



**Australian  
Competition &  
Consumer  
Commission**

**NBN Co Special Access Undertaking  
Long Term Revenue Constraint Methodology  
2015–16: Draft Determination**

**and**

**Price compliance reporting 2015–16**

**April 2017**



Australian Competition and Consumer Commission  
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## List of abbreviations and acronyms

ABBRR	Annual Building Block Revenue Requirement
ACCC	Australian Competition and Consumer Commission
ACIPA	Annual Construction in Progress Allowance
ASAE	Australian Standard on Assurance Engagement
AVC	Access Virtual Circuit
CCA	<i>Competition and Consumer Act 2010 (Commonwealth)</i>
CFO	Chief Financial Officer
CFRA	Carry Forward Revenue Adjustment
CIF	Cumulative Inflation Factor
CIP	Construction in Progress
CPI	Consumer Price Index
CPO	Chief Procurement Officer
CVC	Connectivity Virtual Circuit
FTTN	Fibre-to-the-node
HFC	Hybrid Fibre Coaxial
ICRA	Initial Cost Recovery Account
LTRCM	Long Term Revenue Constraint Methodology
NBN	National Broadband Network
NEBS	NBN Co's Ethernet Bitstream Service
RAB	Regulatory Asset Base
SAU	Special Access Undertaking
SFAA	Standard Form Access Agreement
WBA	Wholesale Broadband Agreement

# Executive Summary

The Australian Competition and Consumer Commission (ACCC) must make a Long Term Revenue Constraint Methodology (LTRCM) Determination under clause 1E.1.2 of NBN Co's Special Access Undertaking (SAU) each year until 2023.

The LTRCM is a component of NBN Co's SAU, which forms part of the regulatory framework for the National Broadband Network (NBN). The SAU was accepted by the ACCC on 13 December 2013. The LTRCM is a methodology for determining the amount of revenue NBN Co is allowed to earn via its prices over the term of the SAU. The LTRCM provides NBN Co with the opportunity to recover its prudent and efficient costs of supply, including an appropriate return on investment. The LTRCM is one of various incentives in the SAU to encourage NBN Co to operate and invest prudently and efficiently.

Schedule 1F of the SAU requires NBN Co to submit certain regulatory information for each financial year, including financial information required to determine the revenue NBN Co is allowed to earn via its long term revenue constraint. NBN Co is also required to certify that it has complied with the price controls set out in Schedule 1C of the SAU. On 31 October 2016, NBN Co submitted this information, which has been used by the ACCC to inform this draft determination.

This report sets out the ACCC's draft determination in relation to NBN Co's LTRCM and its draft view on NBN Co's price compliance for the 2015-16 financial year.

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

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

The ACCC's draft LTRCM determination is to accept without modification NBN Co's proposed values (and the inputs to those values) for the ABRR, RAB, and ICRA in accordance with clause 1E.1.2 of NBN Co's SAU. The reasons for accepting the proposed values are set out in section 4 of this draft determination.

In relation to price compliance, the ACCC's draft decision is that it is satisfied that NBN Co's prices for 2015-16 did not exceed the maximum regulated prices applicable at the relevant point in time in accordance with Schedule 1C of the SAU.

In making this draft determination, the ACCC has undertaken an assessment of the information provided by NBN Co to ensure that, firstly, NBN Co's financial details are consistent with its statutory accounts and the formulas and definitions in the SAU. Secondly, the ACCC has engaged with NBN Co in relation to its procedures and processes to ensure that its expenditure is in accordance with the prudence criteria in the SAU. It considers that there is sufficient material to demonstrate that NBN Co complied with these processes and procedures during the relevant period.

The ACCC invites submissions from interested parties on the LTRCM draft determination for 2015-16 by 5pm on **26 May 2017**.

Following its consideration of the submissions on this draft determination, the ACCC intends to release its final LTRCM determination for 2015-16 by 30 June 2017. The final LTRCM determination will be published on the ACCC website at [www.accc.gov.au](http://www.accc.gov.au).

# 1 Introduction

## 1.1 Purpose

On 13 December 2013, the Australian Competition and Consumer Commission (ACCC) accepted a Special Access Undertaking (SAU) from NBN Co. The SAU establishes the regulatory framework for the National Broadband Network (NBN). The SAU will expire on 30 June 2040.

The SAU requires NBN Co to submit certain regulatory information to the ACCC for each financial year, including financial information required to determine the revenues NBN Co is allowed to earn (its long term revenue constraint).<sup>1</sup> NBN Co is also required to certify that its prices have not exceeded the maximum regulated prices set by the SAU.<sup>2</sup> Following NBN Co's submission, the ACCC must make a Long Term Revenue Constraint Methodology (LTRCM) determination within 12 months after the end of each financial year.<sup>3</sup>

The LTRCM is a methodology for determining the amount of revenue NBN Co is allowed to earn via its prices. The LTRCM provides NBN Co with the opportunity to recover its prudent and efficient costs of supply (including an appropriate return on investment). The LTRCM is one of various incentives in the SAU to encourage NBN Co to operate and invest prudently and efficiently.

This report sets out the ACCC's draft LTRCM determination and its view on NBN Co's price compliance for the 2015–16 financial year. This report also seeks stakeholders' views on the ACCC's proposed LTRCM draft determination.

The report is structured as follows:

- Section 2 describes the LTRCM process
- Section 3 provides an overview of the regulatory information submitted by NBN Co
- Section 4 outlines the ACCC's draft assessment of NBN Co's LTRCM proposal, and
- Section 5 sets out the ACCC's draft LTRCM determination for 2015–16.

## 1.2 Making submissions

The ACCC encourages industry participants and other interested parties to make submissions on this draft determination, including reasons to support their views.

To foster an informed and consultative process, all submissions will be considered 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'. The ACCC has prepared a confidentiality guideline for parties wishing to submit confidential information to communications inquiries.

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<sup>1</sup> Schedule 1F of the SAU.

<sup>2</sup> Schedule 1F.3 of the SAU.

<sup>3</sup> Clause 1E.1.2 of the SAU.

The *ACCC-AER information policy: the collection, use and disclosure information* sets out the general policy of the ACCC and the Australian Energy Regulator on the collection, use and disclosure of information. A copy of the guideline can be downloaded from the ACCC's website.

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 Friday 26 May 2017** to [nbn@acc.gov.au](mailto:nbn@acc.gov.au) and copy to:

Scott Harding  
Director  
ACCC  
[Scott.Harding@acc.gov.au](mailto:Scott.Harding@acc.gov.au)

Caroline Serrano  
Assistant Director  
ACCC  
[Caroline.Serrano@acc.gov.au](mailto:Caroline.Serrano@acc.gov.au)

### 1.3 Confidentiality arrangements

NBN Co has established confidentiality arrangements for access to confidential material contained in its LTRCM proposal and supporting submissions. Parties wishing to access confidential material for the purposes of making a submission to this inquiry should contact NBN Co directly to arrange an appropriate confidentiality agreement. Appendix B to NBN Co's supporting submission provides further detail on whether information will be disclosed by NBN Co after entering into a confidentiality agreement.

