



NBN Co Special Access Undertaking

Long Term Revenue Constraint Methodology
2019-20: Final Determination

and

Price compliance reporting 2019-20

25 June 2020

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List of abbreviations and acronyms

ABBRR	Annual Building Block Revenue Requirement
ACCC	Australian Competition and Consumer Commission
ASAE	Australian Standard on Assurance Engagement
CFO	Chief Financial Officer
CPI	Consumer Price Index
EGM	Executive General Manager
ICRA	Initial Cost Recovery Account
LTRCM	Long Term Revenue Constraint Methodology
MRP	Maximum Regulated Price
NBN	National Broadband Network
NBN Co	NBN Co Limited
RAB	Regulatory Asset Base
SAU	Special Access Undertaking

Executive Summary

The ACCC has completed its assessment of NBN Co's Long Term Revenue Constraint Methodology (LTRCM) determination and NBN Co's price compliance reporting for the 2019-20 year. We have determined to accept without modification NBN Co's proposed values for all elements of the LTRCM, including the:

- annual building block revenue requirement (ABBRR) – the amount of revenue NBN Co is allowed to earn in each financial year
- regulatory asset base (RAB) – the net value of NBN Co's regulated assets, and
- initial cost recovery account (ICRA) – an account for accumulating (and rolling forward) NBN Co's initial unrecovered costs.

The ACCC is also satisfied that NBN Co's prices for 2019-20 did not exceed the Maximum Regulated Prices (MRP's) during the relevant period. We are also satisfied that NBN Co has met the prudence conditions for expenditure as set out in the SAU.

The LTRCM is an important component of the framework for regulating access to the National Broadband Network. It operates with other components set out in the Special Access Undertaking to encourage NBN Co to operate and invest according to the prudent cost and prudent design conditions of the SAU.

The LTRCM determines NBN Co's annual regulated revenue, regulated asset base and the initial cost recovery account that allows NBN Co to recover unrecovered costs later in the SAU period. The objective of the LTRCM is to provide NBN Co with the opportunity to recover prudently incurred costs, including a return on investment, over the term of the SAU.

The ACCC has not received any submissions to the 2019-2020 LTRCM process, including in response to the draft determination. We note that the ACCC has commenced a process with NBN Co and industry to consider the broader regulatory arrangements for the NBN under the SAU. This process has started with the recent industry roundtable discussion. We will be considering the revenue control arrangements, including the LTRCM and approach to future expenditure, as part of that process. Broader framework issues raised by stakeholders during previous LTRCM assessments will also be considered.

1. Introduction

1.1. Purpose

NBN Co's Special Access Undertaking (SAU) specifies the overarching framework for regulating access to the National Broadband Network (NBN) until June 2040.

The SAU establishes the Long Term Revenue Constraint Methodology (LTRCM). The LTRCM is a methodology for determining NBN Co's annual regulated revenue, regulated asset base and the account for accumulating initial unrecovered costs that NBN Co can recover later in the SAU period. The LTRCM process gives NBN Co the opportunity to recover costs in accordance with conditions outlined in the SAU. The LTRCM is one of the various components of the SAU that combines with other elements of the SAU to regulate the national broadband network in the long-term interests of end-users.

The SAU requires NBN Co to submit certain 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 set in the SAU during the relevant financial year. The ACCC must make an LTRCM determination within 12 months of the end of the relevant financial year.

1.2. The LTRCM process under the SAU

The SAU establishes the LTRCM, which is a methodology used to determine NBN Co's annual regulated revenue, regulated asset base and the account for accumulating initial unrecovered costs that NBN Co can recover later in the SAU period. The LTRCM provides NBN Co with the opportunity (but not the certainty) to recover its costs of supply according to the prudence conditions in the SAU. This includes allowing for an appropriate return on investment.

As set out in the SAU, the ACCC is required to undertake a number of steps before making a LTRCM final determination for the relevant period. These include receiving NBN Co's submission of regulatory information, publishing a preliminary view on capital and operating expenditure, publishing a draft determination and finally publishing a final determination.

The LTRCM process for the relevant period commences once NBN Co has submitted certain regulatory information to the ACCC including financial information that is necessary to determine its allowed revenue. NBN Co must also certify that its prices have not exceeded the MRP dictated by the SAU at any point during the relevant financial year.

