program may not meet its objectives in the future, the Government initiated the \$600 million Broadband Connect Infrastructure Program. This program is to encourage the further take-up of affordable broadband services in under-served areas of regional Australia. A small number of major projects

of significant scale and service coverage will be funded under the Infrastructure Program.

6. In April 2007, the Government also commenced the \$162.5 million Australian Broadband Guarantee program to provide a smooth transition from BC Stage 2 to the BC Infrastructure Program. The Australian Broadband Guarantee program operates in a similar way to the HiBIS and BC Stages 1 and 2 programs. It makes any Australian resident or small business that is unable to access broadband services at their principal residence eligible for a subsidised broadband service.

7. The audit objectives were to examine if:

- DCITA had effectively planned and administered the HiBIS and BC Stage 1 programs; and
- the programs had achieved their objectives.

The audit focused on DCITA's activities to support the planning, implementation, monitoring and reporting of HiBIS and BC Stage 1 programs.

Overall audit conclusion

8. The HiBIS/BC Stage 1 programs have achieved their objective of providing broadband services to regional Australia at prices and functionality comparable to those in metropolitan areas. The programs have also promoted competition among broadband service providers and effectively targeted those areas in regional Australia with the most need.

9. DCITA established an appropriate management framework to administer the HiBIS/BC Stage 1 programs. The guidelines were comprehensive and provided a sound basis to guide the day-to-day operation of the programs. Regular data speed testing was a particularly valuable initiative to ensure that providers continue to deliver quality services to customers. However, the programs lacked a project implementation plan and risk management strategy that would have assisted DCITA to better identify and manage the programs' risks. Consequently, for much of HiBIS/BC Stage 1, a lack of administrative resources led to inadequate controls over the assessment and payment of provider claims.

10. Customers, providers and DCITA each have responsibilities for assessing the validity of HiBIS/BC Stage 1 claims. DCITA and providers rely heavily on customer attestations as the basis for determining customer eligibility and the incentives paid to providers. However, the extensive

eligibility requirements of the HiBIS and BC Stage 1 programs cannot be addressed effectively by customers answering a few simple questions. DCITA acknowledges that, until recently, it was not sufficiently aware of the steps taken by providers to validate customer attestations before submitting claims.

11. The manual checking of providers' claims was DCITA's primary payment control for much of the HiBIS/Stage 1 programs. Although the vast majority of claims were valid, the Australian National Audit Office (ANAO) estimates that between \$10.6 and \$12.4 million has been paid to providers for invalid or inaccurate claims. The majority of these invalid claims relate to two potential frauds by three providers. In addition, the ANAO identified a number of other issues that may have resulted in providers being paid for other potentially invalid or inaccurate claims. These claims were not costed, as DCITA did not possess sufficient information to reliably quantify their impact. In 2006, DCITA automated its claims checking process and established a program of recurring audits of providers. These measures have improved the claims validation process and will help to reduce the likelihood and severity of potential frauds by providers in the future.

12. The ANAO considers that further administrative efficiencies could be gained for the ongoing Broadband Connect-related programs. A small number of major providers submit over 80 per cent of all claims. DCITA indicated that adopting a systems-based approach would complement its current method of validating claims from major providers. DCITA also advised that it would consider reducing its examination of all claims where these providers established a track record of reliable systems and processes to vet their claims before lodgement.

13. The ANAO made two recommendations to improve the integrity of DCITA's claims validation process and the management of the Broadband Connect-related programs.

DCITA's response

14. DCITA acknowledges and accepts the overall conclusions of the audit report. DCITA considers the report to be well-balanced, acknowledging the successful achievement of a number of important objectives of the programs and making constructive observations and suggestions in relation to areas where controls over assessment of claims for incentive payments could have been improved. DCITA notes that it has addressed a number of the ANAO's concerns in formulating rules and administrative processes for the Australian Broadband Guarantee.

Key Findings

Establishment of HiBIS and BC Stage 1 (Chapter 2)

15. The need for the HiBIS program was well established by the RTI. In response to the greater than expected demand for HiBIS services, the Government extended the subsidies through BC Stage 1 until June 2006.¹ The ANAO reviewed DCITA's implementation strategy for the HiBIS and BC Stage 1 programs.

Project implementation planning and risk management

16. DCITA did not develop and implement a formal project implementation plan or a risk management plan for the HiBIS and BC Stage 1 programs. Although the program area informed DCITA's Audit, Risk and Evaluation Committee that a project implementation plan had been developed and applied for BC Stage 1, this was not correct.

17. DCITA instituted management controls over the programs to address what it perceived to be the risks facing the program. However, the ANAO considers that a project implementation plan, incorporating an appropriate risk management strategy, would have assisted DCITA to better identify and manage some of the risks facing the programs. The lack of appropriate planning contributed to DCITA having inadequate controls over the assessment and payment of provider claims for much of the HiBIS/BC Stage 1 programs.

Program resourcing

18. Resourcing in the context of the HiBIS/BC Stage 1 programs can be considered in two respects: administered (or program) funding available for incentive payments and the capacity of DCITA to administer the programs. The HiBIS and BC programs have required periodic injections of additional funding to meet providers' entitlements. Although HiBIS's original budget was \$107.8 million over four years, DCITA will have paid four times this amount to providers as incentives under HiBIS and BC-related programs over the same period. The original HiBIS budget was based on predictions, most notably the take-up rate of HiBIS services by customers, which were all significantly

¹ The subsidies have been further extended to at least June 2008 through the BC Stage 2 and Australian Broadband Guarantee programs.

exceeded as the program progressed. DCITA indicated that the rate of take-up of new technologies is very difficult to predict. The ANAO acknowledges these difficulties but considers DCITA's submission to the Government would have been enhanced had it included sensitivity analysis that identified the 'alternative' budgets that would be required using different assumptions (for example, a range of customer take-up rates) and their impact on the required program budget. Such analysis can assist to inform decision makers of the range of possible outcomes.

19. An internal audit into HiBIS in mid-2005 found that the number of staff implementing the HiBIS program (six) was insufficient, given the program's size and the expected number of providers and customers. The audit report also noted that staff did not have the necessary skills, which could adversely affect DCITA's capacity to manage the program. DCITA advised that its staff administering the incentives component of BC grew from 11 in June 2005, to 25 in December 2005, to 30 in June 2006.

Funding agreements with providers

20. The funding agreements between DCITA and each provider accurately represented the HiBIS/BC Stage 1 terms and conditions published in the program guidelines. DCITA has also strengthened the funding agreements to address shortcomings concerning providers' submission of claims and the limit on funding that any one provider can receive.

Other elements of program establishment

21. DCITA had an appropriate management framework and management information system to support the administration of the programs. It also developed comprehensive program guidelines for the day-to-day operation of the programs and established performance measures to assess the programs' performance against objectives.

Management framework supporting HiBIS and BC Stage 1 (Chapter 3)

22. Customers, providers and DCITA each have responsibilities for assessing the validity of HiBIS/BC Stage 1 claims. Customers are required to provide attestations of their eligibility to providers before accessing HiBIS/BC services. Customers answer a few simple questions and make a declaration that they and their premises are eligible under the programs. Providers rely heavily on customer attestations as the basis for submitting claims to DCITA.

Customer attestations

23. DCITA considers that the attestation forms addressed the most important eligibility requirements. However, the attestations, in isolation, are not a particularly strong program management control. The ANAO found that:

- attestations did not cover some aspects of eligibility affecting a significant number of HiBIS/BC customers; and
- customers may inadvertently, carelessly or deliberately complete the attestation in a manner that makes it appear that they are eligible. The only real sanction for the customer in such circumstances is the loss of a broadband service that they would not have otherwise received.

Verification of eligibility by providers

24. DCITA acknowledges that, until recently, it has not been sufficiently aware of the steps taken by providers to validate customer attestations before they submitted claims. In addition, DCITA's audits of providers in 2006 identified a number of ad hoc and systemic issues. These included providers claiming the incorrect incentive level, and not obtaining or retaining key documentation supporting customer eligibility. Unless invalid claiming by providers is widespread or systemic, the only real sanction for providers who submit invalid claims is the loss of the incentive payments that they would not have otherwise received.

25. In December 2006, DCITA asked providers to inform it of the processes they used to assess the validity of customer attestations before claims are submitted. DCITA is currently pursuing providers who have not taken appropriate steps to validate the eligibility of customers.

Validation of claims by DCITA

26. Prior to February 2006, the primary means DCITA had to verify independently the validity of provider claims was a manual check of claims before payment. The ANAO questioned the effectiveness of the manual checking process as a claims validity control measure, given the small number of staff who examined over 7000 claims each month (on average). For BC Stage 1, DCITA improved the controls surrounding claims processing by:

- introducing a regular program of auditing provider claims using a risk-based approach; and

- progressively introducing automated checking of customer eligibility into the claims validation process (although DCITA did not achieve full automation until September 2006 in BC Stage 2).

Other program management controls

27. In addition to the controls DCITA had in place for claims processing, the ANAO found that:

- the regular data speed testing program established by DCITA has been a valuable initiative to ensure that providers continue to deliver quality services to customers. Testing results indicated that, overall, HiBIS/BC providers meet the minimum data speed requirements of the programs. The ANAO did not identify any systemic or extended pattern of failed data speed testing results for providers over the life of HiBIS/BC Stage 1;
- providers submitted regular reports establishing their compliance with their obligations under the program. However, as at February 2007, DCITA advised that 85 per cent of 2004–05 and 2005–06 reports had been received and their assessment was well advanced. The early identification of provider issues or problems is more likely to lead to an earlier resolution; and
- DCITA began a mid-term review of HiBIS in mid-2005. The review was never finalised as it was overtaken by the development of a submission to the Government to extend the program (into what later became BC). Nevertheless, an advanced draft report identified a number of suggestions and recommendations that DCITA took into account in designing and implementing BC Stage 1.

Assessment and payment of HiBIS and BC Stage 1 claims (Chapter 4)

28. DCITA paid claims totalling over \$272 million to 51 providers for approximately 160 000 HiBIS and BC Stage 1 customers connected between the start of HiBIS on 8 April 2004 and the end of BC Stage 1 on 30 June 2006. The primary HiBIS/BC eligibility requirements relate to the registration of providers and their services, the types of customers, and the location of premises. The ANAO found that:

- DCITA registered providers and services according to the requirements of the HiBIS/BC Stage 1 guidelines, except for the maximum prices

providers could charge customers for their Added Value Services.² The ANAO found considerable variations in providers' pricings for the same services, which was often in the thousands of dollars. The ANAO considers that greater attention to the pricing of Added Value Services during DCITA's assessment of these services could improve the outcomes for customers and for the programs;

- the broad eligibility requirements for residential customers (who comprise over 90 per cent of all HiBIS/BC customers) mean that it is likely that the vast majority claimed by providers are eligible. However, DCITA's inability to independently verify the exclusions to eligibility for small business customers (over eight per cent) means it cannot be as certain of the proportion of these customers who are eligible; and
- analysis of HiBIS/BC Stage 1 data identified the payment of over 1 200 claims for ineligible premises. In addition, compliance audits of three providers by DCITA identified some 4 000 invalid claims and evidence of potential fraud. The ANAO considers that these potential frauds could have been detected earlier had DCITA's claims checking process been fully automated at the time the claims were lodged. This may have reduced the severity of the potential frauds.

29. The ANAO considers that the vast majority of HiBIS/BC Stage 1 funding has been paid to providers for valid claims. However, it is estimated that DCITA has paid between \$10.6 and \$12.4 million to providers for invalid or inaccurate claims.³ These claims are outlined in Table 1.

² Added Value Services are broadband services that have features or functionality above the minimum standards for HiBIS/BC services.

³ Inaccurate claims are claims that have been paid at the incorrect incentive rate.

Table 1**Costed likely invalid or inaccurate claims**

Costed Issues	Adverse financial impact \$m
4 019 incentive payments claimed by three providers (now in administration or liquidation) to which they were not entitled	9.9
Approximately 800 premises with duplicate incentive payments that are likely to be ineligible for multiple services	1.7
314 customers whose premises are ineligible as they are located within the Metropolitan Exclusion Area (MEA)	0.5
112 Telstra customers where the high-cost incentive was incorrectly claimed instead of the standard incentive for eligible premises within pre-existing areas ^a	0.2
95 customers where providers received the full incentive when they were entitled to only a share of the incentive	0.1
53 ineligible customers (mainly city/shire councils)	0.1
TOTAL	\$10.6–\$12.4m^b

Source: ANAO analysis of DCITA data.

a – Pre-existing areas are areas that already had access to metro-comparable services at the start of HiBIS. Only premises in pre-existing areas that could not access metro-comparable services due to technical impairment were eligible. Providers are generally entitled to a standard incentive (\$1 400) where the eligible premises had access to Telstra's Integrated Services Digital Network (ISDN) or a high-cost incentive (\$3 000) where the premises did not have access to ISDN, at the start of HiBIS.

b – Total takes into account overlaps between the different costed issues, where possible.

30. The ANAO also identified a number of other issues that may have led to providers being paid for other potentially invalid or inaccurate claims. These claims (outlined in Table 2) have not been costed, as DCITA did not possess sufficient information to reliably quantify their impact.

Table 2**Other potentially invalid claims**

Uncosted issues
An unknown proportion of the 2 019 customers who either received a HiBIS/BC service at a location different to their current address or received a service at multiple addresses
An unknown proportion of the 13 000 small business customers who do not meet the legal structure for franchises required by HiBIS/BC Stage 1 or have more than 20 full-time employees nationwide. (The ANAO identified 173 small business customers where the organisations' names are recorded as either schools/colleges, and churches and businesses with nationwide representation.)
An unknown proportion of the 177 customers whose premises may be located within the MEA ^a
An unknown proportion of the 11 000 recipients of a Telstra Extended Zones Satellite Service (TEZSS) who have also received a HiBIS/BC service
An unknown proportion of provider claims that have incorrectly claimed the high-cost incentive instead of the standard incentive. A non-statistically based sample of providers' customers identified an incentive error rate of 3.2 per cent
An unknown proportion of 4 499 customers of two providers who claimed incentives without retaining the supporting documentation or without performing the requisite testing to determine which incentive rate applied. Two-thirds of the customers were claimed at the high-cost incentive rate

Source: ANAO analysis of DCITA data.

a – DCITA's geospatial management system could not pinpoint the location of these customers' premises and instead identified a region in which they are located. Therefore, the ANAO is unable to determine whether they meet program eligibility requirements.

Funding limits to individual providers

31. The HiBIS/BC Stage 1 programs limited the amount of funding any one provider could receive to 60 per cent of the HiBIS/BC Stage 1 funding available each financial year (that is, 'the funding cap'). DCITA anticipated that Telstra would be the only provider that the funding cap would apply to, given the size of its operations. The ANAO found that, over the life of HiBIS, DCITA was obliged to pay Telstra (under its funding agreements) \$12.8 million (8.3 per cent) in excess of the 60 per cent funding cap. The ANAO considers that this occurred due to delays in Telstra lodging claims for customer connections, DCITA misunderstanding the funding cap requirements and Telstra's claims against the cap not being properly monitored. DCITA has introduced changes to tighten the funding cap provisions under BC Stage 1.

32. The funding cap control mechanism developed by DCITA does not cater for unregistered wholesale services provided to HiBIS/BC Stage 1 retail

providers.⁴ While retail providers receive full incentive payments⁵, they also pay fees to the wholesale provider to connect HiBIS/BC Stage 1 customers. However, the fees received by providers for unregistered wholesale services do not count towards the funding cap. DCITA is of the view that any charges paid to wholesale providers under commercial arrangements by retailers should not count towards a provider's funding cap. These charges are not known to DCITA and it would not be in a position to obtain information on them.

Incentives not to exceed providers' allowable costs

33. 'Allowable costs' is a concept introduced into the HiBIS/BC Stage 1 programs that limits the incentive payments that providers can receive, to the costs incurred by providers to supply HiBIS/BC services. DCITA requires providers to prepare annual Statements of Allowable Costs and have them independently audited. The ANAO considers that this is a good mechanism to manage the risk of providers making windfall profits from the HiBIS/BC Stage 1 programs. However, its effectiveness has been inhibited by a failure to specify the format of the Statements and the audit opinions, a lack of follow-up on outstanding 2004–05 Statements, and delays in reconciling providers' allowable costs to their incentive payments.

Achievement of HiBIS and BC Stage 1 objectives (Chapter 5)

Comparability of prices for broadband services

34. The HiBIS/BC Stage 1 programs have realised their primary objective of achieving prices for higher bandwidth services in regional Australia that are comparable to metropolitan services. DCITA has demonstrated this through:

- benchmarking minimum higher bandwidth services against those offered in metropolitan areas at the start of the HiBIS program. There are also processes in place to maintain the quality of the services. Faster higher bandwidth services are available to customers who are prepared to pay more for them;

⁴ The programs allow wholesale service providers to sell their services to retail providers who then supply services to HiBIS/BC Stage 1 customers.

⁵ Retail providers who use the services of wholesale providers share incentive payments when both are registered under HiBIS/BC Stage 1. However, retailers receive full incentive payments when they use the services of an unregistered wholesaler.

- using appropriately benchmarked prices for minimum higher bandwidth services, against offerings in metropolitan areas at the start of HiBIS. Prices have since been reviewed and reduced in light of downward trends in the average pricing of broadband services in metropolitan markets; and
- enabling a significant proportion of those eligible to receive HiBIS/BC Stage 1 services to have access to terrestrial broadband services under the programs. The ANAO considers that the majority of the increased access would not have been achieved without support from the HiBIS/BC Stage 1 programs. In addition, all eligible customers have access to HiBIS/ BC Stage 1 satellite broadband services.

Competition among broadband service providers

35. Further, the HiBIS/BC Stage 1 programs have realised their first supporting objective of promoting competition among higher bandwidth service providers in regional Australia. The ANAO noted:

- an increase in the number of providers in regional Australia;
- an increase in the number of HiBIS/BC Stage 1 areas where there is more than one provider of HiBIS/BC Stage 1 services; and
- some HiBIS providers reducing their prices to match those of competitors.

Targeting areas of need efficiently

36. In addition, the HiBIS/BC Stage 1 programs have largely realised their second supporting objective to ensure efficient use of funds by effectively targeting support to areas of need in regional Australia. The ANAO noted that:

- areas in need of funding support had been appropriately defined;
- controls are in place to manage the risk of providers making windfall profits from HiBIS/BC Stage 1; and
- providers generally received standard incentives for low cost service solutions and high-cost incentives for high cost service solutions.

