



NBN Co Special Access Undertaking

Long Term Revenue Constraint Methodology
Draft Determination 2020-21

and

Price compliance reporting 2020-21

April 2022

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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
CPO	Chief Procurement Officer
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

In accordance with section 1E.1.2 of NBN Co's current 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 2020-21.

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 4 and 5 of this report.

The ACCC is also satisfied that NBN Co's prices for 2020-21 did not exceed the maximum regulated prices, in accordance with Schedule 1C of the SAU. The reasons for this decision are outlined in section 6 of this report.

The LTRCM is a component of the current SAU, which forms part of the regulatory framework for access to the National Broadband Network (NBN). While the current SAU only applies to fibre-to-the-premises, fixed wireless and satellite services, the LTRCM determination includes expenditure associated with all of the access technologies that NBN Co provides under the multi-technology mix. The ACCC uses the LTRCM to determine the amount of revenue NBN Co is allowed to earn through its prices over the term of the SAU. The LTRCM provides NBN Co with the opportunity to recover the amount determined in accordance with the requirements in the SAU, including an appropriate return on investment. It is also one of the incentives in the SAU to encourage NBN Co to operate and invest prudently, 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 2020-21 to the ACCC on 29 October 2021.

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 draft determination follows the ACCC's preliminary view on NBN Co's capital and operating expenditure for 2020-21, which was published in December 2021. The ACCC did not receive any submissions in response to its preliminary view. The ACCC now invites submissions on the draft decision until 13 May 2022.

As part of this year's process, we also propose to correct a typographical error recorded in last year's 2019-20 LTRCM determination. The LTRCM final determination reported the closing value of the nominal RAB as \$27,245,750,000. However, this figure should be \$27,345,750,000.¹

¹ Note this has been rounded to the nearest thousand.

1. Introduction

In accordance with section 1E.1.2 of NBN Co's current 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 2020-21.

In making the draft determination, the ACCC has considered the regulatory information submitted by NBN Co for 2020-21 and assessed the various components against the relevant requirements of the current SAU. Based on this assessment, the ACCC has reached its draft determination that the values proposed by NBN Co for allowable revenues, the regulatory asset base (RAB), initial cost recovery account (ICRA), and all associated inputs have been determined in accordance with the SAU. The ACCC is satisfied that prudence requirements for expenditure have been satisfied. The ACCC has also considered NBN Co's price compliance and is satisfied that NBN Co's prices did not exceed the maximum regulated prices in the SAU in 2020-21.

This report sets out the ACCC's LTRCM draft determination for 2020-21 and reasons for reaching this decision, as well as the ACCC's price compliance review for 2020-21.

1.1. LTRCM process

NBN Co's SAU is a key component in the framework to regulate access to the National Broadband Network (NBN). The SAU establishes the LTRCM, which determines NBN Co's allowed annual regulated revenue and the value of its regulatory asset base, including all inputs required to calculate these values. The LTRCM process commences after we receive NBN Co's submission of regulatory information. We use this information to prepare an LTRCM determination and assess NBN Co's compliance with the maximum regulated prices. We received NBN Co's regulatory information on 29 October 2021.

The SAU specifies how each of the inputs that comprise the LTRCM are to be calculated and/or determined, along with the prudence conditions that must be satisfied for expenditure to be included. The LTRCM process is intended to provide NBN Co the opportunity to recover only its prudent costs, including an appropriate return on investment, over the term of the SAU. While the current SAU only applies to fibre-to-the-premises, fixed wireless and satellite services, the LTRCM determination includes expenditure associated with all of the access technologies that NBN Co provides under the multi-technology mix.

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. The ACCC must then make an LTRCM determination within 12 months of the end of the relevant financial year. NBN Co must also certify that its prices have not exceeded the maximum regulated prices allowed in the SAU during the relevant financial year.

1.2. The continued evolution of the NBN

With the NBN transitioning from a rollout phase into an operational phase, we continue to expect NBN Co's expenditure profile to resemble that of an established network operator. We expect that NBN Co's focus will be on the maintenance and day to day running of the network, rather than on building new parts of the network which would be capital intensive. We anticipate that NBN Co's capital expenditure should continue to decline compared to the

peak levels seen during the NBN build. NBN Co also expects operating costs to continue to decline as it moves towards being an established service delivery company.²

This transition has also provided the juncture to consider whether aspects of the current regulatory framework, established prior to the commencement of the network build, has remained suitable for the day to day running of the network. The ACCC is currently reviewing the regulatory arrangements for wholesale access to the NBN.³ We expect that any changes to the revenue constraints in the SAU will only apply from 1 July 2023 onwards.