The ACCC will monitor the operation of NBN Co's confidentiality arrangements. The ACCC is keen to ensure that the arrangements achieve an appropriate balance between promoting transparency and protecting NBN Co's confidential information. The ACCC encourages stakeholders to advise the ACCC of any significant concerns regarding the implementation of these confidentiality arrangements. The ACCC will discuss with NBN Co any concerns raised by stakeholders about the operation of the confidentiality arrangements.

### 1.4 Next steps in this inquiry

The ACCC will consider the issues raised in submissions before releasing a final determination for 2015–16. The ACCC's final LTRCM determination will be published by 30 June 2017 on the ACCC website.

## 2 Long Term Revenue Constraint Methodology and Price Compliance

### 2.1 Long Term Revenue Constraint Methodology

The LTRCM is a methodology for determining the amount of revenue NBN Co is allowed to earn via its prices over the SAU term. This will be done on an *ex-post* basis during the first 10 years of the SAU (the Initial Regulatory Period) and on an *ex-ante* basis for the remainder of the SAU period (the Subsequent Regulatory Period).

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

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

The LTRCM sets out a mechanism for determining NBN Co's RAB and ABBRR based on a range of financial inputs that must be submitted by NBN Co. The ABBRR is in turn used, together with NBN Co's actual revenue (as defined in the SAU), to calculate the extent of unrecovered costs in each year, the cumulative value of which is captured in the ICRA. Once NBN Co begins to earn sufficient revenue each year to meet its annual revenue requirement, the SAU permits NBN Co to recover more than its annual revenue requirement until the ICRA reaches zero (subject to the price controls set out in the SAU).<sup>4</sup>

### 2.2 The ACCC's role in the LTRCM process

During the Initial Regulatory Period of the SAU, the ACCC's role in making an LTRCM determination is to determine whether capital expenditure and operating expenditure meet the relevant requirements in the SAU for inclusion in the RAB and the ABBRR. If the ACCC is not satisfied that NBN Co's expenditure meets those requirements the ACCC can determine substitute values in its LTRCM determination.

In making the LTRCM determination, capital expenditure may only be included in the RAB to the extent that the ACCC is satisfied that:

- it meets the Prudent Cost Condition<sup>5</sup> – broadly speaking, capital expenditure meets the Prudent Cost Condition if it was incurred in connection with the design, engineering and construction of the relevant assets under a 'conforming contract'<sup>6</sup> (that is, generally, in accordance with the procurement rules); or in an open and competitive market; or through another 'value for money' process. The SAU requires NBN Co to develop procurement rules that establish procurement processes that seek to generate an efficient and competitive outcome and reflect good industry practice, and
- it meets the Prudent Design Condition<sup>7</sup> – capital expenditure meets the Prudent Design

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<sup>4</sup> Clause 1E.6.1 of the SAU.

<sup>5</sup> Clause 1D.3.2(a)(i)(A) of the SAU.

<sup>6</sup> Clause 1D.4.1(a)(i)(B) of the SAU contains additional requirements where there is a material change of circumstances affecting the Conforming Contract.

<sup>7</sup> Clause 1D.3.2(a)(i)(B) of the SAU.



Condition if it is 'materially consistent' with the Network Design Rules<sup>8</sup> or a permitted variation, endorsed network change or ACCC approved network change to the Network Design Rules,<sup>9</sup> or

- capital expenditure was incurred in connection with the specific matters listed in clause 1D.3.2(a)(ii) of the SAU – that is, capital expenditure is considered to be prudent under the SAU if it relates to the following: the Telstra or Optus arrangements, interim satellite or transit arrangements, Tasmanian tri-area service arrangements, trial sites, or third party funded network changes; or was incurred prior to the approval of the SAU on 13 December 2013.<sup>10</sup>

The ACCC may only include operating expenditure in the ABBRR to the extent that the ACCC is satisfied that:

- it was incurred in accordance with NBN Co's procurement processes (including in accordance with the Procurement Rules), was incurred pursuant to a 'conforming contract', was procured in an open and competitive market, or was procured in a manner that is likely to achieve value for money,<sup>11</sup> or
- it was incurred in connection with the specific matters specified in clause 1E.8.2(a)(ii) of the SAU – that is, operating expenditure is considered to be prudent under the SAU if it relates to: the Telstra or Optus arrangements, interim satellite or transit arrangements, Tasmania tri-area service arrangements, trial sites, or third party funded network changes or was incurred prior to the approval of the SAU on 13 December 2013; or it was required to address an urgent network issue or a force majeure event.

The ACCC's role is to assess whether NBN Co has incurred its expenditure in accordance with these criteria, and that the relevant LTRCM components have been calculated in accordance with the formulas set out in the SAU, and to determine whether those expenditures (as set out in NBN Co's LTRCM proposal) should be included in the LTRCM determination.

The ACCC may determine LTRCM values that are different from the values submitted by NBN Co, provided those values are determined in accordance with Schedule 1D and Schedule 1E of the SAU.<sup>12</sup> The SAU includes provisions which set out the factors to consider when determining a substitute amount of capital or operating expenditure.<sup>13</sup>

## 2.3 ACCC powers to seek additional information

The ACCC may request additional information from NBN Co at any time if the ACCC considers that the information is necessary for it to:

- determine the ABBRR, RAB, ICRA and the values of inputs to each of these values
- assess the matters contained in an expenditure compliance report

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<sup>8</sup> The document describes the design of NBN Co's network and network components. Capital expenditure must be in accordance with the Network Design Rules in order to be included in the Regulated Asset Base, in addition to meeting the 'Prudent Cost' condition. The Network Design Rules were updated on 30 June 2015.

<sup>9</sup> Clause 1D.6 of the SAU.

<sup>10</sup> Schedule 1D of the SAU.

<sup>11</sup> Clauses 1E.8.2(a)(i) and 1E.8.3 of the SAU.

<sup>12</sup> Clause 1E.1.2(c)(iv) of the SAU of the SAU.

<sup>13</sup> See clauses 1D.3.2(d) and 1E.8.2(c) of the SAU. For example, a substitute amount of capital expenditure determined by the ACCC must meet the Prudent Design Condition and must be consistent with capital expenditure that has been included in the RAB in respect of any prior financial year, having regard to the relative amounts of capital expenditure incurred in those years, the relative cost of goods and services in those years, any relevant differences in the scale and scope of the relevant assets, the NBN Co Corporate Plan and any other matter the ACCC considers relevant.

