



NBN Co Special Access Undertaking

Long Term Revenue Constraint Methodology 2019-2020: Draft Determination

and

Price compliance reporting 2019-2020

27 April 2021

Table of Contents

List of abbreviations and acronyms	3
Executive Summary	4
1. Introduction	5
1.1. Background.....	5
1.2. The recent evolution of NBN Co's operating environment and ACCC regulation.....	5
1.3. Submissions to preliminary view	6
1.4. Issues raised in prior LTRCM processes.....	6
1.5. Consultation.....	6
1.6. Structure of report.....	7
2. NBN Co's 2019-2020 regulatory information	8
3. Assessment of expenditure compliance and reporting.....	10
3.1. SAU requirements.....	10
Expenditure Compliance	10
Procurement Rules.....	10
3.2. NBN Co's LTRCM submission	11
Expenditure compliance report.....	11
Independent assurance reports.....	11
Procurement rules compliance report	12
3.3. ACCC draft position	12
3.3.1. Expenditure compliance report and supporting materials.....	12
3.3.2. Relevant prudency conditions	13
3.3.3. Procurement rules compliance.....	13
4. Assessment of LTRCM financial information	15
4.1. SAU requirements.....	15
Forecast financial information.....	15
Actual financial information.....	15
Proposed financial information	15
4.2. NBN Co's LTRCM submission	16
Basis of preparation	16

Actual and proposed financial information	16
Independent assurance reports	17
4.3. ACCC draft position	17
Financial information reporting	17
Regulatory asset base components.....	18
Annual building block revenue requirement components.....	19
Initial cost recovery account components	20
5. Assessment of price compliance	22
5.1. SAU requirements.....	22
5.2. NBN Co's LTRCM submission	22
5.3. ACCC draft position	23
6. The ACCC's LTRCM draft determination	25

List of abbreviations and acronyms

ABBRR	Annual Building Block Revenue Requirement
ACCC	Australian Competition and Consumer Commission
ACIPA	Annual Construction in Progress Allowance
ASA	Auditing Standard of Australia
ASAE	Australian Standard on Assurance Engagement
CFO	Chief Financial Officer
CIF	Cumulative Inflation Factor
CPI	Consumer Price Index
EGM	Executive General Manager
FTTB/N	Fibre to the basement/node
HFC	Hybrid Fibre Coaxial
ICRA	Initial Cost Recovery Account
LTRCM	Long Term Revenue Constraint Methodology
MRP	Maximum Regulated Price
NBN	National Broadband Network
NBN Co	NBN Co Limited
RAAM	Regulatory Accounting and Allocation Manual
RAB	Regulatory Asset Base
SAU	Special Access Undertaking
WBA	Wholesale Broadband Agreement

Executive Summary

In accordance with section 1E.1.2 of NBN Co's special access undertaking (the SAU), the ACCC has made a draft determination in relation to NBN Co's long term revenue constraint methodology (LTRCM) for the 2019-20 financial year.

The ACCC's draft determination is to accept without modification NBN Co's proposed values (and the inputs to those values) for the Allowable Building Block Revenue Requirement (ABBRR), Regulated Asset Base (RAB), and the Initial Cost Recovery Account (ICRA) in accordance with clause 1E.1.2 of NBN Co's SAU. The reasons for accepting the proposed values are set out in sections 3 and 4 of this report.

The ACCC is also satisfied that NBN Co's prices for 2019-20 did not exceed the maximum regulated prices, in accordance with Schedule 1C of the SAU. The reasons for this decision are outlined in section 5 of this report.

The LTRCM is a component of the SAU, which forms part of the regulatory framework for access to the National Broadband Network (NBN). The ACCC uses the LTRCM methodology to determine the amount of revenue NBN Co is allowed to earn through its prices over the term of the SAU. It provides NBN Co with the opportunity to recover its prudent and efficient costs of supply, including an appropriate return on investment. It is also one of various incentives in the SAU to encourage NBN Co to operate and invest prudently and efficiently, according to the prudent cost and prudent design conditions in the SAU.

Under Schedule 1F of the SAU, NBN Co must submit certain regulatory information to the ACCC each financial year, including financial information and reports certifying its expenditure compliance, procurement rules compliance, and price compliance. NBN Co submitted this regulatory information for 2019-20 to the ACCC on 30 October 2020.

In making an LTRCM determination, the ACCC must determine the following values (and the inputs to these values):

- Annual Building Block Revenue Requirement (ABBRR) – the amount of revenue NBN Co is allowed to earn for each financial year
- Regulatory Asset Base (RAB) – the net value of NBN Co's regulated assets
- Initial Cost Recovery Account (ICRA) – the account for accumulating and rolling forward NBN Co's initial unrecovered costs.

This is based on an assessment of NBN Co's compliance with the prudency conditions and methods for calculating LTRCM values specified in the SAU.

This draft determination follows the ACCC's preliminary view on capital and operating expenditure for the LTRCM determination for 2019-20, which was published in December 2020. The ACCC did not receive any submissions in response to its preliminary view. The ACCC now invites submissions on the draft decision until 25 May 2021.

1. Introduction

1.1. Background

In module 1 of the SAU, the ACCC must publish a draft determination and final determination of NBN Co's regulatory asset base, allowable building block revenue requirement, and initial cost recovery account. Together, these three figures determine the long-term revenue restrictions placed on NBN Co.

NBN Co's SAU is a key component of the framework for regulating access to the NBN. The SAU establishes the LTRCM, which determines NBN Co's allowed annual regulated revenue and the value of its RAB, including all inputs required to calculate these values.¹ The SAU specifies detailed rules on how each of the inputs are to be calculated or determined, including prudence conditions that must be satisfied for expenditure.

The LTRCM also allows NBN Co to roll forward any initial unrecovered costs to enable cost recovery later in the SAU period through the initial cost recovery account. The LTRCM process provides NBN Co the opportunity to recover only its prudent and efficient costs, including an appropriate return on investment, over the term of the SAU. Prudent costs are determined through the prudent cost and design condition, outlined in the SAU.