The ACCC's role in considering the LTRCM is to:

- assess whether NBN Co's capital expenditure and operating expenditure meet the relevant requirements in the SAU for inclusion in the RAB and ABBRR
- assess if the relevant LTRCM components have been calculated in accordance with the formulas set out in the SAU, and
- determine whether the expenditures (as set out in NBN Co's LTRCM proposal) should be included in the LTRCM determination.¹

¹ For more detail on each of these LTRCM assessment requirements see the 2017-18 LTRCM draft determination, pp. 8-9.

The ACCC may determine LTRCM values that differ from those submitted by NBN Co as long as the values are determined in accordance with schedule 1D and schedule 1E of the SAU.² The factors that the ACCC must consider when determining a substitute amount of capital expenditure or operating expenditure are set out in the SAU.³

1.3. The 2019-20 LTRCM and interaction with the review of NBN Co's regulatory framework

On 30 October 2020, NBN Co submitted its regulatory information for the 2019-20 financial year.

On 21 December 2020, the ACCC provided NBN Co with its preliminary view that it does not intend to determine a substitute amount of capital expenditure in accordance with clause 1D.3.2(d) or a substitute amount of operating expenditure in accordance with clause 1E.8.2(c) of the SAU. Our preliminary view also set out some longer-term issues that we proposed to consider and invited feedback on these matters.⁴ We received no submissions to the preliminary view from stakeholders.

The ACCC published its LTRCM draft determination on 27 April 2021, accepting the proposed values by NBN Co for their ABBRR, RAB and ICRA. The draft determination also invited further submissions from interested parties.

The LTRCM process is an aspect of the ongoing discussions between NBN Co, the ACCC and relevant RSPs and stakeholders. The LTRCM process as a whole is likely to change as a result of any amendments included in a revised SAU following the discussions between NBN Co, RSPs and the ACCC.

Longer-term issues for consideration and the impact of COVID-19

Prior years' LTRCM processes have noted the concerns of stakeholders regarding the LTRCM process, transparency and SAU concerns. Our preliminary view noted that NBN Co had completed the bulk of its rollout, and will transition towards a more business-as-usual state, with a stronger focus on service delivery. We also note however, continued capital expenditure is required to maintain that steady state.

The LTRCM should appropriately capture these developments and ensure ACCC oversight of NBN Co's expenditure and revenues, together with appropriate transparency and compliance measures, remain fit for purpose.

As set out in our draft determination, we have decided not to pursue further changes within the 2019-20 LTRCM process given the ongoing discussions through the review of the regulatory arrangements under NBN Co's SAU.⁵

We will consider any issues raised by stakeholders in previous LTRCM processes during the ongoing discussions between industry, NBN Co and the ACCC. The SAU review process will include the broader revenue constraint arrangements, including the LTRCM and approach to expenditure. We consider this process to be more suited to considering the broader framework issues raised by stakeholders in previous LTRCM assessments.

² Clause 1E.1.2(c)(iv) of the SAU

³ In determining a substitute amount, the ACCC must have regard to expenditure from previous years and adjust for relevant factors. See clauses 1D.3.2(d) and 1E8.2(c) of the SAU.

⁴ ACCC, LTRCM 2019-20 *preliminary view note*. See: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2019-20>

⁵ ACCC, 2019-20 LTRCM *draft determination*, 27 April 2021, p. 5.

1.4. Structure of the report

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

- Section 2 provides an overview of the regulatory information submitted by NBN Co
- Section 3 outlines the ACCC's final LTRCM determination
- Section 4 presents the ACCC's final LTRCM determination and assessment of NBN Co's price compliance for 2019-20.

2. NBN Co's 2019-20 regulatory information

On 30 October 2020, NBN Co submitted its regulatory information for the 2019-20 financial year. This information consisted of NBN Co's actual and proposed financial information, an expenditure compliance report, a procurement compliance report, and a price compliance report.

NBN Co also submitted three independent reports from PricewaterhouseCoopers (PwC), a price compliance spreadsheet, an LTRCM spreadsheet and a copy of its chart of accounts. The ACCC has published public versions of NBN Co's regulatory information on the ACCC website.⁶

2.1. Expenditure compliance

NBN Co's regulatory information included an expenditure compliance report for 2019-20, pursuant to clause 1F.2.1 (a) of the SAU. This report contained certification from NBN Co's CFO that NBN Co's proposed capital and operating expenditure complies with the relevant expenditure conditions set out in the SAU.