- assess compliance of NBN Co's Procurement Rules with the requirements for these rules set out in the SAU, or
- determine NBN Co's compliance with the price schedule set by the SAU.

NBN Co must comply with any request from the ACCC and respond within the timeframes specified by the ACCC.

## 2.4 Process for making an LTRCM Determination

Under the SAU, the ACCC is required to undertake a number of steps in making an LTRCM determination. In brief, the ACCC is required to provide a preliminary view to NBN Co on whether it intends to determine a substitute amount of capital expenditure and operating expenditure, followed by a draft and final LTRCM determination. These processes are further explained below.

### The ACCC's preliminary view

Within 40 business days of receiving NBN Co's regulatory information, the ACCC must notify NBN Co of its preliminary view on the extent to which the ACCC intends to determine a substitute amount of capital expenditure or operating expenditure in making the LTRCM determination.<sup>14</sup>

On 22 December 2016, the ACCC provided its preliminary view to NBN Co 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. The ACCC's preliminary view is available on the ACCC website.

### Draft and final decisions

The ACCC must initially publish a draft LTRCM determination and its reasons for the draft determination. The ACCC must consult with NBN Co and other persons the ACCC considers appropriate. The ACCC must then make a final decision after considering any submissions that are received within the time limit specified by the ACCC.

The ACCC must publish an LTRCM determination on its website for each financial year in the Initial Regulatory Period no later than 12 months after the end of the financial year to which that LTRCM determination relates. The LTRCM determination for 2015-16 must be made by 30 June 2017.

### This year's approach to LTRCM Determination

This year, the ACCC has undertaken a number of additional steps to form part of its assessment process for making an LTRCM Determination. These include a further information request to NBN Co in respect of its procurement process to gain a direct understanding as to how NBN Co is meeting the prudency conditions set out in the SAU.

The ACCC considers these further steps complement its existing assessment process and provide the ACCC with visibility about some of NBN Co processes and how they operate in practice.

## 2.5 Price compliance and reporting

The SAU sets binding price caps, which provide long term pricing commitments to NBN Co's customers. The price controls act in conjunction with the LTRCM to provide incentives to

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<sup>14</sup> Clause 1E.1.2(c)(vii) of the SAU

ensure access seekers are not subject to unreasonable prices and to incentivise NBN Co to incur efficient expenditure. There are a number of pricing provisions in the SAU, the most important being an annual price increase limit of the Consumer Price Index (CPI) less 1.5 per cent.<sup>15</sup>

By 31 October each year, NBN Co must submit a Price Compliance Report to the ACCC. The Price Compliance Report includes certification from NBN Co's Chief Financial Officer (CFO) that the prices charged during the preceding financial year did not exceed the maximum regulated prices set by the SAU.

The ACCC may request information, at any time, from NBN Co that is reasonably necessary for the ACCC to determine NBN Co's compliance with Schedule 1C of the SAU.

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<sup>15</sup> Schedules 1C.5 and 2B.2 of the SAU.

### 3 NBN Co's 2015–16 regulatory information

To enable the ACCC to conduct its LTRCM assessments during the Initial Regulatory Period, NBN Co is required to submit certain information to the ACCC by 31 October, every year for the first 10 years of the SAU.

On 31 October 2016, NBN Co submitted an LTRCM proposal to the ACCC as required under Schedule 1F of the SAU. NBN Co's LTRCM proposal consists of the following material:

- NBN Co's actual financial information – this is based on NBN Co's reported statutory accounts which are consistent with the definitions in the SAU
- NBN Co's proposed financial information – this is NBN Co's proposed values (and inputs to those values) for the ABBRR, RAB, ICRA and certain other inputs to the LTRCM
- an Expenditure Compliance Report – a report signed by NBN Co's CFO certifying that NBN Co's expenditure complies with the requirements of the SAU
- a Procurement Compliance Report – a report signed by NBN Co's Chief Procurement Officer (CPO) certifying that NBN Co's Procurement Rules comply with the requirements of the SAU, and
- a Price Compliance Report – a report signed by NBN Co's CFO certifying that NBN Co's prices for the supply of its services comply with the requirements of the SAU.

To support its submission, NBN Co has also lodged three independent assurance reports from PricewaterhouseCoopers (PwC), a price compliance spreadsheet, an LTRCM spreadsheet and a copy of NBN Co's Chart of Accounts. Public versions of NBN Co's regulatory information have been published on the ACCC's website.

Table 3.1 summarises the key financial information submitted by NBN Co for the 2015-16 LTRCM Determination. The corresponding values for the 2014-15 LTRCM Determination and percentage change are presented for comparison purposes.

**Table 3.1 Summary of NBN Co financial information, 2014-15 and 2015-16 (nominal)**

	2014-15 (\$'000)	2015-16 (\$'000)	Percentage change
Operating expenditure	1 591 219	2 259 775	42%
Capital expenditure	2 166 854	4 523 444	109%
Construction in progress (start of period)	2 315 416	3 482 834	50%
Interest expense	59	247	319%
Revenue	163 867	421 455	157%
Unrecovered cost	2 054 623	2 777 273	35%
RAB (end of period)	4 818 889	8 944 763	86%
ABBRR	2 218 490	3 198 728	44%
ICRA (end of period)	6 243 728	9 428 175	51%

\*Source: LTRCM spreadsheet 2015-16

## 4 ACCC assessment of NBN Co's regulatory information for 2015–16

The ACCC has assessed the regulatory information submitted by NBN Co. The ACCC's draft decision is that the values proposed in NBN Co's LTRCM proposal have been calculated in accordance with Schedules 1D and 1E of the SAU.

The ACCC has also received the relevant price compliance report and pricing information under clause 1F.3 of the SAU. Based on this information, the ACCC is satisfied that NBN Co has not exceeded the maximum regulated prices set by Schedule 1C of the SAU.

### 4.1 Assessment of expenditure compliance and reporting

#### 4.1.1 SAU requirements

As discussed in section 2, in making an LTRCM determination, capital expenditure and operating expenditure may only be included in the RAB and ABBRR respectively to the extent that the ACCC is satisfied that the expenditure meets the relevant requirements in the SAU.

By 31 October each year during the Initial Regulatory Period, NBN Co must submit to the ACCC an Expenditure Compliance Report to inform the ACCC's regulatory decision. The Expenditure Compliance Report is a report signed by NBN Co's CFO (or authorised delegate) which certifies that, in relation to the financial year, the capital and operating expenditure proposed for inclusion in the RAB and ABBRR respectively meet the specified criteria, which includes compliance with the Prudent Design and Prudent Cost conditions.<sup>16</sup> Where capital expenditure or operating expenditure does not meet the specified criteria, the CFO (or delegate) must propose a substitute amount of capital expenditure or operating expenditure for the ACCC's consideration.