The SAU requires NBN Co to submit regulatory information to the ACCC each financial year as part of the LTRCM process. NBN Co's submission must include the financial information necessary to determine its allowed revenue. NBN Co must also certify that its prices have not exceeded the maximum regulated prices dictated by the SAU during the relevant financial year. The ACCC must then make a LTRCM determination within 12 months of the end of the relevant financial year.

1.2. The recent evolution of NBN Co's operating environment and ACCC regulation

We have previously acknowledged that NBN Co has formally completed the NBN rollout. This means that NBN Co will transition to a business-as-usual phase and divert more capital expenditure towards upgrades to the existing network, rather than building the network.

To consider these changes to NBN Co's operating environment and to ensure the LTRCM assessment process remains relevant and fit for purpose, we highlighted a number of issues in our 2019-20 preliminary view and in the 2018-19 LTRCM process that we would consider in the current and future LTRCM processes. These issues included ACCC oversight of NBN Co expenditure following the rollout, transparency of costs and revenues of individual services, and price control compliance.

Although the LTRCM is an important annual process in the regulation of NBN Co, the ACCC recognises that the continued impact of COVID-19 pandemic has influenced the regulatory environment. This is why the ACCC has decided not to pursue changes to the current LTRCM process as part of this year's determination.

The ACCC acknowledges that NBN Co is likely to consider a variation to the SAU to incorporate the multi-technology mix services. This is consistent with the approach outlined in the Minister's Statement of Expectations issued to the ACCC. Additionally, the ACCC is

¹ See section 2 of the 2017-18 LTRCM draft determination for a detailed explanation of the LTRCM process.

considering an assessment of the broader SAU framework, now that NBN Co is no longer in a build phase and is more similar to a typical steady-state infrastructure provider.

We consider that it is important that the LTRCM and other related processes should continue to evolve to ensure ACCC oversight of NBN Co's expenditure and revenues, together with appropriate transparency and compliance measures. This will ensure that the process remains fit for purpose in light of NBN Co's changing operating environment.

1.3. Submissions to preliminary view

On 21 December 2020, the ACCC notified NBN Co of its preliminary view in relation to the capital and operating expenditure amounts proposed by NBN Co in its 2019-20 LTRCM proposal under clause 1E.1.2(c)(vii) of the SAU. The ACCC's preliminary view was that NBN Co's expenditure satisfied the prudency conditions in the SAU, and that it did not intend to determine a substitute amount of capital expenditure in accordance with clause 1D.3.2(d) of the SAU or a substitute amount of operating expenditure in accordance with clause 1E.8.2(c) of the SAU. The ACCC did not receive any submissions in response to its preliminary view.

1.4. Issues raised in prior LTRCM processes

In previous LTRCM processes, some stakeholders have raised broader concerns about NBN Co's regulatory environment and pricing structure. These include concerns that the regulatory regime had not led to efficient price outcomes; transparency concerns; NBN Co's use of discounts under the SAU; the potential for cross-subsidisation in NBN Co's contestable areas and the calculation of the WACC in the SAU.

While these matters do not fall directly within the LTRCM process, we recognise that the matters are important. As such, we consider that these matters should form part of a broader consideration of the NBN regulatory framework to ensure that it continues to operate in the long-term interests of end-users.

1.5. Consultation

We are seeking stakeholder views on this draft determination and will consider submissions before releasing our final LTRCM determination for 2019-20 by 30 June 2021.

The ACCC encourages industry participants and other interested parties to make submissions to this draft determination, including providing reasons to support their views. The ACCC will also be conducting a separate engagement process in the near future, where submissions relating to the broader NBN regulatory framework may be better considered.

To foster an informed and consultative process, all submissions will be considered by the ACCC as public submissions and will be posted on the ACCC's website. Interested parties wishing to submit commercial-in-confidence material to the ACCC should submit both a public and a commercial-in-confidence version of their submission. The confidential version of the submission should clearly identify the commercial-in-confidence material by bookending the confidential material with an appropriate symbol of 'c-i-c'. The public version should ensure that all confidential material has been removed and replaced with 'c-i-c'.

Further information on the process parties should follow when submitting confidential information to the ACCC is available in the ACCC/AER Information Policy, which outlines the ACCC's general policy on the collection, use and disclosure of information.

The ACCC prefers to receive submissions in electronic form, in either PDF or Microsoft Word format, which allows the submission text to be searched. Submitters should ensure that redacted information is not searchable or otherwise able to be disclosed.

Please email submissions by 5pm on Tuesday 25 May 2021 to nbn@acc.gov.au and copy to:

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1.6. Structure of report

This report outlines the ACCC's LTRCM draft determination for the 2019-20 financial year and the ACCC's decision on NBN Co's price compliance. The structure of the report is as follows:

- Section 2 sets out NBN Co's submission on regulatory information.
- Section 3 sets out the ACCC's draft assessment of NBN Co's expenditure compliance and reporting.
- Section 4 sets out the ACCC's draft assessment of NBN Co's financial information.
- Section 5 sets out the ACCC's draft assessment of NBN Co's price compliance.
- Section 6 sets out the ACCC's draft determination for the 2019-20 financial year.

2. NBN Co's 2019-2020 regulatory information

On 30 October 2020, NBN Co submitted its regulatory information to the ACCC as required under Schedule 1F of the SAU. The submission consisted of:

- NBN Co's actual financial information – based on NBN Co's reported statutory accounts, which are consistent with the definitions in the SAU
- NBN Co's proposed financial information – NBN Co's proposed values (and relevant inputs to those values) for the ABBRR, RAB and ICRA
- an expenditure compliance report signed by NBN Co's CFO certifying that NBN Co's expenditure complies with the SAU requirements
- a procurement compliance report signed by NBN Co's Acting Executive General Manager (EGM) Procurement, certifying that NBN Co's procurement rules comply with the SAU requirements²
- a price compliance report signed by NBN Co's CFO, certifying that NBN Co's prices comply with the requirements of the SAU

To support its submission, NBN Co also lodged three independent assurance reports from PricewaterhouseCoopers (PwC), a price compliance spreadsheet, a LTRCM spreadsheet and a copy of its chart of accounts. The public versions of NBN Co's regulatory information is available on the ACCC website.³

Table 2.1 provides a summary of the key headline figures based on the financial information submitted by NBN Co as part of its regulatory information, and compares these accounts against the previous financial year to illustrate the percentage change.