37. The ANAO also noted that eligible HiBIS/BC Stage 1 customers included those already receiving broadband services at the start of HiBIS that were not up to the standard of metro-comparable services (that is, 'migrating customers').⁶ However, providers were entitled to full incentive payments for

⁶ In most instances, migrating customers had the required data speeds, but had lower usage allowances, commonly 200 MB per month.

the thousands of migrating customers although the cost of upgrading their broadband services (by increasing their usage allowances) would usually be significantly lower than the costs of servicing new customers. The ANAO considers that it would have benefited the program if DCITA had adopted a lower incentive payment for these customers. The potential savings to the program would have outweighed the administrative costs of establishing and implementing a differential incentive payment for migrating customers.

Reporting of program performance

38. DCITA could have enhanced the public reporting of the programs' performance by linking it to the programs' three objectives and including additional information already held by DCITA to support the programs' performance. This information includes statistics on broadband access and competition, and actions taken by DCITA and providers that have furthered the achievement of program objectives.

Recommendations

The ANAO has made two recommendations to improve the integrity of DCITA's claims validation process and the management of the Broadband Connect-related programs.

Recommendation No.1

Para 4.29

To improve the integrity of the Broadband Connect (BC)-related programs, the ANAO recommends that DCITA:

- (a) re-assess, where appropriate, the eligibility of the premises that received a HiBIS/BC Stage 1 service that the ANAO's analysis highlighted as potentially ineligible;
- (b) consider taking recovery action in relation to invalid claims; and
- (c) assess the eligibility of premises in all future provider claims more rigorously by using independent information sources.

DCITA's response: Agrees.

Recommendation No.2

Para 4.55

To improve the process for reconciling Allowable Cost Statements submitted by providers, the ANAO recommends that DCITA:

- (a) advise the required format and content of the associated audit opinions;
- (b) specify that audit certificates express an opinion on whether the costs reported in the statements meet the definition of 'allowable costs' as specified in the funding agreements;
- (c) reconcile allowable costs to incentive payments in a timely manner.

DCITA's response: Agrees.

Audit Findings and Conclusions

1. Background and Context

This chapter introduces the Higher Bandwidth Incentive Scheme (HiBIS), Broadband Connect (BC) programs, and other related programs which are aimed at delivering affordable broadband services in regional Australia. It also discusses the audit objectives, scope, and approach and outlines the structure of the report.

Introduction

1.1 In 2002, the Government commissioned the Regional Telecommunications Inquiry (RTI) to independently assess the adequacy of telecommunications services in regional, rural and remote Australia. A specific term of reference was to assess barriers to accessing higher bandwidth services in regional, remote and rural areas.

1.2 The RTI found, among other things, that:

The major impediment to regional, rural and remote Australia having equitable access to higher bandwidth service is the higher prices that users in some areas pay for these services. (Finding 6.4)⁷

Consequently, the RTI recommended that:

The Government should establish an incentive scheme for the provision of higher bandwidth services to regional, rural and remote areas, to enable all Australians to have access to services at prices comparable to those prevailing in metropolitan areas. (Recommendation 6.3)⁸

1.3 In response to RTI Recommendation 6.3, the Government established the \$107.8 million Higher Bandwidth Incentive Scheme (HiBIS).⁹ The HiBIS program was to cover the four-year period from 2003–04 to 2006–07. The program provided a one-off ‘per customer’ payment to providers of higher bandwidth services in areas where a defined minimum level of service (in terms of price and functionality) was not likely to be provided commercially in the immediate future. The Department of Communications, Information Technology and the Arts (DCITA) administered the HiBIS program.

⁷ Regional Telecommunications Inquiry 2002, *Connecting Regional Australia: The Report of the Regional Telecommunications Inquiry*, p. xxiii.

⁸ *ibid.*, p. xxiv.

⁹ Funding includes a reallocation of \$35 million from the Building Additional Regional Networks (BARN) program.

Revised arrangements

1.4 In response to the greater than expected demand for HiBIS services, the Government allocated a further \$50 million to the program in June 2005. The program's timeframe was also reduced to December 2005.

1.5 In August 2005, the Government announced its new \$1.1 billion Connect Australia package.¹⁰ The largest program in this package is Broadband Connect (BC) with funding of \$878 million. BC effectively extended the HiBIS incentives for a further three and a half years to 2008–09. The first stage of BC ran from January to June 2006. The second stage of BC began in July 2006 and has been funded for 2006–07. Approximately \$258 million has been allocated to BC Stages 1 and 2.

1.6 In September 2006, the Minister for Communications, Information Technology and the Arts (the Minister) announced the \$600 million BC Infrastructure Program, which proposed a new method for delivering higher bandwidth services to regional Australia. Under these new arrangements, Government funding will be provided to a small number of large-scale infrastructure projects selected on a competitive basis. Applications closed in December 2006, with the selected projects expected to be announced in late 2006–07.

1.7 In April 2007, the Government also commenced the \$162.5 million Australian Broadband Guarantee program to provide a smooth transition from BC Stage 2 to the BC Infrastructure Program. The Australian Broadband Guarantee program operates in a similar way to the HiBIS and BC Stages 1 and 2 programs. It makes any Australian resident or small business that is unable to access broadband services at their principal residence eligible for a subsidised broadband service.

1.8 Table 1.1 summarises the funding and timeframes for the HiBIS and BC programs.

¹⁰ The Connect Australia package also included Clever Networks \$113.4 million, Mobile Connect \$29.5 million and Backing Indigenous Ability \$89.9 million. Subsequently, the Government increased the Connect Australia threshold to \$3.1 billion with the introduction of the \$2 billion Communications Fund.

Table 1.1**HiBIS and BC-related programs**

Program ^a	Original Funding ^b \$m	Current Funding ^b \$m	Start Date	Finish Date
HiBIS	107.8	154.6	8 April 2004	31 December 2005
BC Stage 1	144.8	124.8	1 January 2006	30 June 2006
BC Stage 2	100.0	133.0	1 July 2006	30 March 2007
Australian Broadband Guarantee ^c	162.5+	162.5+	1 April 2007	30 June 2008+
BC Infrastructure	600.0	600.0	1 July 2007	30 June 2009

Source: ANAO analysis of DCITA data.

a – Shaded programs were examined in this audit.

b – Excludes departmental administration costs to manage the programs.

c – From 1 July 2008, earnings from the investment of the \$2 billion Communications Fund will be available to continue the Australian Broadband Guarantee, if required to meet program objectives.

Program objectives and overview

1.9 The primary objective of HiBIS is ‘to achieve prices for higher bandwidth services in regional Australia that are comparable to metropolitan services’. In pursuit of this primary objective the scheme has two supporting objectives:

- to promote competition among higher bandwidth service providers; and
- to ensure efficient use of public funds by effectively targeting support to areas of need in regional Australia.

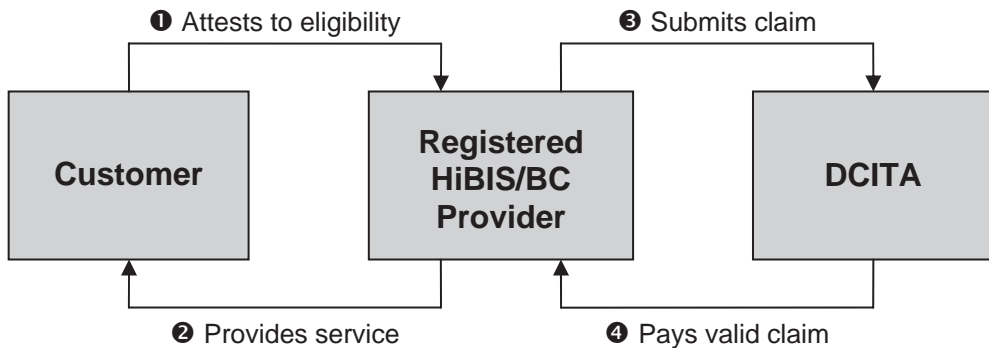
The objectives for BC Stage 1 were identical to those of HiBIS.

1.10 HiBIS/BC Stage 1 provided registered internet service providers (providers) with incentive payments for supplying higher bandwidth services in regional, rural and remote areas at prices comparable to those available in metropolitan areas. Over 1.3 million dwellings were eligible to receive HiBIS services. Eligible customers included residential customers, small businesses, small not-for-profit organisations and not-for-profit organisations that intended providing public access internet facilities. The minimum requirements for HiBIS broadband services were a peak download/upload speed of 256/64 kilo bits per second (kbps) and usage allowance of 500 mega-bytes (MB) per month.

1.11 Potential customers provide attestations of their eligibility for a HiBIS/BC service to providers. On providing the service, providers submit claims for the per-customer incentive payment to DCITA. The Department assesses the validity of each claim and pays providers for each valid claim. This process is illustrated in Figure 1.1.

Figure 1.1

Relationship between HiBIS and BC stakeholders



The numbers ❶ to ❹ describe the sequence of the interactions between the stakeholders.

Source: ANAO analysis of DCITA data.

Audit objective, scope and methodology

1.12 The audit objectives were to examine if:

- DCITA had effectively planned and administered the HiBIS and BC Stage 1 programs; and
- the programs had achieved their objectives.

1.13 The audit focused on DCITA's activities to support the planning, implementation, monitoring and reporting of HiBIS and BC Stage 1 programs.

Audit methodology

1.14 The audit methodology included:

- ANAO analyses of databases supporting DCITA's administration of the HiBIS/BC Stage 1 programs;
- examining relevant program files; and
- interviews with departmental officers.

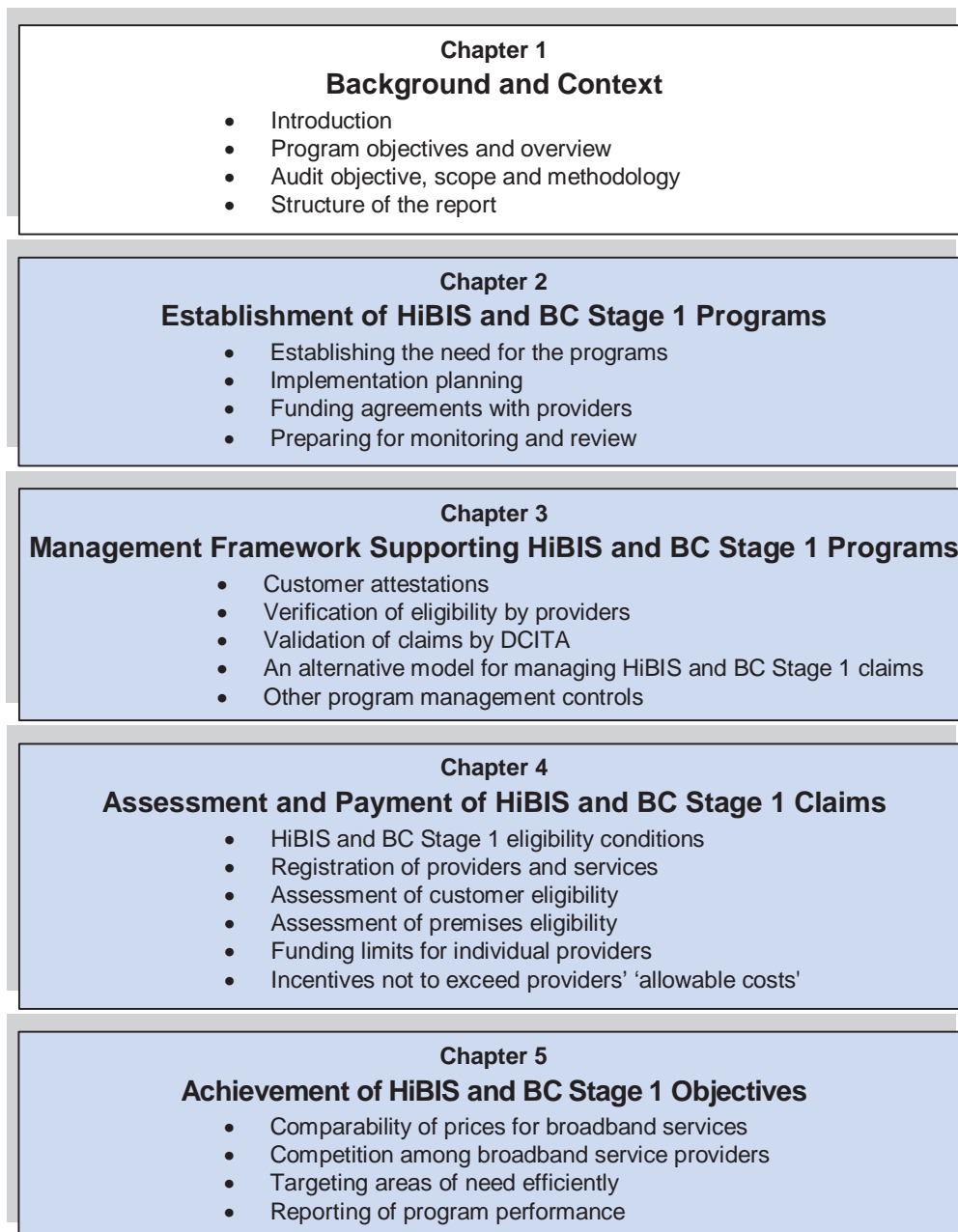
1.15 The audit was conducted in accordance with ANAO auditing standards and cost \$365 000.

Structure of the report

1.16 The structure of the report is outlined in Figure 1.2.

Figure 1.2

Report structure



2. Establishment of HiBIS and BC Stage 1 Programs

This chapter examines how effectively DCITA established the HiBIS/BC Stage 1 programs. The need for the programs, implementation planning, consideration of risks, funding agreements and monitoring and review arrangements are discussed.

Establishing the need for the programs

2.1 As previously noted, the HiBIS program was a key part of the Government's response to the RTI. The program was to provide a one-off 'per customer' payment to providers of higher bandwidth services in regional, rural and remote areas where a defined minimum level of service (in terms of price and functionality) was not likely to be provided commercially in the immediate future. Departmental officials were to further develop the specifics for HiBIS, guided by the principles of:

- technological and competitive neutrality—while also encouraging innovation and the use of the most efficient technologies;
- flexibility and responsiveness to regional requirements;
- underpinning and complementing other broadband attraction strategies, such as demand aggregation; and
- sustainability of services in the long term without government funding.

2.2 The ANAO considers that the need for the HiBIS program was well established by the RTI. A greater than expected demand for the incentive payments was driven by the take-up of HiBIS services by customers. The increased demand led to the Government agreeing to extend the HiBIS subsidies for a further two and a half years from January 2006 to June 2008. The HiBIS extension programs are Broadband Connect (BC) and the Australian Broadband Guarantee.

Implementation planning

2.3 In the context of HiBIS/BC Stage 1, implementation planning involved:

- developing a project implementation plan;
- identifying and managing program risks;
- resourcing the programs;

- communicating with stakeholders; and
- producing the program guidelines.

Project implementation plan

2.4 A project implementation plan gives those managing a program a common understanding of, and the means to coordinate and strategically manage, its risks and interdependencies. DCITA expended some effort in drafting a project implementation plan for the HiBIS program. However, the plan was never finalised or used during program implementation. DCITA also did not develop a project implementation plan for BC Stage 1 as the program was considered so similar to HiBIS as not to justify or require the development of a plan.

2.5 The ANAO viewed working drafts of the HiBIS project implementation plan dated between December 2004 and April 2005. The latest draft (dated April 2005) was considerably advanced and contained: timeframes for implementing the program; the roles and responsibilities of stakeholders; financial and staffing resources; and elements of a risk management plan.

2.6 An internal audit of the systems and controls supporting HiBIS in early 2005 considered that the lack of a project implementation plan increased the risk that HiBIS would not proceed in line with its budget and agreed timetable. DCITA agreed with the internal audit recommendation to finalise and implement a formal project implementation plan for HiBIS by June 2005. Subsequent quarterly reports from the program area to DCITA's Audit, Risk and Evaluation Committee (the Committee) noted that the expected completion of the recommendation had been progressively deferred due to the program's transition from HiBIS to BC.¹¹

2.7 In September 2006, the program area informed the Committee that the recommendation to finalise and implement a formal project implementation plan had been completed (for BC). However, this was not correct. DCITA advised the ANAO that the Committee was inadvertently misinformed, with invalid assumptions made over the completion and approval of the plan.

¹¹ DCITA's Audit, Risk and Evaluation Committee was established by the Secretary to enhance the control framework; improve the objectivity and reliability of externally published financial information; and providing adequate assurance to the Secretary that the Department is meeting its governance responsibilities and complying with statutory and other requirements.

Risk management

2.8 The ANAO found that DCITA did not develop and implement a comprehensive risk management strategy for either HiBIS or BC Stage 1. The ANAO noted separate attempts by DCITA before and after the start of HiBIS to draft risk management strategies to address the risks facing the program. However, these never proceeded beyond the draft stage and were not formally implemented by DCITA.

2.9 Although HiBIS/BC Stage 1 did not have a formal risk management plan, DCITA instituted management controls over the programs to address perceived risks. These are discussed in detail throughout Chapter 3. DCITA also advised that, significant program risks and issues were raised directly with DCITA senior management. Although such risks may have been discussed, DCITA could not provide documentation to support either face-to-face meetings, email messages or more formal communications between the program team and senior managers in relation to a number of significant issues.

2.10 The ANAO considers that with improved risk management practices, DCITA could have better managed some of the risks facing the programs. For example:

- a shortage of staff to appropriately implement HiBIS; and
- the lack of effective pre- and post-payment controls over the validity of provider claims from the start of HiBIS.

2.11 In recent years DCITA, has recognised the need to improve the formality and consistency of its approach to risk management. In April 2005, DCITA released its *Practical Guide to Program Administration* across the Department. This Guide noted the importance of developing 'a risk management strategy based on a well-documented, thorough and careful risk identification and assessment ... during the program design phase'. The ANAO considers that the absence of a risk management strategy for BC Stage 1, which began in 2006, indicates that DCITA has yet to fully implement these guidelines consistently across all program areas of the department. DCITA advised that it expects to roll-out a comprehensive training package on its Practical Guide in the second half of 2007.

2.12 The ANAO considers that the HiBIS/BC Stage 1 programs would have benefited from DCITA developing and applying a formal project implementation plan and risk management strategy. The lack of appropriate

planning contributed to DCITA having inadequate controls over the assessment and payment of provider claims for much of the HiBIS/BC Stage 1 programs.