NBN Co must also develop Procurement Rules to establish procurement processes that, in broad terms, generate an efficient and competitive outcome and reflect good industry practice.<sup>17</sup> 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.<sup>18</sup>

By 31 October each year during the Initial Regulatory Period, NBN Co must submit to the ACCC a Procurement Rules Compliance Report. The Procurement Rules Compliance Report is a report signed by NBN Co's CPO certifying that, in relation to that financial year, NBN Co's Procurement Rules satisfied the procurement rule requirements set out in clause 1D.5.1 of the SAU.<sup>19</sup> In summary, the SAU requirements are that:

- the process must generate an efficient and competitive outcome between the tender participants
- there must be a clear process for the calling and conducting of tenders and NBN Co should assess and award tenders to successful participants which meet the reasonable requirements of procedural fairness and good industry practice
- if NBN Co decides to approve a tender that is not the lowest price tender, this must be appropriately justified

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<sup>16</sup> Clause 1F.2 of the SAU.

<sup>17</sup> Clause 1D.5.1 of the SAU

<sup>18</sup> Clause 1D.5.2 of the SAU.

<sup>19</sup> Clause 1F.2.3 of the SAU.

- NBN Co must ensure that the basis for undertaking the works and services is in accordance with good industry practice and the basis of payment for works and services must be clearly specified, and
- NBN Co must ensure that there is a process for managing contracts that complies with good industry practice and which seeks to achieve value for money and the lowest total cost of ownership.<sup>20</sup>

## 4.1.2 NBN Co's LTRCM submission

### *Expenditure Compliance Report*

On 31 October 2016, NBN Co provided the ACCC with an Expenditure Compliance Report pursuant to clause 1F.2.1(a) of the SAU. The report is signed by NBN Co's CFO and certifies that NBN Co's proposed capital and operating expenditure complies with the relevant expenditure conditions set out in the SAU.

NBN Co's CFO has not reported any exceptions in relation to either capital expenditure or operating expenditure and, as such, NBN Co proposes that all capital expenditure and all operating expenditure incurred during the 2015-16 financial year should be included in the RAB and ABBRR, respectively.

The Expenditure Compliance Report includes some qualifying language to make clear the basis on which the certification is provided and expresses negative assurance conclusions.<sup>21</sup> NBN Co indicates that when undertaking the internal audit, it has taken into consideration the new Australian Standard on Assurance Engagement (ASAE) 3150: *Assurance Engagements on Controls*, which was issued in January 2016.<sup>22</sup> NBN Co submits that 'ASAE 3150 provides guidance for identifying the nature of the procedures which are conducted at a minimum in a limited assurance engagement and the additional procedures which are conducted in a reasonable assurance engagement'.<sup>23</sup>

NBN Co has advised that the CFO's certification set out in the Expenditure Compliance Report is informed by a range of investigations and testing of the relevant processes and controls undertaken by NBN Co's internal audit staff. 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.<sup>24</sup>

### *Independent assurance reports*

NBN Co has engaged PwC to perform an independent limited assurance review to complement NBN Co's CFO's certification. PwC's review considered the design of controls applicable to capital expenditure and operating expenditure in the context of the Prudent Design and Prudent Cost conditions. PwC's limited assurance report expresses an unqualified opinion and

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<sup>20</sup> Clause 1D.5.1. of the SAU.

<sup>21</sup> Negative assurance conclusions note that nothing has come to the author's attention that causes them to believe that the requirements have not been met.

<sup>22</sup> The ACCC understands that ASAE 3150 is that standard that reflects best practice and clarifies how to scope, conduct and report on an assurance engagement on controls to ensure that assurance engagement quality is maintained and where necessary improved.

<sup>23</sup> NBN Co, *NBN Co submission to the ACCC – 2015-16 Regulatory Information and LTRCM Determination*, 31 October 2016, p. 12.

<sup>24</sup> NBN Co, *NBN Co submission to the ACCC – 2015-16 Regulatory Information and LTRCM Determination*, 31 October 2016, p. 12.

complements NBN Co's certification. Similar to NBN Co's internal audit, PwC conducted its work in accordance with the new ASAE 3150: *Assurance Engagements on Controls*.<sup>25</sup>

NBN Co submits that its' Expenditure Compliance Report, taken together with the PwC assurance report, provide an appropriate basis for the ACCC to be satisfied that all capital expenditure and operating expenditure incurred by NBN Co over the relevant period meets the prudency conditions and should be included in the RAB and ABBRR respectively.<sup>26</sup>

### **Procurement Rules Compliance Report**

On 31 October 2016, NBN Co provided a Procurement Rules Compliance Report to the ACCC in accordance with clause 1F.2.3(a) of the SAU. The report is signed by NBN Co's CFO and certifies that NBN Co has developed and maintained Procurement Rules which satisfied a number of conditions under clause 1D.5.1 of the SAU. NBN Co does not report any exceptions in relation to the procurement rules compliance report.<sup>27</sup>

NBN Co submits that the CFO's certification expresses negative assurance conclusions to make clear the basis on which the certification is provided, i.e., any such investigation is necessarily subject to inherent limitations and that there may be unavoidable risk that some deficiencies may not be detected.<sup>28</sup>

### **4.1.3 ACCC draft decision on NBN Co's expenditure compliance**

The SAU requires NBN Co to ensure that its expenditure complies with the relevant prudency conditions. In assessing NBN Co's expenditure compliance, the ACCC has considered the Expenditure Compliance Report signed by NBN Co's CFO, the PwC limited assurance reports and NBN Co's supporting submission.

The Expenditure Compliance Report did not identify any exceptions during the period from 1 July 2015 to 30 June 2016, however, it is subject to some qualifying language and expresses negative assurance conclusions. Therefore, the ACCC has given consideration to NBN Co's supporting materials to determine the extent to which the ACCC can rely on the certification.

In forming its view on expenditure compliance, the ACCC has considered whether:

- NBN Co has developed adequate procurement rules
- there are processes and controls in place to support compliance with the prudency conditions in the SAU, and
- those processes and controls are operating effectively.

To assess the adequacy of NBN Co's procurement rules, the ACCC has checked that NBN Co's Procurement Guidelines comply with the relevant requirements in the SAU. The ACCC has also considered NBN Co's Procurement Rules Compliance Report and the additional information provided by NBN Co in regards to its procurement processes. The ACCC's draft decision on NBN Co's procurement rules is discussed further below.