Table 2.1: Summary of NBN Co's financial information, 2018-19 and 2019-20 (nominal)⁴

	2018-19 (\$m)	2019-20 (\$m)	Percentage change
Operating expenditure	4 454	5 213	17.03%
Capital expenditure	5 767	6 669	15.65%
Construction in progress (start of period)	3 183	3 310	3.98%
Interest expense	352	649	84.64%
Revenue	2 825	3 837	35.83%
Unrecovered costs	4 847	5 333	10.05%

² The role of Chief Procurement Officer for the purposes of this Procurement Rules Compliance Report is currently fulfilled by NBN Co's Executive General Manager Procurement (name removed), as the current equivalent of the Chief Procurement Officer role. As stated in NBN Co's submission – Actual and Proposed Financial Information, p. 16.

³ ACCC, NBN Co – Special Access Undertaking, NBN Co's regulatory information. see <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2019-20>

⁴ Note: These figures have been rounded to whole numbers.

RAB (end of period)	23 331	27 346	17.21%
ABBRR	7 672	9 171	19.54%
ICRA (end of period)	25 459	32 039	25.85%

Source: NBN Co, LTRCM spreadsheet 2019-20

3. Assessment of expenditure compliance and reporting

3.1. SAU requirements

Expenditure Compliance

As part of its submission of regulatory information to the ACCC, NBN Co must submit a report signed by its CFO (or an authorised delegate) that certifies that:

- capital expenditure proposed for inclusion in the RAB was incurred in accordance with the prudent cost condition and the prudent design condition, and
- operating expenditure proposed for inclusion in the ABBRR was incurred in accordance with the relevant SAU provisions.

If NBN Co's CFO (or delegate) is not satisfied that NBN Co's capital expenditure or operating expenditure fulfil these requirements, then the CFO (or delegate) must identify in a report to the ACCC the nature and extent of the non-compliance, and offer a substitute amount of capital expenditure or operating expenditure for consideration by the ACCC.

Procurement Rules

NBN Co must develop and maintain procurement rules that contain a competitive tendering and procurement process, and that meets the requirements set out in clause 1D.5.1 of the SAU. The SAU requires that:

- the procurement process seeks to generate an efficient and competitive outcome between tender participants
- there is a clear process for the calling, conducting, assessment and awarding of tenders, which meet reasonable requirements of procedural fairness and good industry practice
- any decision to approve a tender that is not the lowest price tender to be appropriately justified and documented
- the basis for the undertaking of works and services be in accordance with good industry practice, with the basis of payment for works and services clearly specified, and
- there be a process for managing contracts both before and after the award of tenders, which are in accord with good industry practice. This procurement process will seek to achieve value for money.

NBN Co must also provide the ACCC with a copy of the procurement rules within 30 days of making any material amendments to the rules.

As part of its submission of regulatory information to the ACCC, NBN Co must include a procurement rules compliance report signed by its EGM Procurement. This report must certify that NBN Co's procurement rules satisfy the SAU requirements for the relevant financial year.

3.2. NBN Co's LTRCM submission

Expenditure compliance report

NBN Co has submitted an expenditure compliance report signed by its CFO which certifies that NBN Co's capital expenditure and operating expenditure meets the relevant prudency conditions set out in the SAU.

NBN Co has not reported any exceptions in relation to its capital expenditure and operating expenditure and has proposed that all capital expenditure and operating expenditure incurred over the 2019-20 financial year be included in the RAB and ABBRR respectively. The expenditure compliance report uses qualifying language to provide negative assurance conclusions to indicate that nothing has come to the author's attention that caused them to believe that the assurance requirements were not met.⁵

NBN Co's CFO engaged the internal audit function to review, document and test the underlying end-to-end business processes and the effectiveness of controls relating to capital expenditure, operating expenditure prudency to satisfy the prudent design condition and the prudent cost condition and the equivalent conditions for operating expenditure. This included:

- performing process walkthroughs with relevant staff
- confirming end-to-end process maps
- identifying relevant control objectives and control procedures, and
- testing of control design and effectiveness.⁶

NBN Co's internal audit work was based on the Australian Standard on Assurance Engagements (ASAE) 3150: Assurance Engagements on Controls (January 2016), which provides guidance for identifying the nature of the procedures which are conducted at a minimum in a limited assurance engagement and the additional procedures that are conducted in a reasonable assurance engagement.⁷

Independent assurance reports

NBN Co engaged PwC to perform an independent limited assurance review in relation to the design of controls applicable to capital expenditure and operating expenditure prudency. PwC's limited assurance opinion complements the certification from NBN Co's CFO.

NBN Co submitted that the expenditure compliance report, taken together with the PwC limited assurance report, provides an appropriate basis for the ACCC to be satisfied that all capital expenditure and operating expenditure incurred by NBN Co over the relevant period

⁵ Negative assurance is a technique commonly used by auditors to provide a representation that particular facts are believed to be accurate since no conflicting/contrary evidence has been found. NBN Co has had regard to Australian Standard on Assurance Engagement (ASAE) 3150 "Assurance Engagements on Controls" in developing the qualifying language in the certification. Further, NBN Co has submitted that PwC's independent assurance report audit has been conducted under (ASAE) 3150. See NBN Co, 2019-20 Regulatory information - Supporting submission, p.15.