As in previous years, NBN Co engaged PwC to perform an independent limited assurance review in relation to the design of controls applicable to capital and operating expenditure prudence. PwC's report expresses an unqualified opinion and complements the certification from NBN Co's CFO.

In its regulatory information, NBN Co submitted a procurement rules compliance report in accordance with clause 1F.2.3 (a) of the SAU. The report contained a certification from NBN Co's Executive General Manager (EGM) Procurement that NBN Co has developed and maintained Procurement Rules that satisfy the relevant conditions in clause 1D.5.1 of the SAU.⁷

2.2. Financial information

In addition, NBN Co submitted its actual and proposed financial information for the 2019-20 financial year. This submission consisted of the following six schedules:

- 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
- 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.

⁶ See: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2019-20>

⁷ NBN Co, 2019-20 Regulatory Information – Actual and Proposed Financial Information, p. 16. 'The role of Chief Procurement Officer for the purposes of this Procurement Rules Compliance Report is currently fulfilled by NBN Co's Acting Executive General Manager Procurement [name removed], as successor to the Chief Procurement Officer role.'

NBN Co also submitted an LTRCM spreadsheet that set out the underlying calculations of NBN Co's proposed ABBRR, RAB and ICRA values.

We have summarised the key financial information submitted by NBN Co for the 2019-20 LTRCM determination (table 2.1) along with a comparison of the corresponding values in the previous period and percentage changes.

Table 2.1: Summary of NBN Co's financial information, 2018-19 and 2019-20 (nominal)⁸

	2018-19 (\$'000)	2019-20 (\$'000)	Percentage change
Operating expenditure	4 454 260	5 212 619	17.03%
Capital expenditure	5 766 682	7 402 690	28.37%
Construction in progress (start of period)	3 182 847	3 309 660	3.98%
Interest expense	351 672	649 327	84.64%
Revenue	2 824 879	3 836 984	35.83%
Unrecovered costs	4 846 872	5 333 785	10.05%
RAB (end of period)	23 330 671	27 345 750	17.21%
ABBRR	7 671 752	9 170 768	19.54%
ICRA (end of period)	25 458 678	32 038 694	25.85%

Source: LTRCM spreadsheet 2019-20

NBN Co also lodged three independent assurance reports from PwC to support its actual and proposed financial information submissions. This includes:

- a reasonable assurance audit report for Schedules 6 to 9: PwC's opinion in this report was unqualified and complements the audit of NBN Co's general-purpose financial statements.
- a factual findings of agreed upon procedures report for Schedule 10: PwC checked that the relevant values for previous years were in accordance with the 2018-19 LTRCM determination, that the relevant input values for 2018-19 were correctly extracted from Schedules 6 to 9 into the LTRCM spreadsheet, and that the relevant LTRCM calculations were undertaken in accordance with the SAU. And,
- a limited assurance engagement on the design and implementation of controls around expenditure compliance in relation to NBN Co.

2.3. Price compliance reporting

In its regulatory information, NBN Co submitted a price compliance report and a price compliance spreadsheet for the period from 1 July 2019 to 30 June 2020.⁹

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

⁸ These figures have been rounded to whole numbers. Note, figures have also been rounded throughout the document where appropriate.

⁹ Pursuant to clause 1F.3(a) of the SAU.

relevant requirements in Schedule 1C of the SAU.¹⁰ 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.¹¹

¹⁰ The certification provided by NBN Co's CFO was informed by a range of investigations and testing conducted by NBN Co set out in more detail in the 2019-20 LTRCM draft determination, p. 22. See: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2019-20>

¹¹ 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 – LTRCM Supporting submission, p. 15. Available at: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2019-20>

3. ACCC's assessment of NBN Co's regulatory information

On 27 April 2021, the ACCC published the 2019-20 LTRCM draft determination.

The ACCC's draft determination proposed to accept NBN Co's proposed values (and inputs to the values) for the ABBRR, RAB and ICRA. The draft determination set out the ACCC's detailed assessment of NBN Co's regulatory information, which was submitted under Schedule 1F of the SAU. The ACCC's draft view was that:

- NBN Co had incurred capital and operating expenditure in accordance with the relevant provisions of the SAU
- NBN Co's proposed LTRCM values had been calculated in accordance with Schedules 1D and 1E of the SAU, and
- NBN Co's prices had not exceeded the maximum regulated levels set out in Schedule 1C of the SAU.

This section summarises the ACCC's draft determination, which remains unchanged in the final determination.