2.13 In respect of the current BC-related programs, DCITA advised that:

- it has started to prepare a project implementation plan for the recently announced Australian Broadband Guarantee program; and
- a project implementation plan will be developed for the BC Infrastructure Program after grantees are selected and while funding deeds are being developed.

2.14 The ANAO considers that these plans should incorporate assessments of program risks, which are periodically reviewed.

Program resourcing

2.15 Resources in the context of the HiBIS/BC Stage 1 programs can be considered in two respects:

- the quantum of administered (or program) funds available to providers as incentive payments; and
- the quantum of funds available to DCITA to engage appropriately qualified staff and contractors/consultants to manage the programs.

Program funding

2.16 The expected take-up of HiBIS services by customers was one of the greatest 'unknowns' when DCITA developed its submission to the Government to establish the HiBIS program. This had a direct impact on calculating an appropriate budget for HiBIS. Factors that would influence customer take-up of HiBIS services included:

- the size of the incentives for providers, and the circumstances under which providers could access the different levels of incentives (which influenced the pace of roll-out of broadband infrastructure);
- the boundaries set for eligible customers and eligible premises;
- the pricing of HiBIS services for customers; and
- customers' desire for the benefits that broadband services could deliver.

However, at the time the Government approved the budget for HiBIS, the first three listed factors had yet to be finalised, and it is doubtful whether the last listed factor could ever be measured accurately.

2.17 The HiBIS budget approved by Government was based on assumptions concerning the number of eligible customers, the anticipated rate of take-up of HiBIS services by eligible customers and the incentive levels. As the HiBIS program guidelines were developed and the program's parameters confirmed, it became increasingly apparent that there was a real possibility that HiBIS funds would not meet the full level of demand. The actual number of eligible customers, the actual incentive levels and the actual take-up rate of HiBIS services by customers all significantly exceeded the levels assumed at the time of the Government's approval of HiBIS. Table 2.1 provides a comparison of anticipated and actual levels for the program.

Table 2.1

Program parameters influencing quantum of HiBIS funding

Parameter influencing quantum of HiBIS funding	Assumption at time of Government's approval of HiBIS	Actual HiBIS levels/results
Eligible customers	Communities of 1 500 or less (approx. 900 000 dwellings) ^a	All of Australia except: (i) all State/Territory capital cities and adjacent high population centres; and (ii) pre-existing areas (approx. 1.3 million dwellings) ^a
Incentive levels	\$750 and \$2 200	\$1 400 and \$3 000
Customer take-up of broadband services over 4 years	8% (2003) ^b	19% (as at May 2005)

Source: DCITA

a – ABS data as at March 2003.

b – Penetration of higher bandwidth services in regional areas at the time of the Government's approval of HiBIS was five per cent.

2.18 As a result, nearly 3.5 times the original budgeted number of customers are expected to take-up HiBIS/BC services. HiBIS and BC have required periodic injections of additional funding to meet providers' entitlements for incentives.¹² Although HiBIS's original budget was \$107.8 million over

¹² The HiBIS/BC Stage 1 program guidelines contained a mechanism to restrict providers' entitlements to incentive payments to the financial years' funding allocations. However, this was never invoked under HiBIS/BC Stage 1 as extra funding was made available when any shortfalls to meet demand were forecasted.

four years, DCITA will have paid four times this amount to providers as incentives under HiBIS and BC-related programs over the same period.¹³

2.19 DCITA indicated that the rate of take-up of new technologies is very difficult to predict. The ANAO acknowledges these difficulties but considers that this makes it all the more important to clearly identify assumptions underpinning program budgets and how changes to the assumptions could impact on the funding required. DCITA's submission to the Government would have been enhanced had it included sensitivity analysis that identified the 'alternative' budgets that would be required using different assumptions (for example, a range of customer take-up rates) and their impact on the required program budget. Such analysis can assist to inform decision makers of the range of possible outcomes. The ANAO suggests that DCITA consider such an approach when developing submissions for future programs, particularly where budgets rely heavily on assumptions that are difficult to predict accurately.

Administrative resources

2.20 An internal audit into the HiBIS program in mid-2005 considered that the program team had not formally analysed staffing needs to identify the number of staff required to implement each stage of HiBIS. The different skill sets required for the effective staffing of each key role had also not been fully considered. This shortcoming was attributed to the absence of an approved project implementation plan.

2.21 The internal audit considered that the number of staff implementing the HiBIS program (six) was insufficient, given the program's size and the expected number of providers and customers. The report also noted that many team members were 'generalists', which could lead to operational difficulties when particular skills were required¹⁴, adversely affecting DCITA's capacity to manage the HiBIS program.

2.22 The internal audit report recommended that, as part of the proposed project implementation plan, DCITA analyse, and make available to HiBIS, the staffing skills and resources needed for each stage of the project. DCITA agreed to implement the recommendation by June 2005. As part of developing a submission to Government to extend the HiBIS program (into what later

¹³ DCITA based the calculation of the \$878 million budget for the four-year BC program on projected increases in national broadband take up rates culminating in a market penetration rate of 55 per cent in the HiBIS/BC area by June 2009.

¹⁴ For example, data-matching, post-payment testing or contract disputes.

became BC Stage 1), DCITA calculated that it required an entire Branch, comprising 31 staff, to administer the program. The Department advised that the staffing levels for administering the incentives component of BC grew from 11 in June 2005, to 25 in December 2005 and to 30 in June 2006.

Conclusion

2.23 DCITA could have improved its approach to resourcing the HiBIS/BC Stage 1 programs. Undertaking sensitivity analysis of the programs' budgets would have better informed the Government of the funding required to implement the programs. In addition, earlier consideration of the staffing resources required, as part of a project implementation plan, would have allowed DCITA to better match resources to HiBIS's administrative requirements.

Producing program guidelines

2.24 The program guidelines for HiBIS/BC Stage 1 were the primary focus of DCITA's planning activity for the programs. The HiBIS program officially began on 8 April 2004, when its program guidelines received Ministerial approval. The program was originally intended to commence in early 2004, but was delayed due to the time taken to finalise the lengthy guidelines (75 pages plus attachments).

2.25 The development of the program guidelines was informed by extensive consultations with program stakeholders. This included presentations or discussions with relevant peak bodies, other Australian and State Government agencies, internet service providers and interested individuals. Further consultations occurred between DCITA and the providers to identify areas in regional Australia that would not be eligible for HiBIS services because they were already receiving, or were about to receive, a metro-comparable service (that is, pre-existing and imminent areas). DCITA also consulted with Telstra to gain access to maps of its exchange coverage areas and to a tool that all providers could use to determine whether premises had access to Telstra's Integrated Services Digital Network (ISDN).¹⁵

2.26 The guidelines released for HiBIS identified the requirements of the program, including:

- registration of providers and their services;

¹⁵ Premises access to Telstra ISDN was the determining factor for whether providers could claim the standard incentive payment or the high-cost incentive payment for their HiBIS/BC Stage 1 customers.

- the eligibility of customers and premises;
- how financial support received from other government programs would be taken into account;
- the submission, assessment and payment of claims;
- the terms and conditions under which providers must offer HiBIS services;
- providers to maintain minimum data speeds for their contracted customers; and
- providers to assert regularly that they have complied, and will comply, with the requirements of HiBIS.

2.27 The HiBIS program guidelines were comprehensive and did not require amendment during the program. The only area of concern related to provisions limiting the funding that any one provider could receive (discussed in Chapter 4). The guidelines required only minor amendments to form the BC Stage 1 guidelines. These amendments reflected suggested program improvements from the draft HiBIS mid-term review report and clarified the expression of a small number of provisions. The ANAO considers that the program guidelines provided a sound basis for DCITA's day-to-day operation of the HiBIS/BC Stage 1 programs.

Communicating with stakeholders

2.28 By the launch of HiBIS in April 2004, DCITA's Corporate Communications area had developed a Communications Strategy for the HiBIS program. The Communications Strategy identified:

- the target audiences (that is, providers and customers in regional Australia);
- other stakeholders (including governments, peak consumer and industry bodies) who could be used to channel support for HiBIS and promote its benefits to their constituents;
- the key messages for the target audiences and sensitivities that may require management;
- the mix and timing of communication to be brought to bear (including branding the program as an Australian Government initiative, information materials, direct mail-outs to providers, 1 800 number, website/email, media releases, and conferences/seminars); and

- the communications budget over the life of the program.

2.29 The HiBIS Communications Strategy addressed the communication needs for the program. Although DCITA implemented aspects of the Communications Strategy, it is unclear the extent to which the Strategy guided DCITA's communication of the HiBIS message to stakeholders as the program progressed. Nevertheless, the 2005 Review of HiBIS cited the high rate of customer take-up of HiBIS services as evidence of the effectiveness of DCITA's promotional efforts.

Funding agreements with providers

2.30 The funding agreements between DCITA and each provider accurately represented the HiBIS/BC Stage 1 terms and conditions published in the program guidelines. However, funding agreements have been varied to require all providers to make declarations that their claims are legitimate, accurate and are supported by sufficient evidence. This variation resulted from a decision by the Australian Federal Police (AFP) and Commonwealth Director of Public Prosecution (CDPP) not to pursue a HiBIS provider for alleged program fraud. In this case, it was alleged that a provider may have fraudulently claimed over 1 700 HiBIS incentive payments valued in excess of \$4 million. The AFP and CDPP found that claim forms submitted by the provider were of little evidentiary value to possible legal proceedings as they were unsigned and contained no declaration that the contents were true and correct as per the funding agreement. The provider in question went into liquidation and DCITA's lawyers have advised that it unlikely to recover any overpayments of HiBIS funds.

2.31 DCITA also varied providers' funding agreements to better reflect the policy on limiting the funding that any one provider can receive. The change was prompted by problems with the effectiveness of the original provision (as noted in Chapter 4).

Preparing for monitoring and review

2.32 DCITA incorporated into the programs' administrative processes a number of mechanisms to monitor the performance of HiBIS/BC Stage 1. Chapter 3 contains a discussion of the key monitoring mechanisms and their influence within the programs' governance arrangements.

Management information system

2.33 DCITA has in place an appropriate management framework for administering the HiBIS/BC Stage 1 programs. It has established a geospatial database management system (HiBIS Online Management System/BC Online Management System—HOMS/BCOMS) to record and manage key information under the HiBIS/BC Stage 1 programs that includes::

- summarised information on providers and their services;
- digitally stored maps of the HiBIS/BC area and the service areas for all providers;
- details of all customers for which providers have claimed incentives¹⁶; and
- the payment status and amount of all claims to providers and their wholesalers, where applicable.

2.34 DCITA also maintains files for each provider containing their registration details and assessment, along with information documenting contact between the department and the providers.

Reconciling HOMS/BCOMS to DCITA's finance system

2.35 Payments to providers are made through DCITA's finance system based on data from HOMS/BCOMS. Each month provider claims assessed by DCITA as valid are batched from HOMS/BCOMS to generate recipient created tax invoices. The tax invoices are cleared by the providers before payments are raised in DCITA's finance system and paid via electronic funds transfer. In most cases, summaries of HOMS/BCOMS data mirrored the payments made to providers from DCITA's finance system. However, sometimes data from HOMS/BCOMS required manual adjustment before payments were made.

2.36 Regular reconciliations of payments recorded in HOMS/BCOMS to payments actually made according to DCITA's finance system are an important administrative control. The ANAO found that under BC Stage 1, reconciliations have been performed monthly. Under HiBIS, DCITA advised the ANAO that reconciliations of HOMS to DCITA's finance system for both 2004–05 and 2005–06 were conducted and documented, with satisfactory results. However, documentation was not available to support these reconciliations.

¹⁶ Customers can be linked geospatially via an address field to the digitally stored maps.

Establishing performance measures

2.37 In October 2003, six months before the start of the HiBIS program, DCITA drafted a Risk Management and Evaluation Strategy. This draft Strategy identified:

- an extensive range of potential performance indicators for determining the achievement of HiBIS objectives, linked to strategies for their measurement; and
- administrative issues that should be evaluated, including HiBIS market strategies, cost-effectiveness of administration processes, DCITA's resourcing of HiBIS, and the identification and management of program risks.

However, DCITA advised that the draft Strategy was never finalised or implemented.

2.38 It was not until March 2005, in preparation for the HiBIS mid-term review¹⁷, that DCITA again considered performance measures for the program. DCITA's Communications Research Unit (CRU) produced a discussion paper that identified and discussed potential performance indicators, and the data required, in respect of each HiBIS objective. Although the measures were developed nearly 12 months after the start of the program, this did not inhibit DCITA's ability to obtain the necessary performance data. The potential performance indicators identified by CRU were a sub-set of those identified earlier in the draft Strategy.

2.39 Another important consideration for program performance measurement is the specification of performance baselines at the start of programs. This is necessary to isolate, as much as possible, the performance of the programs from pre-existing results. In many respects, the HiBIS program focused on areas that were without metro-comparable services at metro-comparable prices—that is, a 'zero starting base'. Before the start of HiBIS, DCITA engaged a consultant to construct an inventory of the broadband market in regional, rural and remote Australia. However, the resulting report was of little use to DCITA. Other research data (including from the Australian Bureau of Statistics) helped provide a performance baseline to measure the effectiveness of the HiBIS/BC Stage 1 programs.

¹⁷ DCITA undertook a mid-term review of HiBIS in 2005, but never produced a final report. It was overtaken by the development of a submission to Government to extend the HiBIS program (into what later became BC).

2.40 The ANAO considers that the HiBIS/BC Stage 1 programs had appropriate performance indicators and baselines to measure the programs' performance against their objectives. This finding is consistent with the results of the 2005 HiBIS mid-term review.

3. Management Framework Supporting HiBIS and BC Stage 1 Programs

This Chapter examines the processes and controls in place at the customer, provider and departmental level to validate HiBIS/BC Stage 1 claims and manage other aspects of the programs.

Introduction

3.1 HiBIS and BC Stage 1 are entitlement programs, where recipients (that is, providers) are entitled to receive a payment for every eligible customer that is provided with a suitable broadband service. DCITA assesses each claim it receives against the programs' eligibility criteria. If these criteria are met, payment is made to the provider. No payment is made for claims assessed as invalid. Figure 1.1 in Chapter 1 illustrates the relationship between customers, providers and DCITA.

3.2 Customers, providers and DCITA each have responsibilities for assessing the validity of HiBIS/BC Stage 1 claims. The ANAO examined the processes and controls DCITA has in place for the assessment and payment of claims at each of these levels.

Customer attestations

3.3 Customers are required to provide attestations of their eligibility to providers under the HiBIS and BC Stage 1 programs. Providers ask a few simple questions based on the eligibility requirements of the programs. The larger providers often used online questionnaires or customer voice recordings, while the customers of smaller providers usually completed attestation forms. Customers are also required to make a declaration that they and their premises are eligible under the program. DCITA vetted the format of the customer attestations prepared by each provider.

3.4 The ANAO found that the attestations did not cover some aspects of eligibility affecting a significant number of HiBIS/BC customers. For example, those small business customers with franchise operations were not required to attest to whether the structure and ownership of the franchise met eligibility requirements.¹⁸ Also, customers were not asked if they had received

¹⁸ There are approximately 13 000 small business customers and many of these are franchise operations. To be eligible, franchises must be separate legal entities from the franchisors and the franchisors must not be in partnership with or own all or part of the franchises.

a Telstra Extended Zone Satellite Service (TEZSS), which would rule them ineligible.¹⁹

3.5 During the audit, DCITA modified the standard customer attestation form and the BC guidelines to strengthen and standardise the attestation process. DCITA considers that it and providers now have greater assurance concerning the eligibility of customers. Further amendments to customer attestations are also being considered to make relevant customers aware of the eligibility requirements specific to franchises.

3.6 At the start of HiBIS, DCITA had anticipated that TEZSS customers would be upgraded to metro-comparable services, independent of the HiBIS program, within a reasonably short period of time. This did not occur. DCITA will allow TEZSS customers access to subsidised broadband services under the Australian Broadband Guarantee program introduced from April 2007.

3.7 Although customer attestations are an essential part of the programs' governance arrangements, in isolation, they are not a particularly strong control. Customers may inadvertently, carelessly or deliberately complete the attestation in a manner that makes it appear that they are eligible. The only real sanction for the customer in such circumstances is the loss of a broadband service that they would not have otherwise received.²⁰

Verification of eligibility by providers

3.8 Providers rely heavily on customer attestations as the basis for submitting their claims. DCITA is not aware of the processes providers employ, if any, to verify claims before they are submitted. It was not until September 2005, one year after the first HiBIS claims were paid, that DCITA required providers to make declarations confirming they possessed 'sufficient evidence' to substantiate claims as a pre-requisite for payment. In addition to customer attestations, DCITA indicated that 'sufficient evidence' covered customer contracts, and logging and billing information.²¹ However, this evidence does not address the veracity of claims made by customers in their attestations.

¹⁹ TEZSS is a separate program managed by DCITA that has 11 000 customers across Australia.

²⁰ Customer attestations require customers to acknowledge that they understand that deliberately making a false or misleading statement is a criminal offence. However, DCITA has not contemplated using this sanction.

²¹ Providers must retain these records for no less than seven years after the end of HiBIS or BC.

3.9 The only independent verification noticeably undertaken by providers was the check of whether they were eligible for a standard incentive or a high-cost incentive payment for each customer.²² However, audits of providers conducted by DCITA from February 2006 found that some providers were not consistently performing this check correctly or on a regular basis. The ANAO also identified approximately 800 premises where providers had claimed and been paid more than once for providing HiBIS/BC Services. (Invalid and inaccurate claims are discussed in more detail in Chapter 4.²³)

3.10 Unless invalid claiming by providers is widespread or systemic, the only real sanction for providers who submit invalid claims is the loss of incentive payments that they would not have otherwise received. DCITA advised that it has investigated a small number of providers who were suspected of widespread or systemic claiming irregularities. The providers were required to repay incentives received for invalid or inaccurate claims.

3.11 DCITA acknowledges that, until recently, it has not been sufficiently aware of the steps taken by providers to validate customer attestations before submitting claims. In December 2006, DCITA asked providers to inform it of the processes they used to assess the validity of customer attestations before claims are submitted. DCITA is currently pursuing providers who have not taken appropriate steps to validate the eligibility of customers.