1.3. Submissions to preliminary view

In December 2021 we published our preliminary view on capital and operating expenditure and invited submissions by 11 February 2022. We did not receive any submissions.

1.4. Structure of report

This report outlines the ACCC's LTRCM draft determination and price compliance review for 2020-21. It also considers a proposed amendment to the 2019-20 LTRCM determination. The structure of the report is as follows:

- Section 2 sets out NBN Co's submission of regulatory information
- Section 3 sets out the proposed amendment to the 2019-20 LTRCM determination
- Section 4 sets out the ACCC's draft assessment of NBN Co's expenditure compliance and reporting
- Section 5 sets out the ACCC's draft assessment of NBN Co's financial information
- Section 6 sets out the ACCC's draft assessment of NBN Co's price compliance
- Section 7 sets out the ACCC's draft determination for 2020-21.

1.5. Consultation

We are seeking stakeholder views on this draft determination by 13 May 2022. We will then prepare our final LTRCM determination for 2020-21 by 30 June 2022.

The ACCC encourages industry participants and other interested parties to make submissions to 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'.

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.

² See NBN Co Full Year Results FY21 CEO and CFO speech - <https://www.nbnco.com.au/content/dam/nbn/documents/media-centre/media-statements/2021/FY21-financial-results-ceo-and-cfo-speech.pdf> p. 20

³ Detail on the review available on the ACCC website - https://www.accc.gov.au/regulated_infrastructure/communications/national-broadband-network-nbn/review-of-nbn-regulatory-framework

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 13 May 2022 to nbn@acc.gov.au and copy to:

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2. NBN Co's 2020-21 regulatory information

On 29 October 2021, 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 from NBN Co's Chief Procurement Officer (CPO) regarding the basis on which NBN Co's procurement rules meet the relevant conditions set out in the SAU. Note that for 2020-21 this report has been signed by the EGM of Procurement (as successor to the CPO role at NBN Co).⁴
- a price compliance report signed by NBN Co's CFO, that certified that the basis on which the pricing of NBN offers and other charges meet the relevant conditions as set out in 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 are available on the ACCC website.⁵

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 percentage change.

Table 2.1: Summary of NBN Co's financial information, 2019-20 and 2020-21 (nominal)⁶

	2019-20 (\$'000)	2020-21 (\$'000)	Percentage Change
Operating expenditure	5,212,619	4,174,955	-19.91%
Capital expenditure	6,669,153	3,282,773	-50.78%
Construction in progress (start of period)	3,309,660	1,699,456	-48.65%
Interest expense	649,327	771,036	18.74%
Revenue	3,836,984	4,629,109	20.64%
Unrecovered costs	5,333,785	2,724,175	-48.93%
RAB (end of period)	27,345,750	28,737,716	5.09%
ABBRR	9,170,768	7,353,283	-19.82%
ICRA (end of period)	32,038,694	36,183,087	12.94%

Source: NBN Co, *LTRCM spreadsheet 2020-21*

⁴ NBN Co's EGM Procurement is the successor to the Chief Procurement Officer role. NBN Co, *2020-21 Supporting submission*, p. 17.

⁵ ACCC, *NBN Co – Special Access Undertaking, NBN Co's regulatory information*: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2020-21>

⁶ These figures have been rounded to the nearest thousand.

3. Proposed amendment to 2019-20 LTRCM determination

NBN Co has identified a typographical error in the ACCC's LTRCM determination for 2019-20. The LTRCM final determination determined the closing value of the nominal RAB as \$27,245,750,000, however, this value should be \$27,345,750,000. NBN Co has requested that the ACCC amend the 2019-20 LTRCM determination to correct for this error. We agree that the error is typographical and should be corrected in this year's LTRCM process.

3.1. Relevant SAU provisions

Under clause 1E.1.3(a) of the SAU, there is provision for the ACCC to amend or revoke an LTRCM determination no later than 12 months after the date of such a determination. To do so, the ACCC must be satisfied there is a material error or deficiency in the LTRCM determination of one or more of the following kinds:

- a clerical error or an accidental omission
- a miscalculation or misdescription
- a defect in form, or
- a deficiency resulting from the provision of false or materially misleading information to the ACCC.