To determine whether there are processes and controls in place to encourage compliance with the prudency conditions in the SAU, the ACCC has relied on PwC's assurance report regarding the design of controls applicable to capital expenditure and operating expenditure. The ACCC notes that PwC tested whether NBN Co has adequate controls in place to ensure that capital

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<sup>25</sup> NBN Co, *NBN Co submission to the ACCC – 2015-16 Regulatory Information and LTRCM Determination*, 31 October 2016, p. 15.

<sup>26</sup> NBN Co, *NBN Co submission to the ACCC – 2015-16 Regulatory Information and LTRCM Determination*, 31 October 2016, p.15.

<sup>27</sup> NBN Co, *NBN Co submission to the ACCC – 2015-16 Regulatory Information and LTRCM Determination*, 31 October 2016, p. 16.

<sup>28</sup> NBN Co, *NBN Co submission to the ACCC – 2015-16 Regulatory Information and LTRCM Determination*, 31 October 2016, p. 16.



and operating expenditure is incurred in accordance with the Prudent Design and Prudent Cost 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 audit work.

NBN Co advised that it identified the relevant control objectives<sup>29</sup> and procedures<sup>30</sup> and revised them from the previous year to take into account the general updates to operating procedures and the introduction of the Multi-Technology Mix, amongst other changes. NBN Co then selected appropriate samples to enable control testing. NBN Co used a 'judgemental' approach to selecting the sample and has advised that the samples have been selected to cover a wide cross-section of transactions.<sup>31</sup>

NBN Co has increased its sample size since 2013-14, where NBN Co's internal audit staff tested a sample of 30 transactions across all controls whereas during 2015-16, NBN Co's internal audit staff tested 18 control procedures, with a total sample of 232 transactions. The 232 samples were tested to confirm the operating effectiveness of the Prudent Design and Prudent Cost Controls. The sample size for each control procedure was determined based on the frequency of the control operating. For example, for controls that operate multiple times each day, a sample of 30 was selected, whereas for controls that only operate annually, a sample size of one was selected.<sup>32</sup>

NBN Co advised that it undertook testing for each of the sample items to confirm that all aspects of the controls were operating as designed. NBN Co further indicated that supporting documentation was identified, recorded and reviewed for its appropriateness. This involved reviewing documentation such as procurement records, contracts, purchase orders and network design documents for applicability and appropriate authorisation.<sup>33</sup>

The ACCC considers that the larger sample size will help to provide more robust audit results. The ACCC has also considered PwC's reports submitted by NBN Co, which provides a further, independent check of NBN Co's internal processes and controls.

As part of the 2015-16 LTRCM process, the ACCC sought further information from NBN Co in relation to their procurement processes. The ACCC sought this information to gain a more thorough understanding of how NBN Co is complying with the prudency conditions as stipulated in the SAU. The additional information received during this process is intended to complement NBN Co's procurement rules compliance report, and other elements of its LTRCM submission, in the ACCC forming the LTRCM determination for 2015-16. In particular, the ACCC sought information in regards to the following:

- *General information on NBN Co's procurement activities* – this includes statistical information on the nature, size and scope of NBN Co's procurements.
- *Case studies and examples of various types of procurements*. The ACCC sought examples of various case studies which related to four different types of conforming contracts considered in the prudent cost condition, as set out in the SAU (competitive tendering and procurement, only one potential supplier, arm's length transaction and exceptional circumstances). In particular, the ACCC sought information on how the prudent cost condition is considered in procurement decisions and reflected in the procurement guidelines.

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<sup>29</sup> Control objectives are included in Appendix A of NBN Co's supporting submission, p. 19.

<sup>30</sup> NBN has classified control procedures as 'confidential of particular sensitivity'. The reasons for this classification are set out in Appendix B of NBN Co's supporting submission, p. 20.

<sup>31</sup> NBN Co, *NBN Co submission to the ACCC – 2015-16 Regulatory Information and LTRCM Determination*, 31 October 2016, p. 13.

<sup>32</sup> NBN Co, *NBN Co submission to the ACCC – 2015-16 Regulatory Information and LTRCM Determination*, 31 October 2016, p. 14.

<sup>33</sup> NBN Co, *NBN Co submission to the ACCC – 2015-16 Regulatory Information and LTRCM Determination*, 31 October 2016, p. 14.



- *Specific matters relating to NBN Co's procurement guidelines.* The ACCC sought additional information from NBN Co specific to its procurement guidelines.

NBN Co has subsequently provided additional information to the ACCC in response to the information request, including through a procurement briefing given by NBN Co's procurement team to the ACCC. Following its review of the material provided, the ACCC is satisfied that NBN Co has appropriate procedures and processes in place to ensure that its expenditures are in accordance with the prudency conditions set out in the SAU. Further, the ACCC considers there is sufficient material to demonstrate that NBN Co's existing processes are operating effectively. Taking into account all of the information set out above, the ACCC is of the preliminary view that NBN Co's expenditure complies with the relevant prudency conditions.

#### **4.1.4 ACCC draft decision on NBN Co's compliance with procurement requirements**

The ACCC is satisfied that NBN Co provided the ACCC with a Procurement Rules Compliance Report by the required date. The Procurement Rules Compliance Report did not identify any exceptions during the period from 1 July 2015 to 30 June 2016. However, the Procurement Rules Compliance Report is subject to some qualifying language and only expresses negative assurance conclusions.

To be satisfied with NBN Co's Procurement Rules Compliance Report, the ACCC has considered the material in NBN Co's supporting submission that describes the factors that have informed the CFO's certification. NBN Co submits that the CFO's certification in the Procurement Rules Compliance Report was informed by a number of investigations.

These investigations found that, from 1 July 2015 to 30 April 2016, the Procurement Rules comprised of a Procurement Manual and a Buying Guide. From 1 May 2016 to 30 June 2016, NBN Co advised that it has merged the Procurement Manual and the Buying Guide to comprise a single document known as the Procurement Guidelines.<sup>34</sup> NBN Co submitted the new Procurement Guidelines to the ACCC on 19 May 2016, which was within 30 days after making any material amendments to the Procurement Rules, as required by clause 1D.5.2 of the SAU. Some further immaterial changes were made to the procurement guidelines on 28 November 2016. NBN Co provided the ACCC with an updated copy of the procurement guidelines on 22 December 2016.<sup>35</sup> The ACCC has considered these amendments and is of the view that they are consistent with the relevant provisions of the SAU.

The ACCC considers that the Procurement Rules Compliance Report meets the requirements of the SAU.

## **4.2 Assessment of LTRCM financial information**

### **4.2.1 SAU requirements**

NBN Co is required to submit NBN Co's forecasts or estimates 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. The Forecast Financial Information includes capital expenditure by asset type, operating expenditure, disposals by asset type and the opening and closing value of construction in progress.<sup>36</sup>

<sup>34</sup> NBN Co, *NBN Co submission to the ACCC – 2015-16 Regulatory Information and LTRCM Determination*, 31 October 2016, p. 16.