Validation of claims by DCITA

3.12 In late-2003, DCITA sought advice from its internal auditor concerning the desired features of a control framework for the HiBIS program. The internal auditor proposed, amongst other things:

- using computer-assisted audit techniques (such as those used by the ANAO during this audit) to regularly analyse HiBIS data collected in HOMS; and
- annual site visits to the top 20 per cent of providers who were receiving 80 per cent of HiBIS funding. Additional providers could also be visited on a random basis.

²² Customers' access to Telstra's Integrated Services Digital Network (ISDN) determines whether providers are entitled to a standard or high-cost incentive payment. Telstra has an ISDN Service Qualification Tool that providers are to use when signing up new customers.

²³ Inaccurate claims are claims that have been paid at the incorrect incentive rate.

3.13 DCITA advised that these initiatives were not incorporated from the start of HiBIS in April 2004 due, primarily, to a lack of resources. Implementing HiBIS by April 2004 took all available resources in early-2004. In mid-2004, much of DCITA's resources were spent on registering providers and services under HiBIS. From late-2004 onwards, DCITA's resources were assigned to processing the unexpectedly large number of claims from providers.²⁴ Consequently, the department had insufficient resources to adequately monitor the integrity of provider claims. However, resourcing for the program was not raised with DCITA's senior management until the development of a submission in mid-2005 to extend the HiBIS program.

3.14 DCITA's internal audit conducted an audit of the HiBIS program in mid-2005. The audit recommended that DCITA incorporate into the scheme many of the same initiatives proposed over 18 months earlier. DCITA originally agreed to implement the recommendations by September 2005, subject to the availability of resources. However, they were not implemented until the third quarter of 2006 due to the transition from HiBIS to BC Stages 1 and 2.

Manual checking

3.15 Prior to February 2006, the primary means DCITA had to verify independently the validity of provider claims, either before or after payment, was a manual check of claims before payment. DCITA indicated that this involved the two or three claims processing staff reviewing each claim to ensure that:

- they contained no duplicate customers (by checking their names, premises' addresses and telephone numbers); and
- the date cited for connection of services had passed for each customer.

3.16 The ANAO questioned the effectiveness of the manual checking process as a claims validity control measure given that the small number of staff who examined an average of over 7 000 claims each month. Table 3.1 outlines that claims lodged between April 2004 and June 2006.

²⁴ Claims lodged between April 2004 and June 2006 are outlined in Table 3.1.

Table 3.1**Claims lodged each month by providers between April 2004 and June 2006**

Claim month	No. of claims	Claim month	No. of claims	Claim month	No. of claims
Aug 2004	40	Apr 2005	4 555	Dec 2005	2 918
Sep 2004	195	May 2005	10 473	Jan 2006	3 159
Oct 2004	635	Jun 2005	10 737	Feb 2006	3 117
Nov 2004	972	Jul 2005	9 423	Mar 2006	10 352
Dec 2004	1 651	Aug 2005	8 296	Apr 2006	14 298
Jan 2005	1 771	Sep 2005	8 584	May 2006	24 416
Feb 2005	1 341	Oct 2005	9 119	June 2006	25 375
Mar 2005	3 098	Nov 2005	14 129	<i>TOTAL</i>	<i>168 654</i>

Source: ANAO analysis of HOMS/BCOMS.

3.17 DCITA acknowledged that the manual processing of claims increased the risk of invalid claims not being detected. Over the life of HiBIS, providers withdrew, or DCITA rejected, 2.4 per cent of all provider claims. However, after DCITA automated its claims checking processes for BC Stage 1, the percentage of claims providers withdrew or DCITA rejected increased to 6.9 per cent, indicating some shortcomings with the manual claims checking process used for HiBIS.

3.18 DCITA considered it responded appropriately to minimise the risk of providers submitting invalid claims and to maximise retrieval of these funds by establishing an audit and compliance framework (see below) and changing funding agreements that increased the Australian Government's rights to recover funding.

Improvements introduced by DCITA in 2006

3.19 From the start of HiBIS in April 2004, DCITA has found it difficult to obtain the precise location of some customers receiving HiBIS services. This information can be important to ensure that customers are not located in ineligible areas (for example, the Metropolitan Exclusion Area²⁵) and to screen for potential duplicate claims. From the start of BC Stage 1 in January 2006, DCITA explicitly required providers to identify the specific location of their

²⁵ The Metropolitan Exclusion Area includes all State/Territory capital cities and the adjacent high population centres of Wollongong (NSW), the Central Coast of NSW, Newcastle (NSW), Geelong (Vic), Gold Coast/Tweed Heads (Qld/NSW), and Palmerston (NT).

customers, by using a unique address or other geospatial method (such as latitude/longitude).

3.20 DCITA progressively introduced automation into its claims checking processes under BC Stage 1. DCITA indicated that an automated system could not be purchased 'off the shelf' and BC Stage 1 could not be delayed until one was in place and operating effectively. In January 2006, interim system improvements allowed for user-initiated searches to identify possible duplicates. By late-February 2006, the replacement system for HOMS (BCOMS) contained automated phonetic data matching as well as simple exact text matches. Full automation and functionality of the online management system was achieved for BC Stage 2 in September 2006, after the conclusion of HiBIS and BC Stage 1. BCOMS can now:

- automatically reject claims without specific customer locations;
- assess the BC services areas in which claims were lodged (as the BC service areas of terrestrial providers are valid for 12 months only)²⁶;
- assess the timeliness of claim lodgement (as claims lodged more than 45 days after the connection and supply of a BC Stage 1 service to a customer are invalid)²⁷;
- assess the number of full-time employees reported by providers (as small business customer claims are invalid where full-time employees are greater than 20); and
- monitor cumulative incentive payments against the funding cap for any one provider.

3.21 The ANAO considers that the system improvements are valuable additions to the program's control framework. Had they been in place from the start of HiBIS, DCITA would have more accurately determined the validity of providers' claims. All HiBIS/BC Stage 1 claims totalling over \$272 million had been processed before full automation was introduced.

Auditing of provider claims

3.22 Before introducing its provider audit program in February 2006, DCITA undertook post-payment auditing of claims only when it identified a

²⁶ From 1 January 2006, terrestrial providers' entitlement to incentive payments for each of their service areas is limited to 12 months from the date of their first claim in the area.

²⁷ Under HiBIS, providers were required to submit claims 'as soon as possible' after connecting customers.

pattern of irregularities in providers' claims or a pattern of customer complaints.²⁸ DCITA advised that this occurred on two or three occasions. These audits involved:

- direct contact with a randomly-selected sample of the provider's claimed customers;
- an examination of the provider's records at their premises; and
- a broader assessment of the existence of duplicate claims across several months of submitted claims from the provider.

DCITA further advised that, in 2006, it completed seven non-scheduled audits in response to specific concerns of provider non-compliance with the requirements of the programs. For example, suspected incorrect claiming at the high-cost incentive rate.

Scheduled audits

3.23 In February 2006, some 18 months after providers submitted the first HiBIS claims, DCITA began a regular program of auditing provider claims. DCITA uses a risk-based approach to select providers for audit. This includes selecting a sample of BC Stage 1 customers and verifying:

- the existence of a contract, attestation and a stream of payments for each HiBIS/BC customer;
- the provider claimed the correct incentive level;
- claims were lodged within the recommended 30 days;
- customers were separately notified of the BC Stage 1's terms and conditions; and
- the accuracy of the providers' allowable costs.

3.24 The ANAO examined the results of DCITA's first round of audits. This involved 16 providers, including the top eight recipients of HiBIS/BC Stage 1 funding. The audits identified a number of ad hoc and systemic issues, including:

- providers claiming the incorrect incentive level; and
- shortcomings in the documentation of:

²⁸ DCITA and/or the Telecommunications Industry Ombudsman investigated all formal customer complaints under the HiBIS/BC Stage 1 programs.

- customer attestations;
- customer contracts;
- ISDN checking; and
- notifying customers of the HiBIS/BC programs' terms and conditions.

DCITA indicated that it will follow-up identified shortcomings during future audits of the providers concerned.

3.25 The ANAO considers that the provider audit program provides DCITA with some assurance regarding the incentive payments that providers received for valid claims. However, in respect of the first round of audits, the ANAO noted that:

- the audits did not independently examine the veracity of the information contained in customer attestations;
- the breadth and depth of audit coverage was time dependent, and this meant that the amount of testing was greater for those providers with good accounts and records; and
- the severity of audit findings was sometimes inconsistent with the audit conclusion within an audit and between audits.

3.26 The ANAO considers that the audit program could be improved by:

- setting benchmarks for acceptable levels of error (that is, the number of errors allowed by a provider before it is declared a problem area);
- introducing statistical rigour into the audit process so that sample results can be extrapolated to the population of provider claims; and
- expanding the scope of audits to include examining the documentation held by providers to support customer attestations.

3.27 DCITA has indicated that it will consider implementing these suggested improvements in the audit program.

Repayment of HiBIS/BC funds

3.28 The funding agreements between DCITA and the providers indicate that incentives incorrectly paid to providers, regardless of the party at fault, are subject to repayment to DCITA. However, this control is only useful where the liquidity of providers is not in question. Most providers under HiBIS are

'lean' organisations, with little working capital. For example, in the case of one provider who wrongly claimed and received over \$4.0 million of HiBIS funding, DCITA sought recovery of these funds. However, the provider went into liquidation and DCITA has been advised that it is unlikely to recover any of these funds.²⁹ In addition, the provider's customers are entitled to another HiBIS service from other providers. DCITA indicated that less than 20 per cent of the provider's former customers have received new HiBIS/BC services from other providers. The cost of providing these replacement services was almost \$500 000.

An alternative model for managing HiBIS and BC Stage 1 claims

3.29 A small number of major providers submitted over 80 per cent of all HiBIS/BC Stage 1 claims. Under current arrangements, DCITA is responsible for validating every claim. This transactional approach is resource intensive, particularly as the number of claims submitted by providers has increased over time. As well as automating its claims checking process, DCITA also requires providers to submit copies of customer attestation forms with their payment claims under the Australian Broadband Guarantee program.

3.30 An alternative approach to managing claims could be to give major providers greater responsibility for establishing systems and processes to vet their own claims before lodgement. When assured that these systems are adequate, DCITA could then verify the integrity of the providers' vetting processes. Adopting a 'systems-based approach' for the ongoing BC-related programs would reduce the:

- number of claims DCITA needs to examine to verify that the providers' vetting processes were working as intended; and
- administrative effort needed by DCITA to process claims.

3.31 DCITA indicated that adopting a systems-based approach would complement its current method of validating claims, but would not be practicable for smaller providers under the programs. DCITA also advised that it would consider reducing its examination of all claims where providers established a track record of reliable systems and processes to vet their claims before lodgement.

²⁹ Chapter 2 contains a further discussion of this matter.

Other program management controls

3.32 In addition to the controls in place for claims processing, DCITA:

- regularly tested the data speeds of the HiBIS/BC providers;
- required providers to lodge regular compliance reports; and
- undertook a mid-term review of HiBIS.

Regular data speed testing

3.33 A critical component of the broadband services provided to customers under the programs is for providers to meet and maintain minimum data speeds when providing those services. The ANAO considers that this is a valuable initiative to ensure that providers continue to deliver quality services to customers. The ANAO found that DCITA has:

- developed and implemented an appropriate performance benchmark and testing methodology for broadband services that have been accepted by all providers³⁰; and
- contracted the development of a data speed testing facility, hosting of the facility, and testing and advisory services.

3.34 Regular testing of the data speeds of providers' services began in February 2005. The contractor conducting the tests awards providers a PASS or FAIL result for each test. The frequency of testing, the standard reporting format and the procedure followed on identification of a FAIL result or the contractor's inability to conduct a test, have been determined through experience over time. These are now documented in operating guidelines. HiBIS/BC providers are usually tested at least once each month.

3.35 The contractor's test results indicate that, overall, HiBIS/BC providers meet the minimum data speed requirements of the programs. Some providers took a little time to put in place the facilities needed by the contractor to conduct the tests. However, these are now in place. The guidelines were also amended under BC Stage 1 to require new providers to establish their test facilities before receiving incentive payments. Where providers failed the tests, these were followed up by more tests and direct contact with the providers to resolve issues. On average, three to five providers have failed their data speed tests each month. However, the ANAO did not identify any systemic or

³⁰ DCITA's performance benchmark is for average data download and upload speeds to be at least 60 per cent of peak speeds that are available at least 75 per cent of the time.

extended patterns of failed data speed testing results for providers over the life of the HiBIS/BC Stage 1 programs.

Regular compliance reporting by providers

3.36 The funding agreements between DCITA and the providers require providers to submit regular quarterly and annual compliance reports that address prescribed financial and technical performance matters. From the start of HiBIS, providers have been required to report to DCITA each quarter on:

- the availability and speed of their networks (including reasons for any network failures and insufficient data speeds); and
- complaints from customers and the extent to which they had been resolved.

3.37 Under BC Stage 1, providers' quarterly reporting was expanded to include (non-binding) estimates of allowable costs for the following six months.³¹ The ANAO found that DCITA has increasingly adopted a systematic approach to assessing quarterly reports and this has become more comprehensive over time. DCITA follows up with the providers any anomalies or reports of unsatisfactory performance.

3.38 At the end of each financial year, providers must submit to DCITA an annual compliance report containing information to:

- reaffirm their HiBIS/BC Stage 1 registration; and
- confirm that they are meeting their obligations to DCITA and customers under the programs (including data speeds, pricing, complaints handling and allowable costs).

3.39 At the time of audit fieldwork, DCITA had not assessed the providers' annual compliance reports for 2004–05 but planned to examine these with the 2005–06 compliance reports. DCITA also delayed assessing the 2005–06 reports until a significant proportion were received. As at February 2007, DCITA advised that 85 per cent of reports (for 2004–05 and 2005–06) had been received and their assessment was well advanced. Annual compliance reporting is one of the key mechanisms DCITA has to determine providers' compliance, and their willingness to comply, with their obligations under HiBIS/BC Stage 1. The ANAO considers that DCITA should promptly and comprehensively assess

³¹ Allowable costs are specific types of costs incurred by providers in providing HiBIS/BC Stage 1 services that can be offset against the incentives providers receive. Over the life of HiBIS/BC Stage 1, the incentive payments providers receive must not exceed their allowable costs. Chapter 4 discusses allowable costs in more detail.

annual compliance reports when they are received. The early identification of provider issues or problems are more likely to lead to an early resolution. It also reduces the risk to the program's funding should DCITA require providers to repay any overpayments.

Mid-term review of HiBIS

3.40 In mid-2005, DCITA began a mid-term review of the HiBIS program (the '2005 Review'). It examined the extent to which HiBIS was achieving its objectives and whether any adjustments should be made to pricing, performance requirements or administrative processes to improve the program's effectiveness. The 2005 Review never proceeded to a final report as it was overtaken by the development of a submission to Government to extend the program (into what later became BC). Nevertheless, an advanced draft report identified a number of recommendations and suggestions that were taken into account in designing and implementing BC Stage 1.

3.41 Recommendations and suggestions put forward in the 2005 Review concerning HiBIS's performance requirements and administrative processes are discussed below. Observations on the achievement of HiBIS objectives and pricing are discussed in Chapter 5.

3.42 The 2005 Review recommended that greater clarity and guidance be provided in respect of provider registration forms, the HiBIS data speed measuring facility, and services' acceptable use policies to assist providers and customers. It also recommended several refinements to existing compliance monitoring processes. These included DCITA:

- regularly auditing providers' compliance with HiBIS requirements for promotional activities;
- sampling customers to check the validity of provider claims;
- continuing data matching to identify potential duplicate and fraudulent payments; and
- reassessing HiBIS's formal penalty criteria and processes to deal with any instances of provider non-compliance.

3.43 DCITA indicated that the recommendations were implemented through changes to the guidelines and providers' funding agreements from 1 January 2006 under BC Stage 1. As previously noted, DCITA also progressively introduced automation into its claims checking processes under BC Stage 1.

4. Assessment and Payment of HiBIS and BC Stage 1 Claims

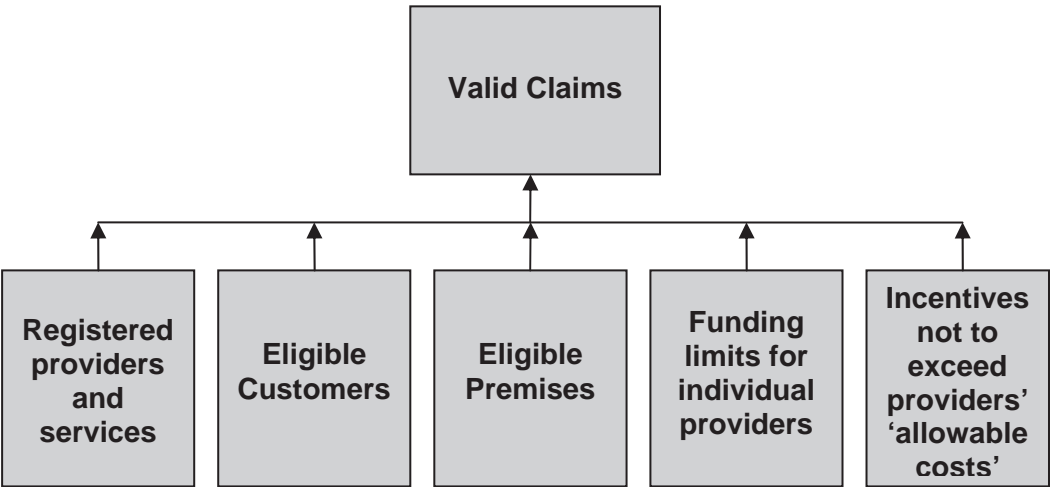
This Chapter examines DCITA’s assessment and payment of provider claims against the HiBIS/BC Stage 1 eligibility conditions.

HiBIS and BC Stage 1 eligibility conditions

4.1 Five primary conditions must be met before a HiBIS/BC Stage 1 claim can be assessed as valid. These conditions are outlined in the program guidelines and are illustrated in Figure 4.1. They also form part of the funding agreements between DCITA and the providers.

Figure 4.1

Requirements for valid HiBIS/BC claims



Source: ANAO analysis of DCITA data.

4.2 DCITA paid claims totalling over \$272 million to 51 providers for approximately 160 000 HiBIS and BC Stage 1 customers connected between the start of HiBIS on 8 April 2004 and the end of BC Stage 1 on 30 June 2006.

4.3 The ANAO examined DCITA’s assessment of what were valid claims from providers by:

- analysing over 175 000 HiBIS and BC Stage 1 claim records stored in DCITA’s HOMS/BCOMS management system; and

- examining the files of the three largest providers of HiBIS/BC Stage 1 services³², who received 75 per cent of the funding.