⁶ NBN Co, NBN supporting submission to the ACCC – 2019-20 Regulatory Information and LTRCM Determination, p. 12. See <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2019-20>

⁷ NBN Co, NBN supporting submission to the ACCC – 2019-20 Regulatory Information and LTRCM Determination, p.12.

meets the relevant prudency conditions and should be included in the RAB and ABBRR, respectively.⁸

Procurement rules compliance report

NBN Co has submitted a procurement rules compliance report signed by its EGM Procurement which certifies that procurement rules met the relevant conditions as set out in the SAU over the course of the 2019-20 financial year. NBN Co has not reported any exceptions in relation to this report.⁹

NBN Co submitted that the certification is subject to appropriate qualifying language to make clear the basis on which the certification is provided and expresses negative assurance conclusions.¹⁰ This is the same certification and wording as used in previous years.

3.3. ACCC draft position

The ACCC has assessed NBN Co's expenditure compliance by considering the expenditure compliance report signed by NBN Co's CFO, the PwC limited assurance reports and NBN Co's supporting submission.

The ACCC has reached the draft position that the information provided by NBN Co demonstrates that it has the processes and controls in place to ensure that its expenditure is in accordance with the prudency conditions set out in the SAU. The reasons for this view are set out below.

3.3.1. Expenditure compliance report and supporting materials

The expenditure compliance report did not identify any exceptions during the 2019-20 financial year, though it did use some qualifying language in expressing its negative assurance conclusion.¹¹ Therefore, the ACCC considered a number of other supporting materials in determining the extent to which the certification is reliable. This included consideration of the:

- adequacy of NBN Co's procurement rules
- processes and controls in place supporting compliance with the prudency conditions in the SAU, and
- effectiveness of the processes and controls.

The SAU also requires NBN Co to provide a copy of its procurement rules to the ACCC within 30 days after the SAU commencement date and within 30 days after NBN Co makes any material amendments to the procurement rules.¹²

⁸ NBN Co, NBN supporting submission to the ACCC – 2019-20 Regulatory Information and LTRCM Determination, p.15.

⁹ NBN Co, NBN supporting submission to the ACCC – 2019-20 Regulatory Information and LTRCM Determination, p.16.

¹⁰ NBN Co, NBN supporting submission to the ACCC – 2019-20 Regulatory Information and LTRCM Determination, p.16. See also footnote 5 for a detailed explanation of NBN Co's use of qualifying language and negative assurance.

¹¹ See footnote 5 for a detailed explanation of NBN Co's use of qualifying language and negative assurance.

¹² Clause 1D.5.2 of the SAU.

The ACCC has reviewed NBN Co's procurement rules and verified that they comply with the relevant provisions of the SAU. We have also considered NBN Co's procurement rules compliance report to determine the appropriateness of NBN Co's procurement rules.

To determine whether there are processes and controls in place to encourage compliance with the prudency conditions in the SAU, the ACCC has considered PwC's assurance report regarding the design of controls applicable to capital expenditure and operating expenditure. We note that PwC tested whether NBN Co has adequate controls in place to ensure that capital expenditure and operating expenditure is incurred in accordance with the prudent design and prudent cost conditions.

3.3.2. Relevant prudency conditions

In assessing whether NBN Co has complied with these processes and procedures, the ACCC has considered the additional information provided by NBN Co in its supporting submission regarding its internal work.

NBN Co has completed an internal audit at the request of the CFO to review, document and test underlying business processes along with the design and operating effectiveness of controls relating to capital expenditure and operating expenditure prudency to satisfy prudent design condition and capital expenditure prudent cost condition (and the equivalent for operating expenditure).¹³

NBN Co conducted control testing in cases where a key control was determined to be adequately designed with samples selected based on generally accepted internal audit sampling criteria. The internal audit staff set sample sizes based on how frequently the control operates (that is, how many times per day, month or year it operates), with reference to relevant assurance standards and guidelines.

NBN Co tested 236 samples to confirm the operating effectiveness of the Prudent Design and Prudent Cost controls for the 2019-20 financial year and the sampling methodology was consistent with the approach taken in the previous financial year. For each control procedure, the internal audit staff identified, recorded and reviewed relevant supporting documents for applicability and appropriate authorisation. Supporting documents included procurement records, contracts, purchase orders and network design components.

NBN Co's internal audit staff did not find any exceptions regarding expenditure compliance. However, NBN Co noted that any such investigation and testing is subject to limitations and there is an unavoidable risk that it may not detect some deficiencies regardless of how thoroughly it conducts its internal audit work.

The ACCC has considered the details in NBN Co's supporting submission as well as the PwC assurance reports that provide a further independent check of NBN Co's relevant processes and controls. On balance, the ACCC is of the view that NBN Co's expenditure complies with the relevant prudency conditions set out in the SAU.

3.3.3. Procurement rules compliance

The ACCC considers that NBN Co has provided a procurement rules compliance report that satisfies the requirements of the SAU. NBN Co submitted that there is no reported exception in relation to this report, which relates to whether, over the period from 1 July 2019 to 30 June 2020, NBN's Procurement Rules satisfied the requirements in clause 1D.5.1 of the

¹³ See NBN Co's 2019-20 LTRCM supporting submission, pp. 12-15 for more detail on its internal audit processes. A high-level summary of NBN Co's internal audit process is provided in the 'Processes and controls operating effectively' section of the paper.

SAU.¹⁴ The report did however include some qualifying language in expressing negative assurance conclusions.¹⁵

NBN Co last updated its procurement rules for the period 23 February 2018 to 30 June 2018. The procurement rules were updated in Purchasing Rules v1.3, which included a documentation and approval process for unusual (and currently unforeseen) circumstances where it may be appropriate to apply the purchasing rules with some specific variations.¹⁶

The ACCC is satisfied with NBN Co's procurement compliance for the purposes of the LTRCM determination.

¹⁴ NBN Co, Submission of Regulatory information 2019-20, p. 16.

¹⁵ See footnote 5 for a detailed explanation of NBN Co's use of qualifying language and negative assurance.

¹⁶ ACCC, 2017-18 LTRCM draft determination, p. 18.