<sup>35</sup> Immaterial changes to the Procurement Guidelines are not required to be submitted to the ACCC.

<sup>36</sup> Clause 1F.1.2 of the SAU

## ***Forecast Financial Information***

On 30 June 2015, NBN Co submitted its Forecast Financial Information for the 2015-16 financial year. The Forecast Financial Information consists of the following two schedules:

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

The Forecast Financial Information submitted by NBN Co is confidential.

## ***Actual and Proposed Financial Information***

By 31 October after the end of each financial year of the Initial Regulatory Period, NBN Co is required to submit to the ACCC its Actual Financial Information, which includes the following:

- June quarter CPI
- capital expenditure, by asset type
- revenue
- operating expenditure
- disposals, by asset type
- interest expense
- accounting and tax asset lifetimes
- risk free rate, and
- nominal rate of return.

NBN Co must also submit information which sets out any material variances between the Forecast Financial Information and the Actual Financial Information, and reasons for the variances.<sup>37</sup> NBN Co has classified this information as 'confidential of particular sensitivity'.

In addition, NBN Co must provide the ACCC with its proposed values for the LTRCM components by 31 October after the end of each financial year in the Initial Regulatory Period.

This 'Proposed Financial Information' includes:

- ABBRR, including each of the inputs to the ABBRR
- opening and closing values of the RAB (nominal and real)
- opening and closing values of the ICRA (nominal and real)
- opening and closing values of the construction in progress account
- unrecovered cost
- proposed impact of dividend imputation franking credits 'gamma' (if the net tax allowance is positive), and
- applicable corporate tax rate.

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<sup>37</sup> Clause 1F.1.3 of the SAU.

## 4.2.2 NBN Co's LTRCM submission

### *Basis of preparation*

NBN Co has prepared its financial information in accordance with its Regulatory Accounting and Allocation Manual (RAAM). The RAAM provides detailed instructions on the principles, guidelines and templates to be used when preparing the LTRCM reports. This includes an explanation of when NBN Co will use an approach to reporting that is not consistent with Australian Accounting Standards in order to meet SAU requirements (that is, it will apply an Alternate Accounting Treatment).

In June 2016, NBN Co advised the ACCC that it is in process of updating its 2014-2015 RAAM. In October 2016, NBN Co provided the ACCC with a copy of its updated RAAM for 2015-16. In its LTRCM submission, NBN Co also provided the ACCC with a copy of its Chart of Accounts with notes to show how the accounts are mapped to the RAAM.

On 31 October 2016, NBN Co provided a statement by NBN Co's CFO which declares that the RAAM has been appropriately updated to meet the financial reporting requirements of the SAU. The statement declares that Schedules 6-9 have been prepared in accordance with the principles of the RAAM (dated 18 October 2016) and have been reconciled with the audited general purpose financial statements. NBN Co also reported that schedule 10 has been prepared in accordance with the reporting requirements of the SAU.

### *Actual and Proposed Financial Information*

On 31 October 2016, NBN Co provided the ACCC with its Actual and Proposed Financial Information for the 2015-16 financial year. The financial information submitted by NBN Co consists of 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.

This information was accompanied by an LTRCM spreadsheet, which provided the underlying calculations of NBN Co's proposed RAB, ABBRR and ICRA values. A public version of NBN Co's LTRCM proposal is available on the ACCC website.

### *Independent assurance reports*

NBN Co also lodged two independent assurance reports from PwC to support the Actual Financial Information and Proposed Financial Information in NBN Co's LTRCM submission. These included:

- a reasonable assurance audit report for the regulatory financial information submitted by NBN Co (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 NBN Co's Actual Financial Information and Proposed Financial Information (Schedule 10). The agreed upon procedures consisted of checking that the relevant input values were extracted correctly from

Schedules 6 to 9 into the LTRCM Spreadsheet and that the relevant LTRCM calculations are undertaken in accordance with the SAU in order to arrive at the output values in Schedule 10.

### **4.2.3 ACCC draft decision regarding financial information**

The ACCC has considered the materials in NBN Co's LTRCM submission and considers that NBN Co has calculated its proposed values for the RAB, ABBRR and ICRA in accordance with the formulas set out in Schedules 1D and 1E of 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 Schedules 1D and 1E of the SAU, the ACCC has considered NBN Co's Actual Financial Information and Proposed Financial Information. The ACCC has also had regard to a spreadsheet that NBN Co has prepared that 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 provide the ACCC with assurance that the financial information has been prepared in accordance with the relevant provisions of the SAU.

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 audit opinion was unqualified and complements the existing auditing of NBN Co's general purpose financial statements. The ACCC considers that this 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**

On 31 October 2016, NBN Co submitted a statement of material variances (Schedule 11) which sets out the variances between the Forecast and Actual Financial Information for operating expenditure, capital expenditure and construction in progress. It also sets out the reasons for these variances.<sup>38</sup>

The ACCC is satisfied that NBN Co has met its reporting requirement to provide a statement of material variances under clause 1F.1.3(b) of the SAU. 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 for the ACCC regarding the magnitude of capital and operating expenditure.

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<sup>38</sup> The statement of material variances has been classified as 'confidential of particular sensitivity'.

## **Regulatory Asset Base components**

The RAB is the value of capital investment made by NBN Co, and the RAB equation determines how that value will change over time. In accordance with Schedule 1D of the SAU, the RAB is calculated by rolling forward the balance of the RAB from the prior year, then adding capital expenditure less disposals and regulatory depreciation. The ACCC has checked NBN Co's calculations with respect to the RAB and is satisfied that they comply with the relevant SAU provisions. The RAB components are set out in Table 4.1 below.

**Table 4.1 RAB calculation (\$'000)**

<b>RAB calculation</b>	<b>2015-16</b>
RAB opening (real)	4 477 166
Add real capital expenditure	4 410 983
Less real disposals	-
Less real straight line depreciation	(435 769)
<b>RAB closing (real)</b>	<b>8 722 380</b>
Cumulative inflation factor	1.025
<b>RAB closing (nominal)</b>	<b>8 944 763</b>

Note: the RAB closing balance is subject to rounding.

### **Capital expenditure**

Based on the ACCC's assessment of capital expenditure compliance in section 4.1 above, the ACCC is satisfied that the capital expenditure proposed by NBN Co in its RAB calculations meets the prudence conditions set out in the SAU.

### **Disposals**

The ACCC understands that there were no disposals during the year.

### **Depreciation**

Under clause 1E.9.1 of the SAU, depreciation should be calculated as straight line depreciation of capital expenditure to be included in the RAB, using asset lives that are consistent with NBN Co's audited accounts. The ACCC has checked the formula used in NBN Co's spreadsheet and is satisfied that it is consistent with the SAU.