Registration of providers and services

4.4 To become a 'registered provider' and receive HiBIS/BC incentive payments, a provider has to apply, be assessed by DCITA and register at least one Threshold Service (that is, a service that meets the minimum requirements for a broadband service under HiBIS/BC Stage 1). Providers may also register one or more Added Value Service (that is, a broadband service that exceeds the minimum requirements for peak download/upload data speeds and/or monthly usage allowance). Providers are entitled to an incentive payment for each Threshold and Added Value Service they supply to eligible customers at eligible premises.

4.5 The guidelines outline the information to be supplied by providers as part of the assessment process. DCITA assessed providers on their corporate standing; technical and financial capabilities; and the sustainability of their businesses. Since late-2005, provider assessments have also involved background checks of financial viability, criminality and regulatory compliance.

4.6 DCITA's assessment of HiBIS/BC Threshold Services involves: reviewing their pricing; data speeds; service functionality and features; service areas; commencement supply dates; other nominated features; marketing arrangements; and estimates of allowable costs for providing the proposed services. Applications for HiBIS/BC Added Value Services are subject to similar scrutiny, but there is more flexibility in the maximum price providers can charge for these services.

4.7 Those providers that are approved for registration with HiBIS/BC are required to enter into funding agreements with DCITA. The agreements bind the providers to offer and supply their HiBIS/BC services on the terms and conditions that they proposed at the time of registration for a period of three years from the date that they begin servicing each customer. DCITA enters into new funding agreements with providers each financial year.

³² These files contain documentation on their application, assessment for registration, compliance reporting and payment history.

4.8 The ANAO examined DCITA's adherence to the HiBIS/BC Stage 1 requirements for provider and service registration. In summary, the ANAO found that:

- DCITA satisfactorily assessed providers and their Threshold Services according to the program guidelines and providers entered into funding agreements with DCITA before participating in the HiBIS/BC Stage 1 programs;
- DCITA has established an effective formal data speed testing program involving all HiBIS/BC providers and has effective processes for addressing data speed complaints from customers in a timely manner;
- DCITA contravened the program guidelines by varying the funding agreements of three providers so that they could use the services of an unregistered wholesaler and receive the full incentive payment (instead of only a share). DCITA advised that it took this action to maintain the policy objective on the sharing of incentive payments. The program guidelines for BC Stage 2 were revised to allow for this to occur; and
- information on the (non-binding) post-HiBIS/BC pricing policies of the providers examined by the ANAO was not publicly available.³³

Added Value Services

4.9 The pricing of Added Value Services (that is, all HiBIS/BC Stage 1 services that are not Threshold Services) is more flexible than for Threshold Services. Providers are required to demonstrate that incentive payments are taken into account in the prices they nominate for their Added Value Services. However, it was not obvious that DCITA always took this into account when registering new Added Value Services.

4.10 The ANAO found that the providers' pricing of Added Value Services frequently varied considerably from provider to provider. When comparing providers' services having the same peak download/upload data speeds and monthly usage allowances, differences between the lowest and highest prices charged over 36 months were often in the thousands of dollars and was sometimes over \$5 000. Table 4.1 illustrates the average price variations per platform.

³³ The guidelines required this information to be published so customers could consider post-HiBIS/BC pricing policies when selecting a HiBIS/BC provider.

Table 4.1**Price variations between providers for Added Value Services**

Technology Platform	No. of common services (same data speeds and usage allowances)	Average difference between lowest and highest pricing per common service (over 36 months)
Asymmetrical Digital Subscriber Line (ADSL)	31	\$3 401
Cable	16	\$150
One-way satellite	14	\$1 535
Two-way satellite	29	\$5 255
Wireless	77	\$2 721

Source: ANAO analysis of DCITA data.

4.11 Delegates approving the registration of new Added Value Services were not provided with comparable information on the pricing of Added Value Services already registered by other providers. Furthermore, DCITA has never queried or sought to vary the prices nominated by providers when registering new Added Value Services. The ANAO acknowledges that healthy competition has the potential to reduce price inefficiencies in the market. However, there are numerous sub-markets where there is only one HiBIS/BC provider, demonstrating the value of a more consistent approach to assessing the pricing of Added Value Services.

ADSL services

4.12 During the audit, the ANAO identified 12 391 HiBIS/BC customers whose premises were located outside the generally accepted coverage area of their Asymmetric Digital Subscriber Line (ADSL) broadband services.³⁴ This called into question the legitimacy of the providers' claims for these customers. To address the ANAO's concern, DCITA (in consultation with the ANAO) surveyed a randomly selected sample of these customers to determine whether or not they were receiving a HiBIS/BC Service. Responses received indicated that all surveyed customers were in receipt of a HiBIS/BC service or that the providers were able to connect customers to a HiBIS/BC service. Telstra also

³⁴ The generally accepted coverage area for ADSL services is within four kilometres of an ADSL-enabled telephone exchange. However, Telstra advised that the gauge of cable in place also affects the distance within which customers can receive ADSL services. Actual availability is only determined by looking at an individual customer's situation.

advised DCITA that it can now provide ADSL services to customers located up to ten kilometres from an ADSL-enabled exchange, with acceptable attenuation, in some circumstances.

Conclusion

4.13 The ANAO considers that the framework for registering providers and their services gave DCITA assurance that registered providers could meet the terms and conditions of the HiBIS/BC programs. Furthermore, the ANAO considers that DCITA registered providers and services according to the requirements of the HiBIS/BC Stage 1 guidelines, except for the maximum prices providers could charge customers for their Added Value Services. Greater attention to the pricing of Added Value Services during DCITA's assessment of these services would have led to more consistent prices across sub-markets for HiBIS/BC services. This could only improve the outcomes for HiBIS/BC customers and for the programs.

Assessment of customer eligibility

4.14 The Guidelines identify three primary categories of eligible customers:

- residential customers;
- small business customers; and
- not-for-profit organisations.

4.15 Residential customers account for 91.6 per cent of HiBIS/BC Stage 1 customers and funding, and small business customers account for a further 8.3 per cent. Not-for-profit organisations accounted for less than 0.2 per cent of HiBIS/BC Stage 1 customers and funding, and these were not examined by the ANAO.

4.16 The ANAO examined whether DCITA properly applied the HiBIS/BC Stage 1 eligibility requirements for customers. In summary, the ANAO found that DCITA effectively relied on customer attestations and providers' verification processes (of which DCITA was not fully aware) to assess customer eligibility under HiBIS/BC Stage 1. DCITA had no independent means of verifying whether all requirements of customer eligibility were met, particularly:

- those impacting the 13 000 small business customers (including the limit on the number of employees small businesses are allowed to have

to remain eligible and the legal structure of franchises required by HiBIS/BC Stage 1); and

- for those 2019 residential customers (identified by the ANAO's analysis) who either received a HiBIS/BC service at a location different to their current address or received a service at multiple addresses.

4.17 The ANAO also identified 226 small business customers of questionable eligibility, including schools/colleges, city/shire councils, churches and businesses with nationwide representation. DCITA has since determined that 53 of these customers (valued at \$74 200), mainly relating to local councils, are invalid. DCITA intends to take recovery action, where appropriate, against the providers concerned.

Conclusion

4.18 The broad eligibility requirements for residential customers mean that it is likely that the vast majority claimed by providers are eligible under HiBIS/BC Stage 1. However, DCITA's inability to independently verify the exclusions to eligibility for small business customers means it cannot be as certain of the proportion of these customers who are eligible.

4.19 The ANAO considers that DCITA has placed heavy reliance on customer attestations as the means for assessing customer eligibility under the HiBIS/BC Stage 1 programs. This has the greatest impact on small business customers. The assessment of those customers' eligibility would be enhanced were providers required to seek and retain relevant documentation from them that demonstrates they are meeting the particular eligibility requirements. DCITA could review the adequacy of this documentation during its scheduled audits of providers.

Assessment of premises eligibility

4.20 The guidelines state that premises are eligible to receive a HiBIS/BC service and providers can claim incentive payments for these premises so long as the following conditions are met:

- the premises are not located in the Metropolitan Exclusion Area (MEA);
- the premises are not located in a pre-existing coverage area or an imminent coverage area (subject to certain exceptions);
- the premises have not already received a HiBIS/BC service (subject to certain exceptions);

- the premises have not already received a metro-comparable service or a service with HiBIS/BC-compliant pricing provided by a non-registered provider; and
- the premises have not already received a service under the TEZSS program.

4.21 In addition, providers who are able to offer metro-comparable services in certain areas as a result of support from other Australian, State/Territory or local government programs, will not be eligible to provide HiBIS/BC services in those areas. This does not prohibit other providers from providing HiBIS/BC services in those areas. Furthermore, the basis for paying providers the standard incentive (\$1 400 excluding GST) or the high-cost incentive (\$3 000 excluding GST) is determined by whether the eligible premises had access to Telstra ISDN.

4.22 The ANAO found that DCITA placed heavy reliance on customer attestations to assess premises eligibility. For much of HiBIS/BC Stage 1, DCITA made available to customers a geospatial mapping system to help them self-assess the eligibility of their premises.³⁵ However, DCITA advised that its claims processing system could not access this technology to assess providers' claims until September 2006 (after BC Stage 1 was completed).

4.23 Using DCITA's geospatial management system, the ANAO identified providers who had claimed and received incentive payments for:

- 314 customers whose premises are located within the MEA and were therefore ineligible under HiBIS/BC Stage 1 (valued at \$541 600).³⁶ A further 177 customers *could* be located within the MEA³⁷; and
- 112 Telstra customers where the high-cost incentive was incorrectly claimed instead of the standard incentive for eligible premises within pre-existing areas (valued at \$179 200).³⁸

³⁵ Customers could determine whether their premises were located in the MEA or in a pre-existing or imminent coverage area.

³⁶ DCITA advised that it has erred on the side of accepting claims where the premises are on the boundary of the MEA provided all other eligibility criteria are met.

³⁷ DCITA's geospatial management system could not pinpoint the location of some customers' premises and instead identified a region in which they are located. Therefore, these 177 customers may or may not be located within the MEA.

³⁸ Premises in areas that had access to metro-comparable services at the start of HiBIS (that is, pre-existing areas) are generally not eligible for HiBIS/BC services. However, these 112 premises are eligible as they were not able to receive metro-comparable services due to technical impairment (for example, pair gains).

4.24 During the audit, the ANAO also identified 2 155 Telstra customers whose premises appeared ineligible as they are within pre-existing areas but were not technically impaired at the start of HiBIS.³⁹ Telstra subsequently advised that all but seven of these premises are eligible. This is because some service addresses recorded in DCITA's database do not easily align with exchange and program areas.⁴⁰ This has led to some claims, particularly those close to boundaries, being wrongly classified.

4.25 The ANAO's analysis also noted:

- providers who claimed and received incentive payments for approximately 800 premises with duplicate entries in HOMs/BCOMs that are likely to be ineligible for multiple services (valued at approximately \$1.7 million); and
- that DCITA cannot independently verify whether providers have incorrectly claimed and received incentive payments for customers who have also received a service under the TEZSS program. As previously noted, TEZSS is a separate program managed by DCITA that has 11 000 customers across Australia.⁴¹

Provider audit results

4.26 Furthermore, DCITA audits of HiBIS/BC providers in 2006 found that providers claimed, and were paid, the wrong incentive rate (mainly the high-cost incentive) in respect of eight per cent of the customers sampled. This rate reduces to 3.2 per cent when adjustments are made for action taken by DCITA against one provider.

4.27 DCITA was unable to ascertain whether two providers claimed the correct incentive rate in respect of any of their customers sampled as the providers concerned had not obtained or retained supporting documentation. This means that DCITA is not aware if these two providers were paid the correct incentive rate for 4 499 of their customers, two-thirds of which were

³⁹ Premises in areas that had access to metro-comparable services at the start of HiBIS (that is, pre-existing areas) are generally not eligible for HiBIS/BC services. However, those premises not able to receive metro-comparable services in pre-existing areas due to technical impairment (for example, pair gaps) are eligible.

⁴⁰ This may occur when approximations are used for actual locations or where location-naming conventions are not standard (for example, alternate street name spellings and newly renamed roads) or in respect of newly created roads that have not been entered onto databases.

⁴¹ DCITA advised that privacy concerns may constrain Telstra from providing the necessary information. DCITA will allow TEZSS customers access to subsidised broadband services under the Australian Broadband Guarantee program introduced from April 2007.

claimed at the high-cost incentive rate. DCITA considers that the lack of evidence to support the incentive rate claimed does not mean that all of these claims were inaccurate. Equally, claims lodged at the standard rate by these providers may have been more appropriately claimed at the high-cost rate, giving rise to underpayments.

Conclusion

4.28 Analysis of HiBIS/BC Stage 1 data identified the payment of over 1 200 claims for ineligible premises. The ANAO considers that DCITA has, or is able to obtain, information that could allow it to re-assess the eligibility of premises claimed by providers with a higher degree of accuracy than was provided by the original assessment. DCITA could then consider the recoverability of any payments made for invalid claims. For example:

- premises located within pre-existing coverage areas provided with HiBIS/BC services by Telstra could be cross-checked against other information from Telstra on the removal of technological impediments (including pair gains⁴²) impeding customer access to ADSL services; and
- premises located within pre-existing coverage areas provided with HiBIS/BC services by providers other than Telstra could be cross-checked against information from Telstra on the periods where particular ADSL-enabled exchanges had reached capacity.⁴³

Recommendation No.1

4.29 To improve the integrity of the Broadband Connect (BC)-related programs, the ANAO recommends that DCITA:

- (a) re-assess, where appropriate, the eligibility of the premises that received a HiBIS/BC Stage 1 service that the ANAO's analysis highlighted as potentially ineligible;
- (b) consider taking recovery action in relation to invalid claims; and
- (c) assess the eligibility of premises in all future provider claims more rigorously by using independent information sources.

⁴² Pair gains is a method of providing land-line telephone services that impedes customers' access to ADSL broadband services.

⁴³ Telstra recently advised that relevant exchanges have thus far never reached capacity, making crosschecking unnecessary.

DCITA's response

4.30 DCITA agrees with this recommendation. Where, as a result of further analysis of potentially invalid claims, DCITA confirms that premises were ineligible and resulted in outcomes inconsistent with the program objectives, DCITA will consider seeking repayment of incentive payments. DCITA notes that recovery of funding will not be possible in some cases, for example, recovery of almost \$10 million paid to companies that subsequently entered into administration or liquidation.

4.31 DCITA will use independent information sources to the extent possible to verify eligibility of premises under the new Australian Broadband Guarantee program. DCITA notes that the customer attestation requirements have been strengthened under the Australian Broadband Guarantee program, as well as requirements on providers to validate claims. DCITA has also refined its mapping and database tools to more effectively identify, on an independent basis, where commercial metro-comparable broadband services are being offered and where Australian Broadband Guarantee services are therefore not eligible to be claimed.

Potential program fraud

4.32 During 2005 and 2006, DCITA referred three providers to the AFP for two alleged occurrences of program fraud. In each case, anomalies in submitted claims led DCITA to conduct a sample-based provider audit. DCITA also undertook full compliance audits before issuing repayment notices or statutory demands and referring the providers to the AFP for possible program fraud. DCITA's audits found some 4 000 claims totalling almost \$10 million to be invalid as they were:

- duplicated;
- made at the incorrect incentive rate;
- for customers in ineligible areas (one potential fraud only);
- for customers of non-registered providers (one potential fraud only);
- not supported by either a signed attestation or a signed contract (or both); or
- for customers who had not logged-on to receive their HiBIS/BC Stage 1 service.

4.33 DCITA took prompt and appropriate action once it detected anomalies in these providers' claims. However, the ANAO considers that it is likely that both potential frauds could have been detected earlier had DCITA's claims checking processes been fully automated at the time the claims were lodged.⁴⁴ This may have reduced the severity of the frauds. The providers concerned have gone into administration or liquidation. DCITA is unlikely to have any HiBIS/BC Stage 1 funding repaid where the company has gone into liquidation. DCITA's full automation of BC claims checking, which was achieved in September 2006, now routinely checks for duplicate claims and claims from ineligible areas.

Funding limits for individual providers

4.34 The funding limit for individual providers is a control mechanism designed to ensure that no one provider receives an overly large proportion of HiBIS/BC funds. It supports one of the two secondary objectives of HiBIS/BC, to promote competition among higher bandwidth service providers. HiBIS/BC provides that a single provider is limited or 'capped' to receiving 60 per cent of the total amount of HiBIS/BC funds that are available in any one financial year or over the life of the scheme (from both retail and wholesale sources). It was anticipated in the planning stages of HiBIS that Telstra would be the only provider that the funding cap would apply to, given the size of its operations.

4.35 The 2004–05 and 2005–06 Telstra HiBIS funding agreements indicated that Telstra could make claims for connections (that is, services provided to customers) up until the date DCITA notified Telstra that it had reached the 60 per cent cap. This arrangement did not take into account the natural delay between when services were connected and when Telstra lodged its claims under HiBIS. Consequently, there was always a risk that Telstra could continue to connect customers after the cap had been reached and until such time that DCITA became aware and notified it that the cap had been reached. The program guidelines also allow for providers to seek access to HiBIS funding in excess of its 60 per cent cap. DCITA can make further funding available after it determines that this will not jeopardise funding available to other providers.

⁴⁴ As noted earlier, DCITA's internal auditor advised DCITA in late-2003 to regularly analyse HiBIS data using computer-assisted audit techniques. However, DCITA did not begin to take action until 18 months later due, primarily, to a lack of resources.

Payments to Telstra in excess of funding cap

4.36 The ANAO found that the funding cap variation provisions were not applied by DCITA in respect of the 2004–05 and 2005–06 funding cap under HiBIS. Table 4.2 outlines the payments to Telstra in comparison to the funding caps for the HiBIS and BC Stage 1 programs.

4.37 The ANAO found that DCITA was obliged to pay Telstra (under its funding agreement) \$28.2 million in excess of its 2004–05 funding cap of \$31.4 million to cover all customers connected on or before 30 June 2005. However, over the life of the HiBIS program (July 2004 to December 2005), DCITA's payment obligation to Telstra in excess of its funding cap of \$92.8 million decreased to \$12.8 million to cover all customers connected on or before 31 December 2005. Overall, Telstra received 68.3 per cent of HiBIS funding. Nevertheless, other providers' ability to claim HiBIS incentives was not inhibited by Telstra receiving more than its 60 per cent cap. Telstra did not exceed its funding cap under BC Stage 1.