4. Assessment of LTRCM financial information

4.1. SAU requirements

NBN Co is required to submit forecasts of certain information (Forecast Financial Information) by no later than 30 June prior to the commencement of each financial year during the initial regulatory period. This financial information must include forecasts of capital expenditure by asset type, operating expenditure, disposals by asset type and the opening and closing value of construction in progress.¹⁷

Forecast financial information

On 28 June 2019, NBN Co submitted its forecast financial information for the 2019-20 financial year. This submission consisted of:

- Schedule 4 – Forecast Statement of Capital Expenditure, Disposals and Construction in Progress
- Schedule 5 – Forecast Statement of Operating Expenditure

NBN Co's forecast financial information is confidential.

Actual financial information

By 31 October after the end of each financial year of the initial regulatory period, NBN Co must provide to the ACCC a report that sets out actual financial information for the previous financial year. This includes the values of the June quarter CPI, capital expenditure, revenue, operating expenditure, disposals, interest expense, accounting and tax asset lifetimes, the risk free rate, and the nominal rate of return.¹⁸

NBN Co must also provide information that sets out any material variance between the forecast financial information and the actual financial information, including a justification for the variances.¹⁹

Proposed financial information

By 31 October after the end of each financial year of the initial regulatory period, NBN Co must also provide to the ACCC its proposed values for that financial year in respect to the:

- ABBRR, including the inputs to this value
- opening and closing values of the RAB and ICRA (nominal and real)
- opening and closing value of construction in progress, and
- unrecovered costs.

¹⁷ Clause 1F.1.2 of the SAU.

¹⁸ Clause 1F.1.3(a) of the SAU.

¹⁹ Clause 1F.1.3(b) of the SAU.

4.2. NBN Co's LTRCM submission

Basis of preparation

NBN Co maintains a Regulatory Accounting and Allocation Manual (RAAM), which provides NBN Co's staff with detailed instructions on the principles, guidelines and templates to use when preparing the LTRCM reports. The RAAM also explains the cases where NBN Co will apply an alternate accounting treatment (that is, where it will report in a way that is not consistent with Australian Accounting Standards in order to meet SAU requirements). NBN Co updates the RAAM annually.

These minor updates to the RAAM are considered as an 'alternate accounting treatment' or 'AAT'. For this financial year, there was a minor amendment to an AAT adopted for right of use assets and lease liabilities under lease arrangements. NBN Co, acting in accordance with AASB Standard 16, is inconsistent with the LTRCM.²⁰ Consequentially, the SAU forecast financial information submitted by NBN Co removes the interest expense for lease assets.²¹

AAT's have been adopted for categories such as: right of use assets under lease arrangements; migration fees; assets received for zero consideration and government grants; construction in progress; inventory; and provisions.

NBN Co's 2019-20 LTRCM submission included a copy of its Chart of Accounts, with notes showing how the accounts are aligned to the RAAM. NBN Co's regulatory information includes a statement by NBN Co's CFO declaring that:

- the RAAM has been appropriately updated by NBN Co to reflect changes in NBN Co's business or structure and to meet the financial reporting requirements of the SAU.
- Schedules 6 to 9 have been prepared in accordance with the principles of the RAAM and have been reconciled with the audited general-purpose financial statements.
- Schedule 10 has been prepared in accordance with the reporting requirements of the SAU.²²

Actual and proposed financial information

As part of its submission of regulatory information, NBN Co has provided the ACCC with its actual and proposed financial information for the 2019-20 financial year. This information included:

- Schedule 6 – statement of capital expenditure, disposals, construction in progress, asset lifetimes and taxation asset lifetimes
- Schedule 7 – statement of operating expenditure
- Schedule 8 – statement of interest expense

²⁰ The AASB 16 Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity. AASB 16 began operation 1 June 2020. Available here: https://www.aasb.gov.au/admin/file/content105/c9/AASB16_02-16_COMPjun20_06-20.pdf

²¹ NBN Co, SAU Forecast Financial Information 2019-20, p. 3. Available at ACCC website: <https://www.accc.gov.au/system/files/NBN%20Co%20-%20SAU%20-%202019-20%20Regulatory%20Information%20-%20Actual%20and%20Proposed%20Financial%20Information.pdf>

²² NBN Co, Submission of regulatory information 2019-20, p. 9.

- Schedule 9 – statement of revenue
- Schedule 10 – statement of LTRCM and RAB items, and
- Schedule 11 – statement of material operating expenditure, capital expenditure and construction in progress variances.

NBN Co also submitted a spreadsheet that sets out the calculations for the proposed values of the ABBRR, RAB and ICRA. Public versions of this information are available on the ACCC website.²³

Independent assurance reports

NBN Co has also provided three independent assurance reports from PwC to support its actual and proposed financial information. These included:

- a reasonable assurance audit report for Schedules 6-9 – PwC’s audit opinion for this work was unqualified and complements the audit of NBN Co’s general purpose financial statements.
- factual findings of agreed upon procedures for Schedule 10 – the agreed upon procedures consisted of checking that the relevant input values were extracted correctly from Schedules 6-9 into the LTRCM spreadsheet and that the relevant LTRCM calculations were undertaken in accordance with the SAU to arrive at the output values in Schedule 10.
- a report providing limited assurance engagement on the design and implementation of controls around expenditure compliance.

4.3. ACCC draft position

Following consideration of the materials contained in NBN Co’s submission, the ACCC is satisfied that NBN Co has calculated its proposed values for the RAB, ABBRR and ICRA in accordance with the formulas set out in the SAU. Therefore, the ACCC’s draft decision is to accept the values proposed by NBN Co without amendment.

The reasons for the ACCC’s draft decision are explained further below.

Financial information reporting

In assessing whether NBN Co’s proposed LTRCM values have been calculated in accordance with the SAU, the ACCC has considered: NBN Co’s actual and proposed financial information; NBN Co’s LTRCM spreadsheet which sets out the calculations used by NBN Co to determine its proposed values for the RAB, ABBRR and ICRA; and the reasonable assurance reports from PwC in regards to this financial information.

Assurance

The declaration provided by NBN Co’s CFO and the independent audit reports prepared by PwC also provide the ACCC with assurance that the financial information has been prepared in accordance with the relevant provisions of the SAU.