If the ACCC revokes an LTRCM under clause 1E.1.3, the ACCC must make a new LTRCM determination in substitution for the revoked LTRCM determination.⁷ The substituted LTRCM determination must only vary from the revoked LTRCM determination to the extent necessary to correct the relevant error or deficiency.⁸

3.2. ACCC draft decision on the proposed amendment

The ACCC considers that the error in the LTRCM determination for 2019-20 was material and was a clerical error. Therefore, the ACCC proposes to revoke the 2019-20 LTRCM determination and issue a corrected version. The ACCC proposes that the closing value of the nominal RAB should be \$27,345,750,000 in the corrected version and that the determination will otherwise remain unchanged.⁹ As a result, the ACCC will use this corrected value as the opening value for the nominal RAB for the 2020-21 determination.

⁷ Clause 1E.1.3(b) of the SAU

⁸ Clause 1E.1.3(c) of the SAU

⁹ The closing value of the nominal RAB is rounded to the nearest thousand in the LTRCM final determination for presentation purposes.

4. Assessment of expenditure compliance and reporting

4.1. 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.
- 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.
- there be a process for managing contracts (both before and after the award of tenders) that accords with good industry practice and seeks 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 the Chief Procurement Officer. This report must certify that NBN Co's procurement rules satisfy the SAU requirements for the relevant financial year.

4.2. 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 2020-21 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 have not been met.¹⁰

NBN Co's CFO engaged NBN Co's internal audit function to review, document and test the underlying end-to-end business processes and the effectiveness of controls relating to capital expenditure and operating expenditure prudence to satisfy the prudent design condition and the prudent cost condition (and the equivalent conditions for operating expenditure).¹¹ This included:

- performing process walkthroughs with relevant staff
- confirming end-to-end process maps
- identifying and reconfirming relevant control objectives and control procedures, and
- testing of control design and effectiveness.¹²

NBN Co's internal audit largely aligns its work on the Australian Standard on Assurance Engagements (ASAE) 3150: Assurance Engagements on Controls (January 2016). 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 that are conducted in a reasonable assurance engagement.¹³

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 prudence. 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 meets the relevant prudence conditions and should be included in the RAB and ABBRR, respectively.¹⁴

Procurement rules compliance report

NBN Co has submitted a procurement rules compliance report signed by its EGM Procurement, which certifies that the procurement rules met the relevant conditions as set out in the SAU over 2020-21. NBN Co has not reported any exceptions in relation to this report and that NBN Co's procurement rules satisfied the requirements in clause 1D.5.1 of the SAU.¹⁵

¹⁰ 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.

¹¹ NBN Co's internal audit function provides another layer to help ensure it has adequate processes and controls in place. More detail on the internal audit function is set out in section 4.3 of this report.

¹² NBN Co, *NBN supporting submission to the ACCC – 2020-21 Regulatory Information and LTRCM Determination*, p. 13. See <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2020-21>

¹³ NBN Co, *Supporting submission 2020-21*, p. 13

¹⁴ NBN Co, *Supporting submission 2020-21*, p. 16

¹⁵ NBN Co, *Supporting submission 2020-21*, p. 17

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.¹⁶ This is the same certification and wording as used in previous years.

4.3. ACCC draft position

Expenditure compliance

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 is reasonable for the purpose of demonstrating that it has 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.

ACCC consideration

The expenditure compliance report did not identify any exceptions during 2020-21, though it did use some qualifying language in expressing its negative assurance conclusion. Therefore, the ACCC considered other supporting materials to determine 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.

Adequate procurement rules

The SAU 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.¹⁷ The relevant procurement rules for this period came into effect on 23 February 2018 and were provided to the ACCC on 21 March 2018. The ACCC has previously reviewed these 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.

Processes and controls in place

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.

¹⁶ See footnote 10 for a detailed explanation of NBN Co's use of qualifying language and negative assurance.

¹⁷ Clause 1D.5.2 of the SAU.

Processes and controls operating effectively

To assess 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 and compliance processes.

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 prudence to satisfy prudent design condition and capital expenditure prudent cost condition (and equivalent for operating expenditure).¹⁸

NBN Co's internal audit process involved performing process walkthroughs with relevant staff (for example in relation to each of the different network types), confirming end-to-end process maps, identifying and reconfirming relevant control objectives and control procedures, and testing of control design and effectiveness.