Table 4.2

Payments to Telstra in excess of funding cap

Program	Time period	Funding available to all providers by time period \$m	60% cap available to Telstra \$m	Payments to Telstra made over life of HiBIS/BC Stage 1	
				for connections in time period ^a \$m	in excess of 60% cap \$m
HiBIS	2004–05	52.3	31.4	59.6	28.2
HiBIS	Jul-Dec 2005	102.3	61.4	46.0	Not applicable
Subtotal: HiBIS overall	Jul 2004- Dec 2005	154.6	92.8	105.6	12.8
BC Stage 1	Jan-Jun 2006	124.7	74.8	72.0	Not applicable
Total		279.3	167.6	177.6	

Source: ANAO analysis of DCITA data.

a – Records payments made to Telstra over the life of HiBIS/BC Stage 1 for connections made in the time periods.

4.38 When DCITA decided to make available more than 60 per cent of HiBIS funding to any one provider, it was required to publish a written notice of its decision on the HiBIS website and advise each provider of its decision. The

ANAO found that, contrary to the requirements of the program guidelines and providers' funding agreements, DCITA did not:

- provide written notice on its website outlining the decision to allow Telstra to claim more than the 60 per cent cap; and
- advise any other providers or scheme beneficiaries that further funding was made available to Telstra.

Monitoring of Telstra's funding cap by DCITA

4.39 The ANAO considers that DCITA's claims processing arrangements for HiBIS and BC Stage 1 inhibited the effectiveness of the funding cap. The program guidelines required providers to submit claims 'as soon as possible' after connecting customers.⁴⁵ However, many providers, including Telstra, regularly submitted claims dated many months after customers had received a HiBIS/BC Stage 1 service. Figure 4.2 demonstrates the significant lag of claims following the connection of customers.

4.40 Between March and October 2005, claims yet to be lodged by Telstra exceeded \$9 million. The natural delay between service connections and claim lodgement, combined with Telstra's slow submission of claims, meant that DCITA could not effectively monitor whether Telstra remained within its funding cap. Figure 4.2 shows that Telstra's HiBIS/BC Stage 1 connections matched claims only between November 2005 and January 2006, and from July 2006. At other times, connections made by Telstra but not yet claimed ran into millions of dollars.

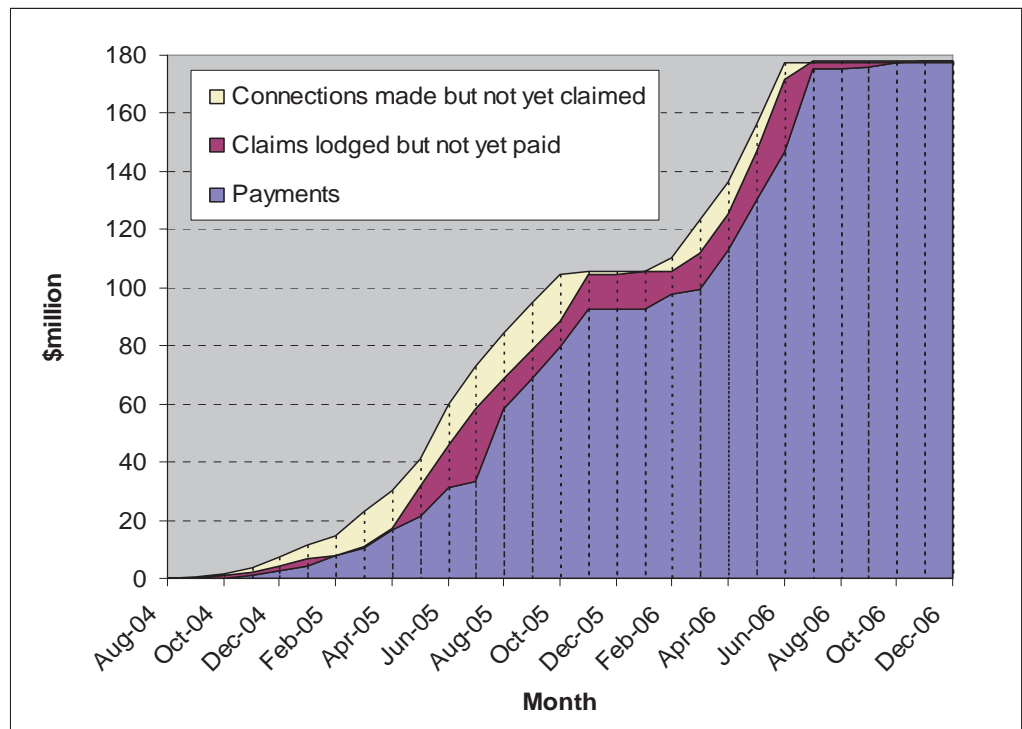
4.41 The ANAO considers that DCITA's approach to monitoring the 60 per cent funding cap has been based on a misunderstanding of the requirements of the program guidelines. DCITA's monitoring of the cap did not take into account claims yet to be received from Telstra for connections already made. On 18 November 2005, DCITA notified Telstra that it had reached its funding cap, based on payments made to October 2005 and Telstra's yet-to-be-paid October 2005 claims. However, Telstra rightly pointed out that DCITA was obliged (under its funding agreement with Telstra) to pay all claims for connections dated before Telstra was notified that the funding cap had been reached. In November 2005, Telstra lodged claims totalling \$16.1 million for over 11 000 customers connected before 18 November,

⁴⁵ Under BC Stage 1, the guidelines were changed to require providers to submit claims within 45 days of connecting customers.

including some connected as early as February 2005. Internal legal advice and a subsequent audit of these claims by DCITA confirmed their eligibility under HiBIS.

Figure 4.2

Cumulative HiBIS and BC Stage 1 connections, claims and payments for Telstra^a



Source: ANAO analysis of HOMS/BCOMS.

a – Includes Telstra's wholesale and retail customers.

4.42 Improved monitoring by DCITA could have identified that the cap had been reached earlier. At the end of May 2005, DCITA had paid Telstra \$21.4 million, and had at least \$10.5 million in outstanding claims (that it later paid). At this point, DCITA could have calculated that Telstra's cap had been reached. If Telstra had been advised at this time, DCITA would have been obliged to pay Telstra for all connections up to the end of May. This would have been a further \$9.3 million, bringing Telstra's total payments for 2004–05 connections to \$41.2 million. The funding cap for 2004–05 would then have been exceeded by \$9.8 million instead of \$28.2 million.

Improving the effectiveness of the funding cap

4.43 DCITA advised that it has tightened the funding cap provisions under Telstra's 2005–06 BC Stage 1 funding agreement to ensure that Telstra was only eligible to receive BC funding up to the limit of its cap. DCITA has also tightened the timeframe for providers to submit claims after customer connection. Under BC Stage 1, claims must be submitted within 45 days of customers being connected for the provider to be eligible for incentive payments. This has the effect of reducing the natural delay between the service connection dates and the dates providers lodge claims, with a consequent reduction in the quantum of unclaimed services at any point in time.

Impact of unregistered wholesale services on the funding cap

4.44 Telstra was a registered provider of wholesale services under the HiBIS program. The program guidelines allow registered wholesalers to resell their services to registered retailers who enter into service contracts with HiBIS/BC customers. Where wholesalers are involved in providing HiBIS/BC services, incentive payments are split between the wholesaler and retailer in proportions agreed by them. Once DCITA notified Telstra that it had reached its funding cap on 18 November 2005, Telstra was no longer entitled to, and did not receive, any further incentive payments (including those for its wholesale services) for the rest of 2005.

4.45 Telstra decided not to register as a provider of wholesale services under the BC Stage 1 program that began on 1 January 2006. Not wishing to disadvantage HiBIS/BC retailers for the independent actions of their wholesalers, DCITA varied the retailers' funding agreements to allow them to use the services of an unregistered wholesaler and to receive full incentive payments. However, the ANAO found that retail providers incorrectly received full incentive payments for 95 customers supplied with HiBIS/BC Stage 1 services before these funding agreements were varied (valued at approximately \$100 000). DCITA considers this circumstance was a 'technicality' and that the payments were made according to the policy intent.

4.46 Telstra continued to provide wholesale services to HiBIS/BC retail providers from 18 November 2005 until the conclusion of BC Stage 1 in June 2006. The commercial arrangements between Telstra and its retailers were independent of the HiBIS/BC Stage 1 programs.

4.47 The funding cap control mechanism developed by DCITA does not cater for unregistered wholesale services provided to HiBIS/BC Stage 1 retail

providers. While retail providers receive full incentive payments, they also pay fees to the wholesale provider to connect HiBIS/BC Stage 1 customers. However, the fees received by providers for unregistered wholesale services do not count towards the funding cap. DCITA is of the view that any charges paid to wholesale providers under commercial arrangements by retailers should not count towards a provider's funding cap. These charges are not known to DCITA and it would not be in a position to obtain information on them.

Incentives not to exceed providers' 'allowable costs'

4.48 'Allowable costs' is a concept introduced into the HiBIS/BC Stage 1 programs to manage the risk of providers making windfall profits from the programs. The incentive payments that providers can receive are limited or 'capped' at the costs incurred by providers to supply HiBIS/BC services—that is, allowable costs.

4.49 Providers' funding agreements and the program guidelines stipulate the types of costs incurred by providers that can be taken into account when calculating allowable costs.⁴⁶ Where costs are incurred to provide both HiBIS/BC services and other services of the provider, only the portion incurred to provide HiBIS/BC services can be included in allowable costs.

4.50 At the end of each financial year, providers prepare and submit audited Statements of Allowable Costs, which DCITA reconciles against the incentives paid to the providers. Where allowable costs exceed incentives received, the balance is available in the following year to be offset against incentives received that year. Where incentives received exceed allowable costs, DCITA can either:

- carry forward the balance to the following year to be offset against allowable costs incurred that year;
- withhold further incentive payments until allowable costs equal or exceed incentive payments made thus far; or
- require providers to repay incentive payments in excess of the allowable costs incurred.

⁴⁶ These include the costs of preparing for, and supplying, HiBIS/BC services and costs incurred by providers to comply with programs.

DCITA indicated that circumstances have not arisen that has required it to withhold incentive payments to providers or seek repayment of incentive payments as a result of allowable cost reconciliations.

4.51 The providers' funding agreements and program guidelines state that providers' allowable costs can be reduced in some circumstances, including where:

- customers transfer customer premises equipment from one eligible premises to another; and
- providers provide HiBIS/BC services with the support of funding from other government programs.

4.52 However, the ANAO found that DCITA's ability to assess whether reductions should have been made to providers' allowable costs was inhibited by DCITA having:

- no means of identifying customers who moved from one eligible premises to another; and
- made no concerted attempt to ascertain whether other DCITA programs, apart from the Coordinated Communications Infrastructure Fund, could have impacted allowable costs.

4.53 The ANAO also examined the Allowable Cost Statements for the three providers who, in total, received 75 per cent of HiBIS/BC Stage 1 funding. The ANAO found that:

- Statements of Allowable Costs and associated audit opinions for 2004–05 and 2005–06 have not been received from one of the providers⁴⁷;
- different providers prepared their Statements using different accounting bases—one used the cash method, while the other used the accrual method⁴⁸;
- the scope of the audit opinions on the Statements varied between providers—one examined whether the costs reported met the definition

⁴⁷ The 2005–06 financial statements of one of the providers received by DCITA do not separately identify allowable costs and therefore do not meet the requirements of a Statement of Allowable Costs. DCITA has now taken action to remedy this deficiency.

⁴⁸ The cash accounting method recognises revenue and expenditure in the accounting period in which cash is received or paid. The accrual accounting method recognises revenue and expenditure in the accounting period in which the revenue was earned and expenditure was incurred, regardless of when cash was received or paid.

of 'allowable costs' as specified in the funding agreements, while the other did not;

- DCITA did not reconcile allowable costs to incentive payments for any of the providers in 2004–05; and
- the lack of a defined reporting format meant that DCITA missed the opportunity to collect pertinent performance information on the program (for example, provider expenditure on infrastructure as opposed to recurrent costs).

4.54 DCITA delayed conducting reconciliations for 2005–06 until it received a significant proportion from providers. As a consequence, there have been delays in identifying any overpayments to providers. Furthermore, Statements and audit opinions should be carefully examined on receipt in case they need to be revised to meet the requirements of the HiBIS/BC Stage 1 programs. This is particularly apparent where audits of the Statements do not express an opinion on whether the costs reported by providers meet the definition of 'allowable costs' under the programs. Without such an opinion, the value of the Statements and their reconciliation to incentive payments is greatly reduced.

Recommendation No.2

4.55 To improve the process for reconciling Allowable Cost Statements submitted by providers, the ANAO recommends that DCITA:

- (a) advise the required format and content of the associated audit opinions;
- (b) specify that audit certificates express an opinion on whether the costs reported in the statements meet the definition of 'allowable costs' as specified in the funding agreements;
- (c) reconcile allowable costs to incentive payments in a timely manner.

DCITA's response

4.56 DCITA agrees with this recommendation and will implement it for the purpose of the 2006–07 annual report under Broadband Connect. DCITA notes that there is no concept of 'allowable cost' in the Australian Broadband Guarantee Transition Program and it is not intended to re-introduce the concept in the full Australian Broadband Guarantee program to commence on 1 July 2007.

5. Achievement of HiBIS and BC Stage 1 Objectives

This chapter examines the performance of the HiBIS and BC Stage 1 programs against their objectives and DCITA's reporting of the program's progress and performance.

Introduction

5.1 As previously noted in Chapter 2, the HiBIS and BC Stage 1 programs each had one primary objective and two supporting objectives. These were the same for both programs. The ANAO reviewed DCITA's performance against each objective.

Benchmarking studies

5.2 In September 2003, DCITA engaged an external consultant to assist with the planning of HiBIS. The consultant was contracted to deliver three reports of time-critical importance that DCITA considered would help:

- target the program to the greatest areas of need;
- set incentive rates for, and customer pricing of, HiBIS services; and
- set the parameters for registering and assessing providers under HiBIS.

These reports were also to set benchmarks against which the performance of HiBIS could be later assessed.

5.3 DCITA found that the reports did not meet its requirements and were of little use for planning HiBIS or as benchmarks for assessing the performance of the program over time.⁴⁹ Instead, DCITA obtained planning information from other sources (primarily, the Australian Bureau of Statistics).

HiBIS mid-term review

5.4 As noted in Chapter 3, DCITA began a mid-term review of the HiBIS program in mid-2005. The 2005 Review was undertaken by the HiBIS program area with assistance from the Department's Communications Research Unit (CRU). The 2005 Review was never finalised as it was overtaken by the development of a submission to the Government to extend the program (into

⁴⁹ For example, the report analysing suppliers of broadband services in rural, regional and remote areas of Australia had major deficiencies and did not meet the agreed contractual requirements. DCITA did not pay for this report.

what later became BC). Nevertheless, it proceeded to an advanced stage and a draft report identified a number of suggestions and recommendations that were taken into account in designing and implementing BC Stage 1. The ANAO considers that the findings, conclusions, suggestions and recommendations of this review are relevant when assessing the extent to which HiBIS/BC Stage 1 have met their objectives.

Comparability of prices for broadband services

5.5 The primary objective of HiBIS and BC Stage 1 was to ‘achieve prices for higher bandwidth services in regional Australia that are comparable to metropolitan services’. For the purposes of HiBIS/BC Stage 1:

- ‘higher bandwidth services’ have been defined as internet access at a peak data download/upload speed of *at least* 256/64 kilo bits per second (kbps) and 500 mega byte (MB) per month usage allowance (‘Threshold Services’);
- ‘prices ... comparable to metropolitan services’ are defined maximum prices providers can charge for their Threshold Services; and
- ‘regional Australia’ has been defined as all of Australia except for all State/Territory capital cities and designated adjacent high population centres (that is, the Metropolitan Exclusion Area).⁵⁰

5.6 In August 2005, the draft report of the mid-term Review concluded that the primary objective of HiBIS had been achieved on the basis that:

- pricing for broadband services offered under HiBIS remained competitive and comparable with metropolitan service offerings, despite reductions in price for ADSL services in metropolitan markets; and
- HiBIS had provided over 600 000 premises in regional Australia with *access* to terrestrial broadband services.⁵¹

⁵⁰ The adjacent high population centres are Wollongong (NSW), the Central Coast of NSW, Newcastle (NSW), Geelong (Vic), Gold Coast/Tweed Heads (Qld/NSW), and Palmerston (NT).

⁵¹ This represents the maximum number of premises that could receive HiBIS services as a result of broadband infrastructure installed by providers with the support of the HiBIS program. The actual number of customers receiving HiBIS services as at June 2005 was approximately 44 000. Terrestrial broadband services are all broadband services, except satellite services.

Higher bandwidth services

5.7 DCITA advised that the metropolitan benchmark for data upload and download speeds was set at 256/64 kbps with 500 MB usage allowance because these speeds were found to be the most prevalent in the metropolitan area at the start of HiBIS. Registered providers are also required to meet and maintain minimum data speeds when supplying HiBIS/BC Stage 1 services. DCITA regularly tests the data speeds of providers' services and has indicated that testing will continue in some form for three years after providers sign up the last BC customer.

5.8 Stakeholder feedback on HiBIS obtained during the 2005 Review indicated that some providers proposed raising the minimum threshold service components. This was to mirror increases in the entry-level service offering from broadband providers in metropolitan markets. The 2005 Review did not support this proposal because:

- customers' choice of services would be reduced;
- there was a demonstrated demand for a lower-priced minimum service model (which was illustrated by four providers lowering their entry-level service offerings to the minimum in response to customer demands); and
- customers already had the choice to connect to an Added Value Service with extra functionality at extra cost if they considered it represented value for money.

5.9 Nevertheless, DCITA has become cognisant of the impact on the BC program from increasing broadband speeds that are becoming commonplace in metropolitan markets. Changes to be introduced to the method of supporting delivery of higher bandwidth services to regional Australia are discussed later in this Chapter.

Pricing of HiBIS/BC Stage 1 services

Pricing of Threshold Services

5.10 DCITA advised that it determined the original price caps for its Threshold Services (which applied from the start of HiBIS in April 2004) as follows:

- ADSL Threshold Services—the average metropolitan price for 16 comparable threshold services; and

- Non-ADSL Threshold Services—the pricing for Telstra’s BigPond™ Regional Connect one-way satellite service (available wherever ISDN is available) with HiBIS subsidy.