### **Cumulative inflation factor**

The cumulative inflation factor (CIF) is used to convert real values to nominal values, and vice versa. The CIF is calculated as the product of the June Quarter Consumer Price Index (CPI) published for each financial year from the commencement of the SAU, relative to the first financial year.<sup>39</sup> The ACCC has checked the June Quarter CPI for 2016 and NBN Co's calculation of the cumulative inflation factor, and is satisfied that the CIF has been calculated and applied correctly.

## **ABBRR 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,

<sup>39</sup> See clause 1E.9.4(b) of the SAU.

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 in the spreadsheet are as set out in Schedule 1E of the SAU. The ABBRR components are set out in Table 4.2 below.

**Table 4.2: ABBRR calculation (nominal, \$'000)**

	<b>2015-16</b>
Return on capital	314 255
<i>Add regulatory depreciation</i>	397 570
<i>Add operating expenditure</i>	2 259 775
<i>Add net tax allowance</i>	-
<i>Add annual construction in progress allowance</i>	227 127
<b>ABBRR</b>	<b>3 198 728</b>

Note: the ABBRR closing balance is subject to rounding.

### **Return on capital**

The SAU allows for NBN Co to earn an appropriate commercial return on its investment in the infrastructure assets used to supply the services that are the subject of the SAU. This return on capital is calculated by multiplying the opening RAB value by the cost of capital. The SAU has specified that the cost of capital will be the risk free rate with a 350 basis point risk premium.

The ACCC has checked NBN Co's calculation of the risk free rate and cost of capital, and is satisfied that these figures have been calculated in accordance with clause 1E.7.1 of the SAU. As a result, the ACCC is 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.

The ACCC has reviewed the formulas used by NBN Co to calculate regulatory depreciation and is satisfied that they comply with clause 1E.9.1 of the SAU.

### **Operating expenditure**

As discussed at section 2.2, operating expenditure can be included in the ABBRR to the extent that it meets the prudency conditions and was incurred in accordance with NBN Co's Procurement Rules. NBN Co's proposed value for operating expenditure is provided in Schedule 7 of NBN Co's submission. Based on our assessment of operating expenditure compliance in section 4.1, the ACCC is satisfied that the amount of operating expenditure proposed by NBN Co meets the requirements of the SAU and can be included in the ABBRR.

### **Net tax allowance**

The ACCC acknowledges that NBN Co is currently in a loss-making position and therefore the net tax allowance is not applicable for the 2015-16 LTRCM draft determination.

### **Annual construction in progress allowance**

The SAU provides the annual construction in progress allowance to account for the financing costs associated with capital expenditure relating to assets that are not yet in service. The

annual construction in progress allowance is calculated by multiplying the value of construction in progress for the year by the cost of capital.<sup>40</sup>

The ACCC understands that the value of construction in progress is determined in accordance with NBN Co's audited accounts, however an Alternate Accounting Treatment is 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 has checked NBN Co's proposed annual construction in progress allowance and is satisfied that it has been calculated in accordance with clause 1E.10.1 of the SAU.

### **Initial Cost Recovery Account (ICRA) components**

The ICRA is determined by calculating the difference between the ABBRR and the amount of revenue actually earned by NBN Co via access prices in that year. This 'unrecovered cost' amount is added to the ICRA balance from the previous year, which is capitalised and carried forward.<sup>41</sup>

**Table 4.3 Unrecovered cost calculation (nominal, \$'000)**

	<b>2015-16</b>
ABBRR	3 198 728
Less revenue	(421 455)
Unrecovered cost	<b>2 777 273</b>

### **Revenue**

The value proposed for revenue by NBN Co is set out in Schedule 9 of NBN Co's submission. It is the same value included in NBN Co's audited general purpose financial statements, except for an adjustment to remove interest income. Similar to previous years, the ACCC remains of the view that it is appropriate to exclude interest income from regulated revenue from the current determination.<sup>42</sup> The ACCC remains of the view that it is appropriate to exclude interest income from regulated revenue from the current determination.

**Table 4.4 ICRA calculation (nominal, \$'000)**

	<b>2015-16</b>
Capitalised ICRA from prior period	6 243 728
Add unrecovered cost	2 777 273
ICRA closing	<b>9 428 175</b>

### **Capitalised ICRA from prior period**

The closing balance of the ICRA account in the prior year is capitalised and carried forward into the current financial period and added to the unrecovered cost from the current year. The cost of capital rate is the same as that used to calculate the return on capital for the purposes of the ABBRR and annual construction in progress allowance (discussed above). The ACCC has checked NBN Co's calculation of the capitalised ICRA balance and is satisfied that the

<sup>40</sup> See formula in clause 1E.10.1 of the SAU.

<sup>41</sup> Clause 1E.5 of the SAU.

<sup>42</sup> The ACCC considered the case for including interest income in detail in its 2013-14 Draft LTRCM Determination. See ACCC, *NBN Co SAU LTRCM 2013-14 Draft Determination and Price Compliance Reporting 2013-14*, February 2015, p.24.



proposed ICRA closing balance for 2015-16 has been calculated in accordance with the relevant provisions in Schedule 1E of the SAU.

## 4.3 Assessment of price compliance

### 4.3.1 SAU requirements

Clause 1F.3 of the SAU requires that by 31 October after the end of each financial year of the Initial Regulatory Period, NBN Co must submit a report signed by the CFO of NBN Co (or an authorised delegate) certifying that, in respect of that financial year the prices for the supply of its services did not exceed the maximum regulated price set by Schedule 1C of the SAU.

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).

### 4.3.2 NBN Co's LTRCM submission

On 31 October 2016, NBN Co provided the ACCC with a Price Compliance Report and a price compliance spreadsheet for the period from 1 July 2015 to 30 June 2016.<sup>43</sup> NBN Co also submitted an independent assurance report to complement NBN Co's Price Compliance Report and supporting information in its supplementary submission.

The Price Compliance Report provides CFO certification that the pricing of NBN Offers and Other Charges over the period from 1 July 2015 to 30 June 2016 satisfied the relevant requirements in Schedule 1C of the SAU. The report does not identify any exceptions. Similar to the Expenditure Compliance Report and the Procurement Rules Compliance Report, this report includes some qualifying language and expresses negative assurance conclusions.<sup>44</sup>

NBN Co has advised that the certification in the Price Compliance Report was informed by a range of investigations and testing. This included identifying the price lists that applied under the WBA2 over the relevant period, and checking these price lists for consistency with Schedule 1C of the SAU. This analysis was set out in a price compliance spreadsheet, which was also submitted to the ACCC. NBN Co further submits that such investigations and testing is necessarily subject to inherent limitations and there is an unavoidable risk that some deficiencies may not be detected.<sup>45</sup>

NBN Co indicated that a number of changes have been made to the price lists during 2015-16. The main changes relate to the following:

- the introduction of NBN Co's ethernet bitstream service (NEBS) supplied through the FTTN network, HFC network and the satellite network
- the introduction of various CVC speed tiers to all networks, except for satellite
- service transfers for all networks, except for satellite
- the introduction of additional AVC speed tiers in respect of NBN Co Wireless network, and
- the introduction of an additional AVC class for the NBN Co fibre network.<sup>46</sup>

<sup>43</sup> Pursuant to clause 1F.3(a) of the SAU.