²³ ACCC, NBN Co – Special Access Undertaking, NBN Co’s regulatory information. Available at ACCC website: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2019-20>

The reasonable assurance audit of the actual financial information provides the ACCC with assurance that NBN Co has prepared the LTRCM financial information in Schedules 6-9 in accordance with the RAAM. PwC's unqualified audit opinion complements the existing auditing of NBN Co's general purpose financial statements. We consider that the PwC report provides independent verification that NBN Co's financial statements have been accurately adjusted in accordance with the alternate accounting treatments specified in the RAAM.

The agreed upon procedures performed by PwC with respect to the LTRCM and RAB information provide the ACCC with some additional comfort that NBN Co's statement of LTRCM and RAB items includes information that has been extracted and calculated correctly.

Statement of material variances

NBN Co's submission of regulatory information included a statement of material variances (Schedule 11)²⁴ which sets out the variances between forecast and actual financial information, and the reasons for these variances.²⁵ The statement helps the ACCC to understand the reasons for any significant differences between forecast and actual expenditure.

The ACCC has reviewed the statement of material variances and is satisfied that it does not raise any significant concerns regarding the variances between NBN Co's forecast and their actual capital and operating expenditure.

Regulatory asset base components

The RAB represents the value of previous capital investment made by NBN Co at a particular point in time and is calculated by rolling forward the balance from the previous financial year, then adding capital expenditure less disposals and regulatory depreciation during the financial year.²⁶

The ACCC has checked NBN Co's RAB calculation and is satisfied that it complies with the relevant SAU provisions. The RAB components are set out in Table 4.1 below.

Table 4.1 RAB Calculation, 2019-20 (real)²⁷

	2019-20 (\$'000)
RAB opening (real)	21 521 935
Add real capital expenditure	6 173 630
Less real disposal	-
Less real straight line depreciation	(2 381 623)
RAB closing (real)	25 313 941
Cumulative inflation factor	1.080%
RAB closing (nominal)	27 345 750

²⁴ In accordance with clause 1F.1.3(b) of the SAU.

²⁵ The statement of material variances has been classified as 'confidential of particular sensitivity'.

²⁶ In accordance with clause 1D.2.1 of the SAU.

²⁷ These figures have been rounded to whole numbers.

Capital expenditure

As noted in sections above, the ACCC is satisfied that the information provided by NBN Co is reasonable for demonstrating that it has processes and controls in place to ensure that the capital expenditure used in its RAB calculations is in accordance with the prudence conditions set out in the SAU.

Disposals

There were no disposals during the 2019-20 financial year.

Depreciation

The method of depreciation used in the calculation of the value of the RAB is straight-line depreciation,²⁸ using asset lives that are consistent with NBN Co's audited accounts. The ACCC has verified that NBN Co has applied the correct formula for depreciation in its LTRCM spreadsheet, and is satisfied that it is consistent with the requirements of the SAU.

Cumulative Inflation Factor

The cumulative inflation factor (CIF) is an index used for converting values from real to nominal and vice versa. The CIF is equivalent to the cumulative product of the percentage change in June quarter CPI published for each financial year from the commencement of the SAU.²⁹ The ACCC is satisfied that NBN Co has calculated and applied the CIF correctly.

Annual building block revenue requirement components

The ABBRR represents the amount of revenue that NBN Co would be required to earn to recover its costs (including a return on its previous capital investments) in a particular year. It consists of the sum of NBN Co's return on previous capital investment, regulatory depreciation, operating expenditure, net tax allowance, and the annual construction in progress allowance.

The ACCC has checked the calculations in the LTRCM spreadsheet and is satisfied that the formulas used meet the requirements of Schedule 1E of the SAU. The ABBRR components are set out in Table 4.2.

Table 4.2: ABBRR calculation, 2019-20 (nominal)³⁰

	2019-20 (\$'000)
Return on capital	1 142 064
Add regulatory depreciation	2 654 074
Add operating expenditure	5 212 619
Add net tax allowance	-
Add annual construction in progress allowance	162 012
ABBRR	9 170 768

²⁸ Consistent with clause 1E.9.1 of the SAU.

²⁹ See clause 1E.9.4(b) of the SAU.

³⁰ These figures have been rounded to whole numbers.

Return on capital

The SAU allows NBN Co to earn an appropriate commercial return on its investment in assets used to supply the services that are the subject of the SAU. The return on capital is equal to the opening RAB value multiplied by the cost of capital. The cost of capital is equal to the risk free rate with a 350 basis point premium.

The ACCC has checked NBN Co's calculation of the risk free rate and cost of capital, and is satisfied that these figures were calculated in accordance with clause 1E.7.1 of the SAU. Therefore, we are satisfied with NBN Co's proposed value for return on capital.

Regulatory depreciation

Clause 1E.9.1(c) of the SAU specifies that the nominal regulatory depreciation is the difference between the nominal straight-line depreciation and the change in value of the nominal RAB due to inflation. It is calculated as the straight-line depreciation component of the opening RAB less the CPI indexation of the opening RAB value for the current year.

We have reviewed the formulas used by NBN Co to calculate regulatory depreciation and we are satisfied that they comply with clause 1E.9.1 of the SAU.

Operating expenditure

Consistent with the ACCC's assessment of operating expenditure compliance, we are satisfied that the information provided by NBN Co demonstrates that it has processes and controls in place to ensure that it has processes and controls in place to ensure that its operating expenditure in its ABBRR calculations is in accordance with the prudency conditions set out in the SAU.

Net tax allowance

Net tax allowance is not applicable for the 2019-20 financial year as NBN Co is currently in a loss-making position.

Annual construction in progress allowance

The SAU provides the annual construction in progress allowance (ACIPA) to account for the financing costs associated with capital expenditure relating to assets that are not yet in service. The ACIPA is calculated by multiplying the value of construction in progress for the year by the cost of capital.³¹

The value of construction in progress is determined in accordance with NBN Co's audited accounts, but with an alternate accounting treatment applied. For the purposes of the LTRCM, construction in progress is reported as an aggregate value at the start and end of each financial year rather than being allocated to various items of property, plant and equipment. This approach is consistent with NBN Co's RAAM.