5.11 Some 14 months after the start of HiBIS, the 2005 Review found that the average pricing of HiBIS Threshold Services across all technologies were significantly less than the maximum providers were allowed to charge HiBIS customers. Nevertheless, the 2005 Review recommended price reductions, which were incorporated into BC Stage from 1 January 2006 (see Table 5.1). The Review also recommended that price caps for each technology platform be reviewed annually to ensure that HiBIS remains appropriately calibrated to meet its objectives.

Table 5.1

Maximum pricing over three years for Threshold Services

Technology Platform	Maximum Threshold Service Package Price—HiBIS ^a	Maximum Threshold Service Package Price—BC Stage 1 ^a
ADSL ^b	\$2 500 or \$2 900	\$1 500 or \$2 500
Two-way satellite	\$3 000 or \$3 400	\$2 600 or \$3 600
Other platforms	\$3 000 or \$3 400	\$2 000 or \$3 000

Source: DCITA

a – Providers can charge customers the higher price where the service includes ‘additional features or functionality of a value equal to or exceeding the additional price allowance’.

b – Asymmetric Digital Subscriber Line, which is broadband services over the standard telephone line.

Pricing of Added Value Services

5.12 As noted in Chapter 4, the ANAO found that the providers’ pricing of Added Value Services frequently varied from provider to provider. Price variations between different providers for the same services over 36 months were often in the thousands of dollars and was sometimes over \$5 000. The ANAO acknowledges that healthy competition has the potential to reduce price inefficiencies in the market. However, as previously noted, there are numerous sub-markets where there is only one HiBIS/BC provider, demonstrating the value of a more consistent approach to assessing the pricing of Added Value Services. This could improve the outcomes for HiBIS/BC customers and for the programs.

Sustainability of pricing limits

5.13 Providers are required to offer HiBIS/BC Stage 1 services to their customers for at least three years at prices not greater than those registered

with DCITA under the programs.⁵² After the three years, providers' pricing and service obligations to customers ceases. Market forces will then determine the future pricing of services. The ANAO was unable to test post-HiBIS pricing as the three-year period for HiBIS's first customers does not expire until July 2007.

Premises with access to HiBIS/BC Stage 1 services

5.14 The CRU considered that the preferred measure for the primary HiBIS objective was the number of additional premises in regional Australia that could be supplied with metro-comparable services at metro-comparable prices as a consequence of HiBIS. To this end, the 2005 Review found that providers had installed infrastructure with the assistance of HiBIS to give nominal access to terrestrial broadband services to 604 000 of the 1.3 million premises eligible to receive HiBIS services (46.5 per cent). DCITA advised that, as at November 2006, this had increased to 960 000 premises (73.8 per cent). One particular advantage of the design of the HiBIS program is that it gave immediate access for all regional and rural Australians to a metro-comparable broadband service via at least one technology platform (satellite).

5.15 Figure 5.1 illustrates the areas in which the HiBIS/BC programs have funded infrastructure to provide broadband services to regional Australia.

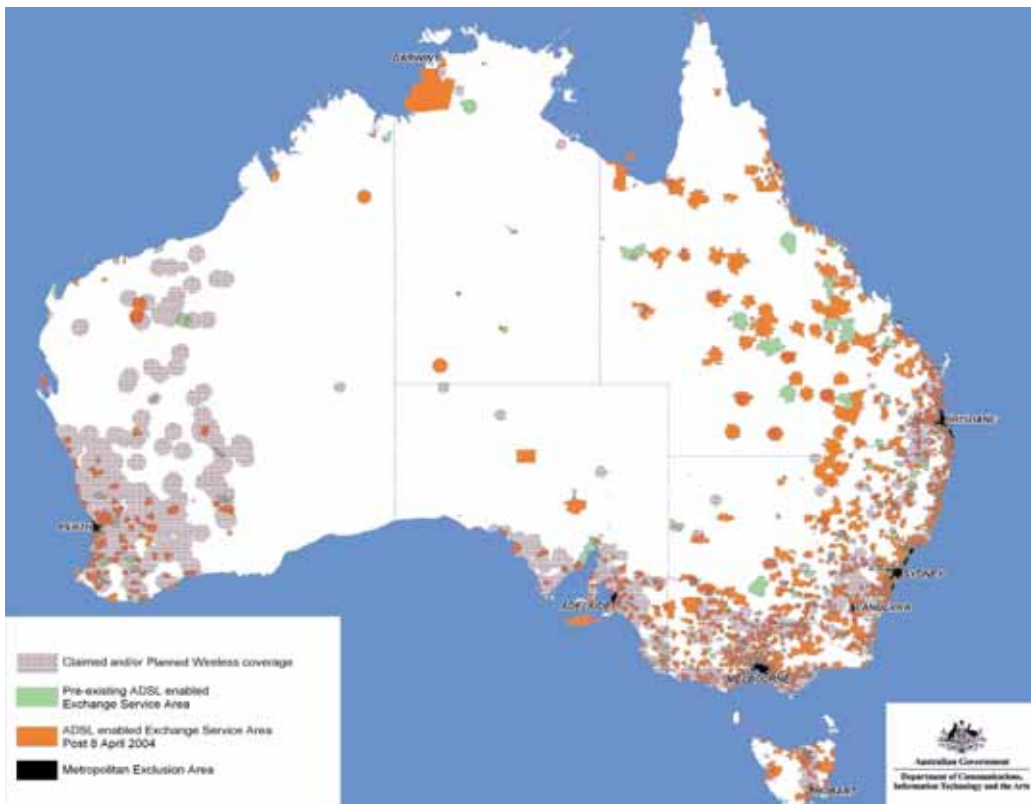
Conclusion

5.16 The ANAO concludes that the HiBIS/BC Stage 1 programs have realised their objective of achieving prices for higher bandwidth services in regional Australia that are comparable to metropolitan services.

⁵² Customers who exceed their download usage allowance may be charged additional fees.

Figure 5.1

Areas in which terrestrial metro-comparable services are available^a



Source: DCITA

a – As at 8 February 2007. Consequently, some of the ‘ADSL enabled Exchange Service Area Post 8 April 2004’ areas have been funded under BC Stage 2, which was not subject to this audit. In addition, ADSL services are generally only available to premises that are within four kilometres (and in some circumstances, ten kilometres) of an enabled telephone exchange. Nevertheless, most telephone exchanges are located near the greatest concentration of people in each service area.

Competition among broadband service providers

5.17 One of the supporting objectives for HiBIS/BC Stage 1 was to promote competition among higher bandwidth service providers. DCITA considers that the design of HiBIS/BC Stage 1 has supported such competition by:

- allowing any internet service provider who can meet the programs’ corporate capacity and service suitability requirements to register;

- not restricting the kind of technology deployed to provide services (that is, technology neutrality) so long as it is of sufficiently high quality to deliver the functionality required;
- having relatively standardised incentive payment levels that lead to providers competing to provide services to particular premises for the same level of incentive payment; and
- providing certainty to providers about eligible service areas, which aids providers' business cases for entering new areas.

5.18 The 2005 Review also found that there was considerable competition in the supply of HiBIS services. This was demonstrated by:

- 40 registered HiBIS providers supplying broadband services across rural, regional and remote Australia, compared to only 17 providers supplying broadband services outside the metropolitan regions at the start of HiBIS;
- 14 of the 40 providers lowering their initial service pricing under HiBIS to match competitive offerings within the market;
- the diversity of the broadband technology platforms providers used included ADSL (three providers), cable (three), satellite (nine) and wireless (31)⁵³; and
- 35 HiBIS service areas where there is direct competition between ADSL providers and other terrestrial-based services.⁵⁴

These competitive measures equate, in many respects, with those recommended by CRU.

5.19 Nevertheless, the 2005 Review noted two particular competition concerns raised by stakeholders—backhaul competition and pricing⁵⁵, and Telstra's dominance. The 2005 Review did not recommend changes to HiBIS in respect of either issue as:

⁵³ Some providers supplied HiBIS services using more than one platform.

⁵⁴ It is not appropriate to consider satellite services in the context of competition in service areas as most satellite services have nominal coverage that extends across the whole of Australia.

⁵⁵ Backhaul is the process of transmitting information to a central point from which it can be distributed over a network. Backhaul services allow telecommunications carriers and internet service providers to aggregate data (such as internet traffic and telephone calls) to a centralised location in a region, then connect that location to bigger sites (hubs).

- numerous wireless providers have found the HiBIS incentive sufficient to cover the costs of backhaul supply;
- the provision of backhaul supply, access and pricing was guided by the Telecommunications Access Regime and overseen by the Australian Competition and Consumer Commission⁵⁶; and
- a reduction to Telstra's funding cap would reduce the roll-out of new infrastructure and services.

5.20 However, providers' competition concerns have still lingered. In late-2006, DCITA advised that a number of regional internet service providers, including some BC providers, considered that:

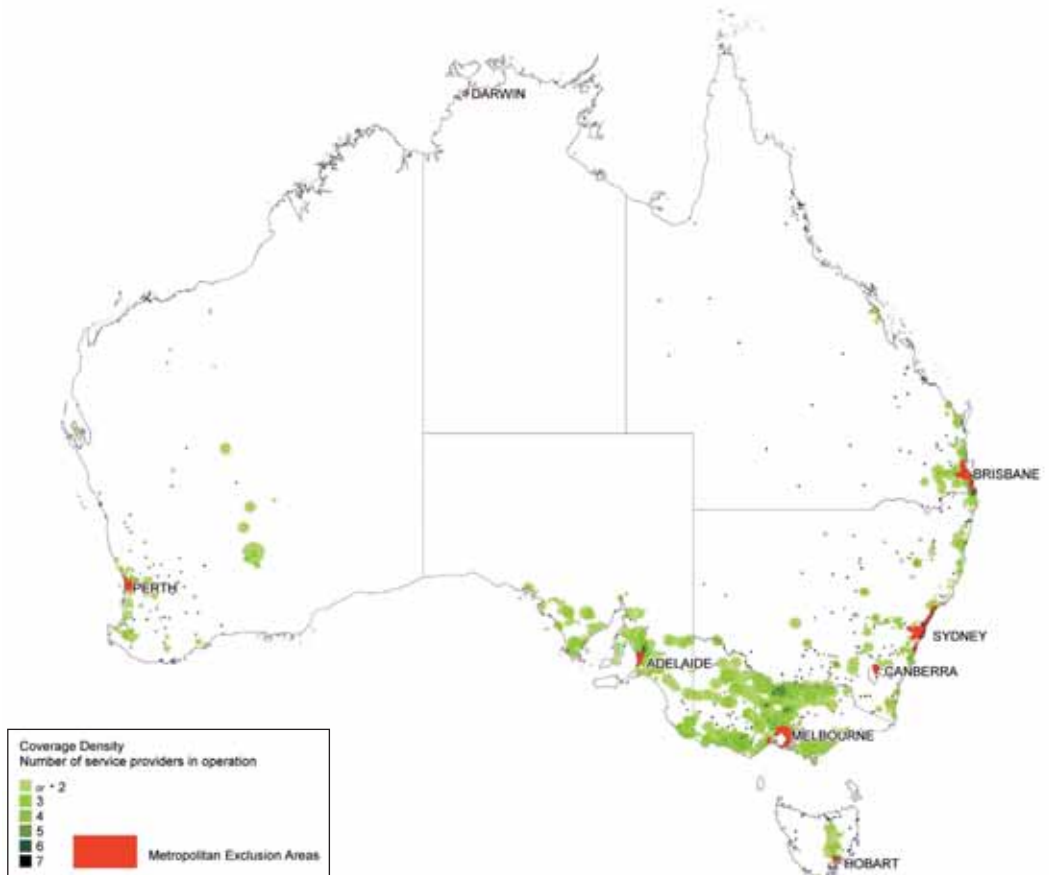
- effective access to backhaul has impeded the capacity of many internet service providers to participate in BC, and to compete effectively in the regional broadband market more generally; and
- providers who establish broadband infrastructure using significant Government funding should be obliged to offer other providers access to that infrastructure at fair and reasonable prices and conditions.

5.21 Figure 5.2 illustrates the extent of competition for providing HiBIS/BC services in regional Australia. It shows that:

- up to seven HiBIS/BC providers service the same areas of regional Australia;
- competition is most prevalent in regional Victoria and is least prevalent in the Northern Territory (which has none); and
- in the other States and Territory, competition is (not surprisingly) centred around the larger regional centres.

5.22 The ANAO considers that the HiBIS/BC Stage 1 programs have realised their supporting objective of promoting competition among higher bandwidth service providers in regional Australia.

⁵⁶ Telecommunications Access Regime contains arrangements for access to telecommunications services, including model terms and conditions for access to particular services. They are regulated by the Australian Competition and Consumer Commission.

Figure 5.2**Areas of competition for providing HiBIS/BC services**

Source: DCITA

Targeting areas of need efficiently

5.23 The second supporting objective of HiBIS and BC is to ensure efficient use of funds by effectively targeting support to areas of need in regional Australia.

Servicing areas of need

5.24 The 2002 RTI made no attempt to define 'regional, rural and remote areas'. Therefore, DCITA defined the HiBIS/BC Stage 1 area (that is, the area of Australia eligible to receive HiBIS/BC Stage 1 services) as all of Australia except the MEA.⁵⁷ DCITA advised that a precedent for this approach had been

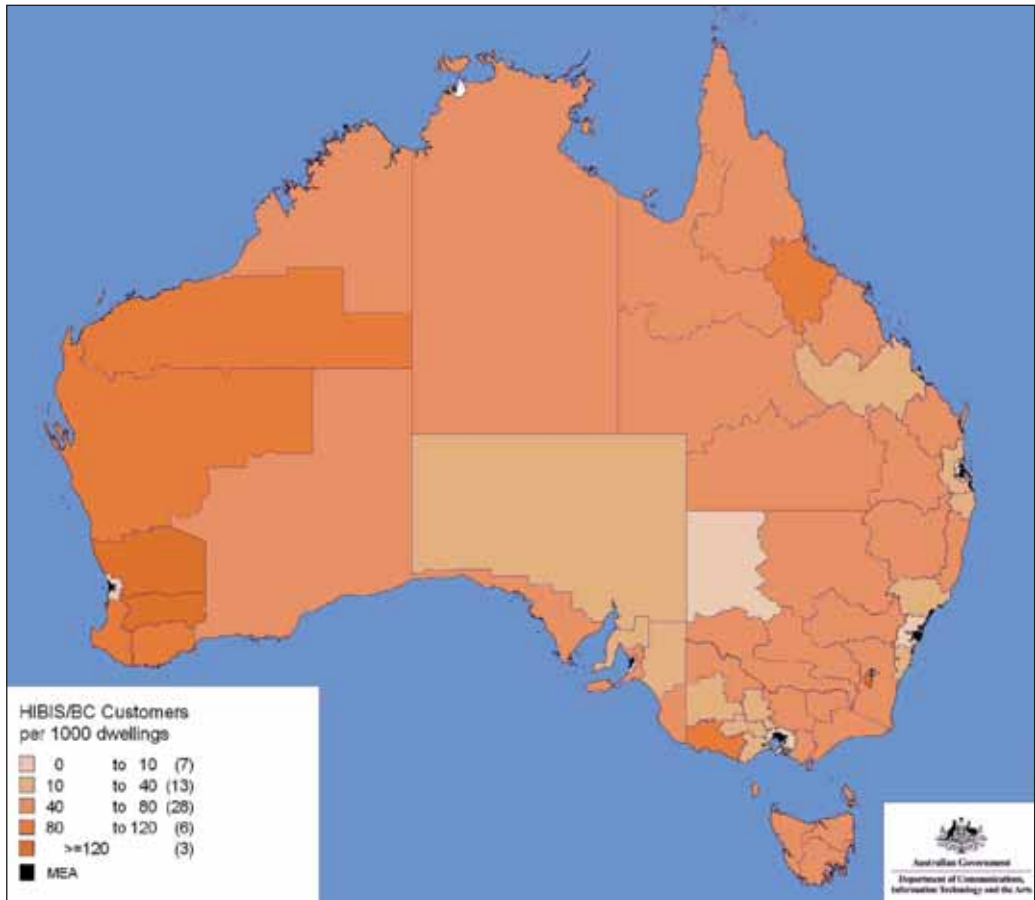
⁵⁷ The MEA included all State/Territory capital cities and the adjacent high population centres of Wollongong (NSW), the Central Coast of NSW, Newcastle (NSW), Geelong (Vic), Gold Coast/Tweed Heads (Qld/NSW), and Palmerston (NT).

set by the Networking the Nation (NTN) program, which excluded the MEA centres from NTN funding on the basis they were not truly regional in character.

5.25 Figure 5.3 illustrates the proportion of dwellings by statistical division that have taken-up HiBIS/BC Stage 1 services in different areas of regional Australia. It shows that apart from a greater take-up of HiBIS/BC services in Western Australia and a slightly lesser take-up in South Australia, there is no other discernable pattern to the take-up rate of HiBIS/BC Stage 1 services in regional Australia.

Figure 5.3

Proportion of dwellings with HiBIS/BC services by Statistical Divisions^a



Source: DCITA

a - Statistical Divisions are relatively homogenous regions determined by the Australian Bureau of Statistics. They aggregate to form the States and Territories. There are 66 Statistical Divisions in Australia, with 57 located within the HiBIS/BC Area.

5.26 The ANAO also examined the proportion of dwellings that had taken-up HiBIS/BC Stage 1 services by (the more specific) Local Government Area.⁵⁸ This analysis did not identify any pattern to the take-up rate for HiBIS/BC Stage 1 services in regional Australia that was not already evident at the statistical division level.

Features aiding the programs' efficiency

5.27 The ANAO considers that the HiBIS/BC Stage 1 programs contained many features that were designed to enhance their efficiency. These include the eligibility criteria affecting providers and their services, customers and premises—examples of which are provided in Appendix 2.

Findings of the 2005 Review

5.28 The 2005 Review found that HiBIS funds were being used cost effectively and that the program's basic design continued to represent the best value for money. This was based on the premise that:

- most of internet service providers who commented on the appropriateness of the incentive levels during program's planning had sought and/or received registration under HiBIS; and
- the parameters of allowable costs, travel costs and the scheme's technology-neutral policy were appropriately calibrated and cost effective.⁵⁹

5.29 Nevertheless, the review considered that HiBIS should be amended to place a 12-month restriction on the period within which providers could claim incentive payments for connection of terrestrial services within a service area. It was considered that this would encourage providers to expand their areas of HiBIS service supply, while reducing providers' reliance on HiBIS funding. Twelve months was considered sufficient to allow providers to sign up the number of customers required to cover the cost of their initial infrastructure investment for a service area. DCITA has implemented the 12-month restriction from the start of the BC Stage 1 program in January 2006.