<sup>44</sup> NBN Co's Price Compliance Report is published on the ACCC website.

<sup>45</sup> NBN Co, *NBN Co submission to the ACCC – 2015-16 Regulatory Information and LTRCM Determination*, 31 October 2016, p. 17.

<sup>46</sup> NBN Co, *NBN Co submission to the ACCC – 2015-16 Regulatory Information and LTRCM Determination*, 31 October 2016, p. 17.



In addition, NBN Co lodged an independent assurance report by PwC on the effectiveness of the control procedures to ensure price compliance. PwC's limited assurance opinion is unqualified in nature and complements NBN Co CFO's certification.

### **4.3.3 ACCC draft decision on price compliance**

The ACCC has considered the Price Compliance Report and supporting materials provided by NBN Co and is satisfied that NBN Co's prices for 2015-16 did not exceed the applicable maximum regulated prices at the relevant point in time, in accordance with Schedule 1C of the SAU.

This assessment is supported by the ACCC's analysis of the price compliance spreadsheet provided by NBN Co. The ACCC has reviewed the prices in this spreadsheet and has compared them to the pricing provisions listed in the SAU. In conducting this analysis, the ACCC did not find any instances in which the listed prices exceeded the applicable maximum regulated prices.

The ACCC notes that some prices listed in the price compliance spreadsheet for the NBN Satellite Network are greater than the maximum regulated prices initially specified in the SAU. This included prices for installations and activations, service modifications and service management as applied to the Satellite Network. However, NBN Co has provided notification of these price changes as required under Schedule 1C of the SAU, and that these prices are therefore compliant with the requirements of the SAU. NBN Co provided notice of these changes in May 2015, with the new prices coming into effect in April 2016.

The price compliance spreadsheet also contains prices for new products. These new products do not have prices specified in the SAU. The ACCC recognises that NBN Co has the ability to determine prices for new products under the SAU. However, the ACCC also has 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.

The ACCC is satisfied that the Price Compliance Report and supporting materials provide assurance that NBN Co has key control procedures in place to ensure that the prices for the products that NBN Co offers do not exceed the applicable maximum regulated prices. In addition, the ACCC considers that PwC's limited assurance report on NBN Co's price compliance provides independent assurance that NBN Co has controls in place to ensure that its prices do not exceed the applicable maximum regulated prices in the SAU. Therefore, the ACCC is satisfied that NBN Co has met its price compliance obligations in the SAU.

## 5 The ACCC's LTRCM Draft Determination

For the 2015-16 financial year, the ACCC is required to consult on an LTRCM Draft Determination in respect of the ABBRR, RAB, ICRA and the values of the inputs to each of those values.<sup>47</sup> For the reasons set out in this document, the ACCC has determined the values in Table 5.1 for the purposes of the ACCC's LTRCM Draft Determination for 2015-16. These values have been derived from the regulatory information provided by NBN Co.<sup>48</sup>

**Table 5.1: 2015–16 LTRCM Draft Determination<sup>49</sup>**

Year	2015-16
<b>CPI and Cumulative Inflation Factor</b>	
June Quarter CPI (annual percentage change) – as per Attachment C to the SAU	1.023%
Cumulative Inflation Factor - as per Clauses 1E.9.4(b) and (c)	1.025

Year	2015-16
<b>Rate of Return – as per Clause 1E.7.1</b>	
Risk free rate of interest - as per Clause 1E.7.1(b) and (c)	3.021%
Nominal rate of return - as per Clause 1E.7.1(a)	6.521%

Year	2015-16
<b>Regulatory Asset Base (\$'000 REAL) – as per Clause 1D.2.1</b>	
Real RAB (start period) - as per Clause 1D.2.1(a) and (b)	4 747 166
Real capital expenditure	4 410 983
Real disposals	-
Real straight line depreciation	435 769
Real RAB (end period) - as per Clause 1D.2.1(b)	8 722 380

Year	2015-16
<b>Regulatory Asset Base (\$'000 NOMINAL) – as per Clause 1D.2.2</b>	
Nominal RAB (start period) - as per Clauses 1D.2.1(a) and 1D.2.2	4 818 889
Nominal straight line depreciation (as per Clause 1E.9.1(b))	446 880
Nominal RAB (end period) - as per Clause 1D.2.2	8 944 763

<sup>47</sup> Clause 1E.1.2(a) of the SAU.

<sup>48</sup> In accordance with Clause 1E.1.2(c)(vi)

<sup>49</sup> The clause references in this table refer to the formulas in the SAU.

<b>Year</b>	<b>2015-16</b>
<b>ABBRR (\$'000 NOMINAL) - as per Clause 1E.4.1</b>	
Return on capital	314 255
Nominal regulatory depreciation – as per clause 1E.9.1(c)	397 570
Nominal operating expenditure	2 259 775
Net tax allowance	-
Annual construction in progress allowance – as per Clause 1E.10	227 127
<b>ABBRR</b>	<b>3 198 728</b>

<b>Year</b>	<b>2015-16</b>
<b>Taxation calculations (\$'000 NOMINAL) - as per Clause 1E.9.3</b>	
Nominal revenue	421 455
<i>Add</i> value of assets received for nil consideration	97 633
<i>Less</i> nominal operating expenditure	(2 259 775)
<i>Less</i> nominal tax depreciation	(433 314)
<i>Less</i> interest expense	(247)
Taxable profit – as per Clause 1E.9.3	(2 184 249)
Tax loss carried forward (Start period) – as per Clause 1E.9.3	(4 760 207)
Tax loss carried forward (End period) – as per Clause 1E.9.3	(6 944 456)
Net tax allowance – as per Clause 1E.9.3	-

<b>Year</b>	<b>2015-16</b>
<b>ICRA and CFRA (\$'000 NOMINAL) – as per Clause 1E.5</b>	
ICRA (start period) – as per Clause 1E.5.2	6 243 728
Unrecovered cost -as per Clause 1E.5.1	2 777 273
ICRA (end period) – as per Clause 1E.5.2	9 428175
Carry forward revenue adjustment – as per Clause 1E.5.3	n/a