The ACCC is satisfied that NBN Co's proposed value for ACIPA has been calculated in accordance with clause 1E.10.1 of the SAU.

Initial cost recovery account components

The value of the ICRA is determined by calculating the difference between the ABBRR and the amount of revenue realised by NBN Co through access prices over the course of the

³¹ See clause 1E.10.1 of the SAU.

financial year. This unrecovered cost amount is added to the ICRA balance from the previous year, which is capitalised and carried forward.³²

We have checked NBN Co's ICRA calculations and we are satisfied that they comply with the relevant SAU provisions. The ICRA components are set out below.

Table 4.3: Unrecovered cost calculation, 2019-20 (nominal)³³

	2019-20 (\$'000)
ABBRR	9 170 768
<i>Less revenue</i>	<i>(3 836 984)</i>
Unrecovered Cost	5 333 785

Revenue

NBN Co's proposed revenue is the same value included in NBN Co's audited general purpose financial statements, including an adjustment to remove interest income.³⁴

Table 4.4: ICRA calculation, 2019-20 (nominal)³⁵

	2019-20 (\$'000)
ICRA from previous period	25 458 678
<i>Add unrecovered cost</i>	<i>5 333 785</i>
<i>Add capitalisation of the ICRA from the previous period</i>	<i>1 246 232</i>
ICRA closing	32 038 694

Roll forward of ICRA

The closing ICRA balance is calculated by adding unrecovered cost to the capitalised ICRA balance from the previous period. The cost of capital rate is the same as that used to calculate the return on capital for the purposes of the ABBRR and ACIPA (discussed above).

The ACCC has checked NBN Co's calculation of the capitalised ICRA balance and is satisfied that the proposed closing balance has been calculated in accordance with the relevant provisions in Schedule 1E of the SAU.

³² See Clause 1E.5 of the SAU.

³³ These figures have been rounded to whole numbers.

³⁴ The ACCC considered the case for including interest income in detail in the 2013-14 Draft LTRCM Determination. See ACCC, LTRCM 2013-14 Draft Determination and Price Compliance Reporting 2013-14, February 2015, p.24. Our view remains that it is appropriate to exclude interest income from regulated revenue for the LTRCM determination.

³⁵ These figures have been rounded to whole numbers.

5. Assessment of price compliance

5.1. SAU requirements

NBN Co must submit a report signed by its CFO (or approved delegate) certifying that in respect of that financial year, prices for the supply of NBN Offer and or other charge did not exceed at any point during the period exceed the MRP's, and that prices complied with the requirements of Schedule 1C (NBN Offers and Other Charges).³⁶

NBN Co must also provide any other information that it considers is reasonably necessary for the ACCC to assess NBN Co's compliance with Schedule 1C of the SAU (NBN Offers and Other Charges).

The ACCC's assessment of NBN Co's price compliance relates strictly to the MRP as set out in section 1F.3 of the SAU.

5.2. NBN Co's LTRCM submission

NBN Co submitted its price compliance report and a price compliance spreadsheet as part of its regulatory information submission for the 2019-20 financial year.³⁷

The price compliance report provides certification from NBN Co's CFO that the pricing of NBN offers and other charges over the period from 1 July 2019 to 30 June 2020 satisfied the relevant requirements in Schedule 1C of the SAU. The report does not identify any exceptions although there is some qualifying language that expresses negative assurance conclusions, similar in nature to the expenditure compliance report and the procurement rules compliance report.³⁸

The certification provided by NBN Co's CFO was informed by a range of investigations and testing conducted by NBN Co, this included:³⁹

- Identification of the price lists that applied under WBA3 (in respect of fibre, long term satellite and fixed wireless), and the CSAS Interim Agreement (in respect of the Cell Site Access Service) over the relevant period;
- Checking of these price lists (and any changes made over the relevant period) for consistency with Schedule 1C of the SAU; and
- Work performed by NBN Co's Internal Audit over relevant processes and controls via process walkthroughs and detailed testing, consistent with previous years. NBN Co's Internal Audit reviewed, documented and tested the underlying end-to-end business processes and the design and operating effectiveness of controls relating to Price Compliance.

Consistent with the language used in the expenditure compliance report and the procurement rules compliance report, NBN Co has advised that any such investigation and

³⁶ See SAU Schedule 1C and 1F.3.

³⁷ ACCC website, <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2019-20>

³⁸ See footnote 5 for a detailed explanation of NBN Co's use of qualifying language and negative assurance.

³⁹ NBN Co, 2019-20 Regulatory Information - LTRCM Supporting Submission, p.17. Available at: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2019-20>

testing is subject to inherent limitations, and that there is an unavoidable risk that they may not detect some deficiencies.⁴⁰ NBN Co's price compliance spreadsheet sets out its analysis of its price compliance. The ACCC has published the public version of NBN Co's price compliance report and price compliance spreadsheet on its website.⁴¹

Throughout the 2019-20 financial year, NBN Co made a number of changes to its price list. The high-level changes relating to the WBA3 pricing include:⁴²

- The introduction of a recurring charge for the AVC TC-4 'Home Fast', 'Home Superfast' and 'Home Ultrafast' speed tiers over the relevant NBN Co Networks.
- The introduction of a recurring charge for the AVC TC-2 5 Mbps and the AVC TC-2 10 Mbps speed tiers over the NBN Co HFC Network.
- The introduction of a recurring charge for the 100GBaseLR4 and 100GBaseER4 NNI Bearer Profiles over the NBN Co Fibre Network, NBN Co FTTB Network, NBN Co FTTN Network, NBN Co FTTC Network, NBN Co HFC Network and the NBN Co Wireless Network.
- The introduction of a recurring charge for an 'Enhanced-4', 'Enhanced-4 (24-7)', 'Enhanced-6' and 'Enhanced-6 (24/7)' Enhanced Fault Rectification Services over the NBN Co HFC Network.
- The introduction of a non-recurring charge for an NNI 100GBaseLR4 and NNI 100GBaseER4 Activation over the NBN Co Fibre Network, NBN Co FTTB Network, NBN Co FTTN Network, NBN Co FTTC Network, NBN Co HFC Network and NBN Co Wireless Network. Along with the introduction of new recurring charges for some NNI Bearer Profiles offered over Enterprise Ethernet in conjunction with new non-recurring charges over Enterprise Ethernet.
- A reduction in the recurring charges for some operator virtual connection bandwidth profiles offered over Enterprise Ethernet and a reduction in the recurring charge for the UNI Zone 3 bandwidth profile offered over Enterprise Ethernet.