⁵⁸ Local Government Areas are spatial units that represent whole geographical areas of responsibility of incorporated Local Government Councils. In 2005, the Australian Bureau of Statistics recognised 667 Local Government Areas throughout Australia.

⁵⁹ Under certain circumstances, providers were entitled to claim from DCITA some of the costs for travelling to/from remote HiBIS/BC Stage 1 customers. Travel claims represent less than 0.1 per cent of HiBIS/BC Stage 1 funding and has not been examined by the ANAO.

Additional targeting measures suggested by DCITA's Communication Research Unit

5.30 DCITA's CRU noted that HiBIS had a two-tiered incentive payment structure, with premises' access to ISDN being the factor that determines which incentive providers could claim. CRU considered that the geographical coverage of ISDN was a proxy for the areas that HiBIS assumed might reasonably be met by lower cost terrestrial solutions (instead of higher cost satellite solutions). Therefore, a well-targeted program would match low cost solutions with the lower incentive and high cost solutions with the higher incentive. The ANAO examined HOMS/BCOMS data and found that providers received high-cost incentives for 9 510 customers (7.6 per cent of all paid claims) who were provided with a low cost solution. However, providers also received standard incentives for 6 386 customers (5.1 per cent) who were provided with a high cost solution. The ANAO considers that these results do not indicate an inefficient use of HiBIS funds.

5.31 The CRU also suggested that DCITA assess whether the administrative and compliance burden on the department and providers was excessive. In mid-June 2006, DCITA reported to the Minister on the administrative complexities of the HiBIS/BC Stage 1 programs. The department had a significant workload to manage assessments and contracts for, and monitor and audit, over 50 service providers. These included a large number of small providers, many without experience in meeting the requirements of Government programs. DCITA considered that this increases the compliance and accountability issues and subsequent financial risk for the Government. Following a large public consultation process and feedback from a wide range of stakeholders, the Government has initiated an alternative method of delivering higher bandwidth services to regional Australia (which is discussed later in this Chapter).

Meeting the needs of different customers

5.32 The ANAO notes that there were three broad categories of customers eligible to receive HiBIS/BC Stage 1 services at the start of HiBIS:

- new customers—those not already receiving a broadband service;
- pre-existing customers—those already receiving metro-comparable services (that is, services with data download/upload speeds of 256/64 kbps and a 500 MB per month usage allowance) but not at metro-comparable prices; and

- migrating customers—those already receiving broadband services that were not up to the standard of metro-comparable services. In most instances, they had the required data speeds, but had lower usage allowances, commonly 200 MB per month.

5.33 Providers were entitled to full incentive payments for all new customers provided HiBIS/BC Stage 1 services. Most of the HiBIS/BC Stage 1 customers were new customers. Providers were entitled to only partial incentive payments for their 2 433 pre-existing customers, in recognition that the cost of providing them with HiBIS/BC Stage 1 services was lower than for other customers. However, the ANAO found that providers were entitled to full incentive payments for the thousands of migrating customers although the cost of upgrading their broadband services (by increasing their usage allowances) would usually be significantly lower than the costs of servicing new customers.⁶⁰ This is because less infrastructure is usually required to upgrade services to a metro-comparable standard, as opposed to new installations.

5.34 The ANAO considers that because there was such a large population of potential migrating customers at the start of the HiBIS program, it would have benefited the program if DCITA had also adopted a lower incentive payment for these customers. The potential savings to the program would have outweighed the administrative costs of establishing and implementing a differential incentive payment for migrating customers.

Budgeted versus actual demand

5.35 The ANAO considers that a comparison of budgeted demand for Government funding to actual demand can also be a useful indicator of whether incentive rates are set at an appropriate level. If incentive rates are set too low, actual demand could be significantly lower than expectations. If set too high, the reverse could be true.

5.36 The Government approved the budget for the HiBIS program in June 2003 in line with calculations negotiated between DCITA and the Department of Finance and Administration. The budget calculation was heavily influenced by predictions made against three variables:

- the size of each incentive payment;

⁶⁰ DCITA's records do not distinguish between migrating customers and other customers. However, an audit of Telstra's customer claims identified over 8000 migrating customers in claims received by DCITA in November 2005.

- the population of eligible customers: and
- the rate of take-up of HiBIS services by eligible customers.

5.37 However, by April 2004, the incentive payments had been significantly increased in light of prevailing market conditions, and the population of eligible customers had expanded by nearly 50 per cent. The Minister informed the Prime Minister and other Ministers at this time that there was a real possibility that HiBIS funds would not meet the full level of demand. By May 2005, actual customer take-up was running at over double what was originally budgeted for. Table 2.1 in Chapter 2 provides a comparison of predictions to actual results for the three variables.

5.38 A comparison between the eight per cent budgeted take-up rate and the actual take-up rate of 19 per cent raises the possibility that the incentive rates may have been set too high. However, this cannot be stated definitively as the program established by the Government did not have any official targets for customer take-up of HiBIS services. DCITA indicated the difference between actual and budgeted take-up rates reflected a growth in demand for broadband services over the 2003–2005 period, rather than the level of incentive payments. Also, the growth in demand and take-up in regional areas has closely matched that which has occurred in metropolitan areas.

5.39 Higher incentive rates have assisted the business cases of providers to provide terrestrial broadband access, or earlier access, to a greater area of regional Australia than would have been otherwise possible. This has helped the reach of HiBIS/BC Stage 1 to increasingly smaller communities in regional Australia, thus better fulfilling the programs' objectives.

DCITA's view of its current performance

5.40 In summary, DCITA considers that funding support has been well-targeted to premises and customers most in need, while providing a reasonably clear and certain basis for registered providers to establish a business case under the program. Registered providers only receive incentive payments after they supply a HiBIS/BC Stage 1 service to eligible customers at eligible premises (that is, those without access to a metro-comparable broadband service at the start of HiBIS). However, as previously noted, the

ANAO estimates that between \$10.6 and \$12.4 million (3.9–4.5 per cent) has been paid to providers for invalid or inaccurate claims.⁶¹

Conclusion

5.41 The ANAO considers that the HiBIS/BC Stage 1 programs have largely realised their supporting objective to ensure efficient use of funds by effectively targeting support to areas of need in regional Australia.

Scalability and sustainability for the future

5.42 By mid-2006, DCITA and other program stakeholders had identified some potential risks to BC meeting its objectives in the future with its current design. These include:

- a slow down in the roll-out of new infrastructure (as new service areas are becoming increasingly remote, with fewer potential customers);
- the scalability of broadband infrastructure (as there is no program requirement for providers to invest in infrastructure that is scalable in the future to higher speed and functionality); and
- the size of providers and the ability for them to upgrade their networks (to match the next generation broadband capacity increasingly being deployed in metropolitan markets).

5.43 Therefore, the Minister has recently approved a revised approach for delivering higher bandwidth services to regional Australia. After receiving input from stakeholders to a discussion paper and an Expression of Interest process, the Minister has decided to establish the \$600 million BC Infrastructure Program. The BC Infrastructure Program is a competitive grants program to support the extension of sustainable metro-comparable broadband services into currently under-served areas of regional Australia. A small number of major projects of significant scale and service coverage are expected to be funded. Projects are likely to be selected in early-mid 2007.

5.44 The ANAO considers that the BC Infrastructure Program has significant implications for the sustainability of services funded under the HiBIS/BC Stage 1 programs. It was originally anticipated that the incentives program would stimulate providers to enter into new service areas, which

⁶¹ These amounts are a summation of likely invalid or inaccurate claims identified by the ANAO's analysis of HiBIS/BC Stage 1 payment data in Chapter 4. The composite amounts are listed in Table 1 in the Key Findings.

would become commercially sustainable without further Government funding. Providers' business cases for currently serviced areas could be affected positively or negatively by the infrastructure projects funded, depending upon the projects' parameters. DCITA advised that the published Guidelines released for the infrastructure program fully address the need to support competition and existing internet service providers.

5.45 In March 2007, the Government also announced the \$162.5 million Australian Broadband Guarantee program covering the period from April 2007 to June 2008. The Australian Broadband Guarantee makes any Australian resident or small business who is unable to access a metro-comparable broadband service at their principal residence eligible to receive a subsidised service. The Australian Broadband Guarantee program replaces the BC Stage 2 and Metro Broadband Connect programs and operates in a similar way to the HiBIS and BC Stages 1 and 2 programs. The Australian Broadband Guarantee program is designed to provide a smooth transition from BC Stage 2 to the BC Infrastructure Program.

Reporting of program performance

5.46 DCITA's 2004–05 and 2005–06 Annual Reports noted that HiBIS/BC Stage 1 have been generally successful in providing metro-comparable broadband to regional Australia. Performance information commonly reported included the number of customers connected, the proportion of customers by technology platform, program expenditure, and number of providers. The 2005–06 Annual Report also includes a:

- chart of the location of available terrestrial broadband services; and
- discussion of an alternative approach to delivering services on the realisation that the incentives-based model might not be the most effective and efficient way to service remaining under-served areas and premises.

5.47 The ANAO considers that DCITA's reported program performance is related to the programs' objectives, but the link may not be obvious to readers of the reports. The ANAO considers that the transparency of the programs' performance would have been enhanced had DCITA structured its performance reporting against the programs' three objectives and included further information to support the programs' performance. This includes:

- the number/proportion of premises eligible for HiBIS/BC Stage 1 services that have access to terrestrial broadband services (which is related to the primary objective);
 - that DCITA reviewed and revised the pricing of HiBIS Threshold Services to ensure that they maintained parity with those services in metropolitan areas (which is related to the primary objective); and
 - that providers reduced their prices in the face of competition and that there was an increase in the number of areas where there was direct competition between terrestrial service providers (which is related to one of the secondary objectives).
-



Ian McPhee
Auditor-General

Canberra ACT
16 May 2007

Appendices

Appendix 1: DCITA's response to this audit report



Australian Government
Department of Communications,
Information Technology and the Arts

Secretary
Helen Williams AO

our reference
2006/3127

Ms Barbara Cass
Executive Director
Performance Audit Services Group
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Dear Ms Cass

PERFORMANCE AUDIT – MANAGEMENT OF THE HIGHER BANDWIDTH INCENTIVE SCHEME AND BROADBAND CONNECT STAGE 1

I refer to your letter of 26 March 2007 providing the Department of Communications, Information Technology and the Arts (DCITA) with a copy of the proposed report in relation to the performance audit on the management of the Higher Bandwidth Incentive Scheme and Broadband Connect Stage 1. I note that the report has been prepared taking into account DCITA's response to the Australian National Audit Office's (ANAO) Issues Papers, ongoing discussions and correspondence with DCITA officers, as well as feedback from Telstra on some of the analysis related to it.

I note that under sub-section 19(4) of the *Auditor-General Act 1997*, if DCITA gives written comments to the Auditor-General within 28 days after receiving the proposed report, the Auditor-General must consider those comments before preparing the final report.

You have requested the following:

- comments from DCITA to be included in an appendix to the final report;
- a response to each of the recommendations; and
- a short (one or two paragraph) summary of DCITA's comments to be used
- in the report summary and brochure.

The material requested is included in the Attachment to this letter.

I understand that Mr Simon Bryant is providing detailed remarks on the report, of an editorial nature, separately from these formal comments.

I would like to thank the ANAO for the collaborative manner in which the officers involved in preparing the report have gone about the audit process. The audit has raised issues the consideration of which has been of real benefit to the officers of DCITA involved in administering the Broadband Connect program and preparing for the Australian Broadband Guarantee program.

Please contact David Lever on (02) 6271 1502 if you have any queries on DCITA's formal response.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Helen Williams', with a stylized flourish at the end.

Helen Williams
24 April 2007

PERFORMANCE AUDIT – MANAGEMENT OF THE HIGHER BANDWIDTH INCENTIVE SCHEME AND BROADBAND CONNECT STAGE 1

FORMAL RESPONSE TO PROPOSED REPORT

DCITA comments for inclusion in Appendix of the Audit Report

DCITA acknowledges and accepts the overall conclusions of the audit report. DCITA considers the report to be well-balanced, acknowledging the successful achievement of a number of important objectives of the programs and making constructive observations and suggestions in relation to areas where controls over assessment of claims for incentive payments could have been improved. DCITA acknowledges that the delayed implementation of automation in the processing of claims as well as the resource-intensive nature of the programs led to some early difficulties in effectively assessing claims. These issues were addressed in the implementation of Broadband Connect Stage 2, which commenced on 1 July 2006.

DCITA notes that there is a need in such incentive programs to balance sometime competing objectives, in this case:

- tightly targeting assistance to consumers who are not being adequately served by the commercial market;
- minimising any undue distortion of competitive commercial outcomes; and
- efficiently allocating public resources in the administration of the programs.

DCITA established tight requirements for eligibility through the Guidelines and Funding Deeds of the HiBIS and Broadband Connect Stage 1 programs. These requirements were necessarily quite complex and necessitated a high level of administrative resource within DCITA as well as a significant administrative load on registered providers. DCITA adopted this approach in preference to a more high level, generic approach to eligibility and compliance, which would have required less administrative overhead for DCITA and registered providers alike, but which would have resulted in far less efficient targeting of Government support and greater distortion of the competitive broadband market in regional areas.

DCITA also notes that a more comprehensive and rigorous approach to eligibility also raised a higher risk that providers would have difficulty in complying with these more complicated requirements. Again DCITA believed that this increased risk was worth accepting in the interest of achieving better and more efficient targeting of public resources, as well as minimising any unfair effect on commercial broadband providers.

DCITA notes that it has addressed a number of the ANAO's concerns in formulating rules and administrative processes for the Australian Broadband Guarantee Program (transitional period). For example, customer attestations requirements are now more comprehensive and providers must now submit copies of attestation forms to DCITA when they submit their claims for payment. DCITA also continues to refine and enhance its automated administrative systems to further improve compliance management.

Response to recommendation

Recommendation No.1: To improve the integrity of the Broadband Connect (BC) program, the ANAO recommends that DCITA:

- (a) reassess, where appropriate, the eligibility of the premises that received a HiBIS/BC Stage 1 service that the ANAO's analysis highlighted as potentially ineligible;*
- (b) consider taking recovery action in relation to invalid claims;*
- (c) assess the eligibility of premises in all future provider claims more rigorously by using independent information sources.*

Response

DCITA agrees with this recommendation. Where, as a result of further analysis of potentially invalid claims, DCITA confirms that premises were ineligible and resulted in outcomes inconsistent with the program objectives, DCITA will consider seeking repayment of incentive payments. DCITA notes that recovery of funding will not be possible in some cases, for example, recovery of almost \$10 million paid to companies that subsequently entered into administration or liquidation.

DCITA will use independent information sources to the extent possible to verify eligibility of premises under the new Australian Broadband Guarantee program. DCITA notes that the customer attestation requirements have been strengthened under the Australian Broadband Guarantee program, as well as requirements on providers to validate claims. DCITA has also refined its mapping and database tools to more effectively identify, on an independent basis, where commercial metro-comparable broadband services are being offered and where Australian Broadband Guarantee services are therefore not eligible to be claimed.

Recommendation No.2: To improve the process for reconciling Allowable Cost Statements submitted by providers, the ANAO recommends that DCITA:

- (a) Advise the required format and content of the associated audit opinions;*

-5-

- (b) *specify that audit certificates express an opinion on whether the costs reported in the statements meets the definition of 'allowable costs' as specified in the funding agreements;*
- (c) *reconcile allowable costs to incentive payments in a timely manner.*

Response

DCITA agrees with this recommendation and will implement it for the purpose of the 2006–07 annual report under Broadband Connect. DCITA notes that there is no concept of 'allowable cost' in the Australian Broadband Guarantee Transition Program and it is not intended to re-introduce the concept in the full Australian Broadband Guarantee program to commence on 1 July 2007.

Short summary of DCITA comments for the report summary

DCITA acknowledges and accepts the overall conclusions of the audit report. DCITA considers the report to be well-balanced, acknowledging the successful achievement of a number of important objectives of the programs and making constructive observations and suggestions in relation to areas where controls over assessment of claims for incentive payments could have been improved. DCITA notes that it has addressed a number of the ANAO's concerns in formulating rules and administrative processes for the Australian Broadband Guarantee.

Appendix 2: HiBIS and BC Stage 1 design features aiding the programs' efficiency

Eligibility criteria	Efficiency consideration
Providers and their services	<ul style="list-style-type: none"> • DCITA limiting the amount of incentives providers can receive to the costs incurred by providers to provide HiBIS/BC Stage 1 services • DCITA establishing, reviewing and revising the pricing of Threshold Services to ensure that they maintained parity with those services in metropolitan areas^a • DCITA establishing a formal data speed testing program to ensure that providers continue to meet stipulated average data speeds for their HiBIS/BC Stage 1 customers
Eligible customers	<ul style="list-style-type: none"> • DCITA allowing only residents, small businesses and not-for-profit organisations access to HiBIS/BC Stage 1 • DCITA providing only partial incentives to providers for pre-existing customers in recognition that the cost of providing HiBIS/BC Stage 1 services to them are lower than for other customers^b
Eligible premises	<ul style="list-style-type: none"> • DCITA not allowing premises in pre-existing coverage areas (unless technically impaired) access to HiBIS/BC Stage 1^c • DCITA not allowing premises already receiving a metro-comparable service access to HiBIS/BC Stage 1 • DCITA taking into account support received by providers from other Government programs to supply broadband services to customers • DCITA having a two-tiered incentive payment structure, with the determining factor (customers' access to ISDN) being a proxy for the areas that might reasonably be serviced by lower cost terrestrial solutions or higher cost satellite solutions^d

Source: HiBIS/BC Stage 1 program guidelines and ANAO analysis

a – Threshold Services are the services that meet the minimum requirements under the programs.

b – Pre-existing customers are those customers already receiving a metro-comparable service, but not at metro-comparable prices.

c – Pre-existing coverage areas are areas that already had access to a metro-comparable service at the start of HiBIS.

d – Integrated Services Digital Network (ISDN) is usually available to premises within an average of six kilometres from ISDN-enabled telephone exchanges. Terrestrial broadband services are all broadband services except for satellite services.

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