Once the series of cross-functional workshops with relevant subject matter experts and the relevant controls had had been identified and reconfirmed, NBN Co then proceeded to undertake control testing. This involved developing appropriate samples with the methodology based on generally accepted internal audit sampling criteria.¹⁹ NBN Co selected an appropriate judgment sample based on the relevant guidance to test the effectiveness for each control procedure. A total of 182 samples were tested to confirm the operating effectiveness of the prudent design and prudent cost controls.

NBN Co then undertook testing for each of the sample items to confirm all aspects of the controls were operating as designed. For each relevant control procedure, applicable 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. Based on NBN Co's internal audit's sample testing, no exceptions were identified regarding expenditure compliance.²⁰

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 prudence conditions set out in the SAU.

Procurement 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 2020 to 30 June 2021, and that the procurement rules satisfied the requirements in clause 1D.5.1 of the SAU.

NBN Co identified that the purchasing rules that came into effect on 23 February 2018 were the relevant procurement rules for the period. NBN Co has since updated its purchasing rules to the 'procurement policy' which will take effect from 1 July 2021 and will therefore pertain to next year's LTRCM determination.

¹⁸ See NBN Co's 2020-21 LTRCM supporting submission, p. 13-16 for more detail on NBN Co's internal audit processes.

¹⁹ In general, NBN Co Internal Audit utilises judgmental sampling in accordance with relevant assurance standards and guidelines (including Auditing Standard of Australia (ASA) 530 Audit Sampling and the Institute of Internal Auditors 'International Professional Practices Framework' (IPPF) Practice Advisory – 2320 – Audit Sampling).

²⁰ Nevertheless, as in previous years, any such investigation and testing is necessarily subject to inherent limitations; there is an unavoidable risk that some deficiencies may not be detected, regardless of how carefully and thoroughly the work is planned and performed.

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

5. Assessment of LTRCM financial information

5.1. 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.²¹

Forecast financial information

On 30 June 2020, NBN Co submitted its forecast financial information for 2020-21. This submission was comprised of:

- Capital Expenditures, by Asset Type
- Disposals, by Asset Type
- the opening value and closing value of Construction in Progress, and
- 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.²²

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.²³

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 cost.

5.2. 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

²¹ Clause 1F.1.2 of the SAU.

²² Clause 1F.1.3(a) of the SAU.

²³ Clause 1F.1.3(b) of the SAU.

when preparing the LTRCM reports. The RAAM also explains the cases where NBN Co will apply an alternate accounting treatment, that is, where it is not consistent with Australian Accounting Standards, to meet SAU requirements. NBN Co noted it has made minor updates to the RAAM in respect of 2020-21.²⁴ These updates reflected: organisational changes, including changes to job titles, and an update to section 9.5 (Inventory).²⁵ This means that any write-offs of inventory will now be recognised within depreciation expenditure instead of operating expenditure.

NBN Co's 2020-21 submission of regulatory information also included a copy of its current chart of accounts, with notes showing how the accounts are mapped to the RAAM. NBN Co's regulatory information included a statement by NBN Co's CFO declaring that:

- the RAAM has been appropriately updated to reflect changes in NBN Co's business and 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 dated 30 June 2021 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.²⁶

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 2020-21. This 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
- 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.²⁷

Independent assurance reports

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

- a reasonable assurance audit report with respect to Schedules 6-9 – PwC's audit opinion for this work was unqualified and complements the audit of NBN Co's general purpose financial statements.

²⁴ NBN Co, *Submission of regulatory information – supporting submission*, p. 7.

²⁵ NBN Co made this change to reflect a reclassification of the inventory balance to property, plant and equipment for statutory reporting purposes to more appropriately reflect its nature.

²⁶ NBN Co, *Submission of regulatory information*, p. 13.

²⁷ ACCC, *NBN Co – Special Access Undertaking, NBN Co's regulatory information*: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2020-21>

- factual findings of agreed upon procedures for Schedule 10 – PwC checked that prior to 2020-21, the relevant values in the LTRCM spreadsheet are in accordance with last year’s ACCC LTRCM determination.²⁸ PwC also checked that the relevant input values are extracted from Schedules 6 to 9 into the LTRCM spreadsheet and that the relevant LTRCM calculations are undertaken in accordance with the SAU to arrive at the output values in Schedule 10.²⁹
- a report providing limited assurance engagement on the design and implementation of controls around expenditure compliance.

5.3. 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 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 regard 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.