3.1. Expenditure compliance and reporting

3.1.1. Expenditure compliance

The ACCC assessed NBN Co's expenditure compliance by considering the expenditure compliance report signed by NBN Co's CFO, PwC's limited assurance reports and NBN Co's supporting submission. The ACCC's draft decision was that NBN Co's expenditure has complied with the relevant prudency conditions in the SAU.

The expenditure compliance report did not identify any exceptions during the 2019-20 financial year and expressed a negative assurance conclusion.¹² The ACCC also considered NBN Co's other supporting materials to determine the extent to which it could rely on the certification.

The ACCC checked that NBN Co's procurement guidelines complied with the relevant provisions of the SAU, as well as considered NBN Co's procurement rules compliance report to determine whether NBN Co had developed appropriate procurement rules.

The ACCC considered PwC's limited assurance report on the design of controls for expenditure compliance to determine whether there are processes and controls in place to support compliance with the prudency conditions in the SAU. The PwC report expressed an unqualified limited assurance conclusion.

The ACCC also considered NBN Co's supporting submission, which outlined its internal audit work, in order to assess whether NBN Co complied with these processes and controls.

3.1.2. Procurement compliance

The ACCC considered that NBN Co had provided a procurement rules compliance report that meets the requirements of the SAU.

¹² See footnote 11 for a detailed explanation of NBN Co's use of qualifying language and negative assurance.

The procurement rules compliance report did not identify any exceptions for the 2019-20 financial year and expresses a negative assurance conclusion. The ACCC also considered the material in NBN Co's supporting submission outlining what has informed the EGM Procurement's certification.

Based on this consideration, the ACCC is satisfied with NBN Co's procurement compliance for the purposes of the LTRCM determination.

3.2. Financial information

The ACCC considered NBN Co's regulatory information and whether NBN Co had calculated its proposed values for the RAB, ABBRR and ICRA in accordance with the formulas in Schedules 1D and 1E of the SAU. Being satisfied that it had, the ACCC's draft decision was to accept NBN Co's proposed values for the RAB, ABBRR and ICRA without amendment.

The ACCC considered NBN Co's actual and proposed financial information in assessing whether NBN Co had calculated its proposed LTRCM values in accordance with schedules 1D and 1E of the SAU. The ACCC also had regard to NBN Co's LTRCM spreadsheet, which sets out the inputs and calculations used by NBN Co to determine its proposed values for the RAB, ABBRR and ICRA. In making its draft decision, the ACCC reviewed the calculations NBN Co submitted in its LTRCM spreadsheet and confirmed that the formulas used in the spreadsheet were as set out in schedule 1E of the SAU.

Further, the ACCC considered the independent assurance reports from PwC and the statement of material variances, which support NBN Co's financial reporting.

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

NBN Co's regulatory information included a statement of material variances (Schedule 11), in accordance with clause 1F.1.3 (b) of the SAU. The ACCC has reviewed Schedule 11 and is satisfied that it does not raise any significant concerns regarding the magnitude of capital and operating expenditure.

4. The ACCC's LTRCM final determination and price compliance

The ACCC has determined the values in Table 4.1 for the purposes of the 2019-20 LTRCM final determination. We have derived these values from the regulatory information provided by NBN Co.¹³

The ACCC is also satisfied that NBN Co's prices for 2019-20 financial year did not exceed the MRP applicable at any point in time, in accordance with schedule 1C of the SAU.

Table 4.1: 2019-20 LTRCM final determination¹⁴

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	27 245 750
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
ABBRR	9 170 768

¹³ In accordance with Clause 1E.1.2(c)(vi) of the SAU.

¹⁴ The clause references in this table refer to the formulas in the SAU. Note: figures have been rounded.

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

The ACCC also considered NBN Co's price compliance report and its supporting submission. The ACCC was satisfied that NBN Co's prices in 2019-20 did not exceed the MRP set out in Schedule 1C of the SAU.

The ACCC undertook analysis of the price compliance spreadsheet submitted by NBN Co. We reviewed the prices listed in the spreadsheet and compared them to Schedule 1C of the SAU. We did not find any instances in which the listed prices exceeded the applicable MRP.

The ACCC was satisfied that NBN Co's price compliance report and supporting submission provide assurance that NBN Co has key control procedures in place to ensure that the prices for NBN Co's products do not exceed the applicable MRP. Our analysis of the price compliance spreadsheet supported this conclusion. Therefore, the ACCC was satisfied that NBN Co has met its price compliance obligations in the SAU.