Consistent with the approach taken last year, NBN Co has not lodged an independent assurance report by PwC on the effectiveness of its control procedures to ensure price compliance. The ACCC agrees that there is limited (if any) utility in such work as NBN Co's price compliance is observable by access seekers throughout the financial year through the publication of changes to the price lists on NBN Co's website. The ACCC may seek additional assurance in future years if required.

5.3. ACCC draft position

Following consideration of NBN Co's price compliance report and supporting submission, the ACCC is satisfied that NBN Co's prices in 2019 – 20 did not exceed the MRPs set out in Schedule 1C of the SAU, and that NBN Co has met its price compliance obligations in the

⁴⁰ NBN Co, regulatory Information supporting submission, 2019-20, p.15. Available at ACCC website: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2019-20>

⁴¹ NBN Co Price Compliance Report and spreadsheet available at ACCC website: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2019-20>

⁴² NBN Co, regulatory information supporting submission, 2019-20, pp.17-18. Available at ACCC website: <https://www.accc.gov.au/system/files/NBN%20Co%20-%20SAU%20-%202019-20%20Regulatory%20Information%20-%20LTRCM%20Supporting%20Submission.pdf>

SAU. Further, we consider that most of NBN Co's services are currently supplied at prices well below the MRPs specified in the SAU, as well as those specified in the WBA3.

The ACCC is aware that the reason NBN Co's prices do not exceed the MRP's set out in Schedule 1C of the SAU is because of the use of bundles and discounts offered by NBN Co. This has been a point of concern conveyed to the ACCC by stakeholders in previous inquiries but will be considered through other avenues than the LTRCM process.

We note that the price compliance spreadsheet also contained prices for new products. These new products do not have prices specified in the SAU. NBN Co has the ability to determine prices for new products under the SAU. The ACCC has, however, the ability to initiate a price review to ensure that new prices are set in a manner that promotes competition and the efficient use of the network, if it considers that this would be appropriate.

6. The ACCC's LTRCM draft determination

For the reasons set out in this document, we have determined the values in Table 6.1 for the purposes of the 2019-20 LTRCM draft determination. We derived these values from NBN Co's submission of regulatory information.⁴³

The ACCC is required to consult on the LTRCM draft determination in respect of the ABBRR, RAB, ICRA and the values of the inputs to each of those values.⁴⁴

Table 6.1: 2019-20 LTRCM draft determination⁴⁵

Year	2019-20
CPI and Cumulative Inflation Factor	
June Quarter CPI (annual percentage change) – as per Attachment C to the SAU	-0.348%
Cumulative Inflation Factor – as per Clauses 1E.9.4(b) and (c)	1.080
Rate of Return – as per Clause 1E.7.1	
Risk free rate of interest – as per Clause 1E.7.1(b) and (c)	1.395%
Nominal rate of return – as per Clause 1E.7.1(a)	4.895%
Regulatory Asset Base (\$'000 REAL) – as per Clause 1D.2.1	
Real RAB (start period) – as per Clause 1D.2.1(a) and (b)	21 521 935
Real capital expenditure	6 173 630
Real disposals	-
Real straight line depreciation	2 381 623
Real RAB (end period) – as per Clause 1D.2.1(b)	25 313 941
Regulatory Asset Base (\$'000 NOMINAL) – as per Clause 1D.2.2	
Nominal RAB (start period) – as per Clauses 1D.2.1(a) and 1D.2.2	23,330,671
Nominal straight line depreciation (as per Clause 1E.9.1(b))	2 572 783
Nominal RAB (end period) – as per Clause 1D.2.2	27 345 750
ABBRR (\$'000 NOMINAL) – as per Clause 1E.4.1	
Return on capital	1 142 064
Nominal regulatory depreciation – as per clause 1E.9.1(c)	2 654 074
Nominal operating expenditure	5 212 619
Net tax allowance	-
Annual construction in progress allowance – as per Clause 1E.10	162 012

⁴³ In accordance with Clause 1E.1.2 (c)(vi) of the SAU.

⁴⁴ Clause 1E.1.2(a) of the SAU.

⁴⁵ The clause references in this table refer to the formulas in the SAU. Note: figures have been rounded to whole numbers.

ABBRR	9 170 768
Taxation calculations (\$'000 NOMINAL) – as per Clause 1E.9.3	
Nominal revenue	3 836 984
<i>Add</i> value of assets received for nil consideration	61 061
<i>Less</i> nominal operating expenditure	5 212 619
<i>Less</i> nominal tax depreciation	2 524 484
<i>Less</i> interest expense	649 327
Taxable profit – as per Clause 1E.9.3	(4 488 385)
Tax loss carried forward (Start period) – as per Clause 1E.9.3	(17 776 762)
Tax loss carried forward (End period) – as per Clause 1E.9.3	(22 265 147)
Net tax allowance – as per Clause 1E.9.3	-
ICRA (\$'000 NOMINAL) – as per Clause 1E.5	
ICRA (start period) – as per Clause 1E.5.2	25 458 678
Unrecovered cost – as per Clause 1E.5.1	5 333 785
ICRA (end period) – as per Clause 1E.5.2	32 038 694
Carry forward revenue adjustment – as per Clause 1E.5.3	n/a