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)³⁰ which sets out the variances between forecast and actual financial

²⁸ Aside from the typographical error that will be correct in this year’s process. See section 3 of this report for more detail on the error and the process to amend.

²⁹ Aside from the typographical error in the ACCC’s 2019-20 LTRCM final determination for the closing value of the nominal RAB, there were no exceptions identified in the report.

³⁰ In accordance with clause 1F.1.3(b) of the SAU.

information, and the reasons for these variances.³¹ The statement also provides 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 forecast and 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.³²

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 5.1 below.

Table 5.1: RAB calculation, 2020-21 (real)

	2020-21 (\$'000)
RAB opening (real)	25,313,941
Add real capital expenditure	2,926,310
Less real disposal	-
Less real straight-line depreciation	(2,623,045)
RAB closing (real)	25,617,207
Cumulative inflation factor	1.122

Capital expenditure

As noted in sections 4.3 and 5.3, 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 prudency conditions set out in the SAU.

Disposals

There were no disposals during 2020-21.

Depreciation

The method of depreciation used in the calculation of the value of the RAB is straight-line depreciation³³ 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.

³¹ The statement of material variances has been classified as 'confidential of particular sensitivity'.

³² In accordance with clause 1D.2.1 of the SAU.

³³ Consistent with clause 1E.9.1 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.³⁴ 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 5.2.

Table 5.2: ABBRR calculation, 2020-21 (nominal)

	2020-21 (\$'000)
Return on capital	1,212,188
Add regulatory depreciation ³⁵	1,890,807
Add operating expenditure	4,174,955
Add net tax allowance	-
Add annual construction in progress allowance	75,334
ABBRR	7,353,283

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 have been 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.

³⁴ See clause 1E.9.4(b) of the SAU.

³⁵ See clause 1E.9.1(c) of the SAU. The formula to calculate nominal regulatory depreciation: nominal straight line depreciation – June quarter CPI x Nominal RAB at the end of the previous financial year. For further information on figures and calculations, refer to the LTRCM spreadsheet at ACCC, NBN Co – Special Access Undertaking, NBN Co's regulatory information: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2020-21>

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 is reasonable for the purpose of demonstrating 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 2020-21 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.³⁶

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 financial year. This unrecovered cost amount is added to the ICRA balance from the previous year, which is capitalised and carried forward.³⁷

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 5.3: Unrecovered cost calculation, 2020-21 (nominal)

	2020-21 (\$'000)
ABBRR	7,353,283
<i>Less revenue</i>	<i>(4,629,109)</i>
Unrecovered cost	2,724,175

³⁶ See clause 1E.10.1 of the SAU.

³⁷ See Clause 1E.5 of the SAU.

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.³⁸

Table 5.4: ICRA calculation, 2020-21 (nominal)

	2020-21 (\$'000)
ICRA from prior period	32,038,694
Add unrecovered cost	2,724,175
Add capitalisation of the ICRA from the prior period	1,420,218
ICRA closing	36,183,087

Capitalised ICRA from prior period

The closing balance of the ICRA 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 ACIPA.

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.

³⁸ 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.

6. Assessment of price compliance

6.1. SAU requirements

NBN Co must submit a report signed by its CFO (or approved delegate) that certifies 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 the Maximum Regulated Price (MRP) at the relevant point in time, and
- prices complied with the requirements of Schedule 1C (NBN Offers and Other Charges).³⁹

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.

6.2. 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 2020-21.⁴⁰

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 2020 to 30 June 2021 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.⁴¹

The certification provided by NBN Co's CFO was informed by a range of investigations and testing conducted by NBN Co. This included preparing a price compliance spreadsheet which identified the relevant price lists that applied during the period and compared them to Schedule 1C of the SAU; and work performed by NBN Co internal audit to test the design and effectiveness of controls.

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 testing is subject to inherent limitations, and that there is an unavoidable risk that they may not detect some deficiencies.⁴² 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.⁴³

Throughout 2020-21, NBN Co made a number of changes to its WBA4 price list. The WBA4 price list was introduced and updated over the period to 30 June 2021 and included the following changes:

³⁹ See SAU Schedule 1C and 1F.3.

⁴⁰ ACCC website, <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2020-21>

⁴¹ See footnote 10 for a detailed explanation of NBN Co's use of qualifying language and negative assurance.

⁴² NBN Co, *2020-21 Regulatory Information - Supporting submission*, p. 18: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2020-21>

⁴³ Public version of NBN Co's price compliance report and spreadsheet <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2020-21>

- the 25/5-10Mbps AVC TC-4 speed tier on FTTC was enhanced to 25/10Mbps.
- the 25-50/5-20 Mbps AVC TC-4 speed tier on FTTC was enhanced to 50/20Mbps.
- the 25-100/5-40Mbps AVC TC-4 speed tier on FTTC was enhanced to 50-100/20-40Mbps.
- the recurring charges for the following NNI Bearer Product Components were permanently reduced (for both nbn Ethernet and nbn Enterprise Ethernet services): 1000BaseEX, 10GBaseER.
- the introduction of an Access Component Reactivation charge 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.
- Price reductions to the non-recurring charges for the following activities provided 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: NNI 1000BaseEX Activation, NNI 10GBaseER Activation, Service Transfer, Transfer Reversal.
- Price reductions to the non-recurring charges for the following activities provided over nbn Enterprise Ethernet: NNI 1000BaseEX Activation, NNI 10GBaseER Activation.
- Price reductions to the non-recurring charges for the following activities provided over the NBN Co Satellite Network: NNI 1000BaseEX Activation, NNI 10GBaseER Activation, Service Transfer, Transfer Reversal.
- The charges for Missed Appointment are now presented as 'First Missed Appointment' and 'Subsequent Missed Appointment'.
- Withdrawal of multicast (Multicast AVC and Multicast Domain) over nbn Ethernet (NBN Co Fibre Network).

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 ongoing 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.

6.3. 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 2020-21 did not exceed the maximum regulated prices set out in Schedule 1C of the SAU, and that NBN Co has met its price compliance obligations in the SAU. Further, we consider that most of NBN Co's services are currently supplied at prices well below the maximum regulated prices specified in the SAU.

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, though the ACCC 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.

7. The ACCC's LTRCM draft determination

For the reasons set out in this document, we have determined the values in Table 7.1 for the purposes of the 2020-21 LTRCM draft determination. We derived these values from NBN Co's submission of regulatory information.⁴⁴

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.⁴⁵

Table 7.1 2020-21 LTRCM Draft Determination⁴⁶

Year	2020-21
CPI and Cumulative Inflation Factor	
June Quarter CPI (annual percentage change) – as per Attachment C to the SAU	3.846%
Cumulative Inflation Factor – as per Clauses 1E.9.4(b) and (c)	1.122
Rate of return – as per Clause 1E.7.1	
Risk free rate of interest – as per Clause 1E.7.1(b) and (c)	0.933%
Nominal rate of return – as per Clause 1E.7.1(a)	4.433%
Regulatory Asset Base (\$'000 REAL) – as per Clause 1D.2.1	
Real RAB (start period) – as per Clause 1D.2.1(a) and (b)	25,313,941
Real capital expenditure	2,926,310
Real disposals	-
Real straight-line depreciation	2,623,045
Real RAB (end period) – as per Clause 1D.2.1(b)	25,617,207
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	27,345,750
Nominal straight-line depreciation (as per Clause 1E.9.1(b))	2,942,566
Nominal RAB (end period) – as per Clause 1D.2.2	28,737,716
ABBRR (\$'000 NOMINAL) – as per Clause 1E.4.1	
Return on capital	1,212,188
Nominal regulatory depreciation – as per clause 1E.9.1(c)	1,890,807
Nominal operating expenditure	4,174,955
Net tax allowance	-
Annual construction in progress allowance – as per Clause 1E.10	75,334
ABBRR	7,353,283
Taxation calculations (\$'000 NOMINAL) – as per Clause 1E.9.3	
Nominal revenue	4,629,109

⁴⁴ In accordance with Clause 1E.1.2(c)(vi) of the SAU.

⁴⁵ Clause 1E.1.2(a) of the SAU.

⁴⁶ The clause references in this table refer to the formulas in the SAU. Note: figures have been rounded.

<i>Add</i> value of assets received for nil consideration	55,510
<i>Less</i> nominal operating expenditure	4,174,955
<i>Less</i> nominal tax depreciation	2,793,725
<i>Less</i> interest expense	771,036
Taxable profit – as per Clause 1E.9.3	(3,055,098)
Tax loss carried forward (Start period) – as per Clause 1E.9.3	(22,265,147)
Tax loss carried forward (End period) – as per Clause 1E.9.3	(25,320,244)
Net tax allowance – as per Clause 1E.9.3	-
ICRA and CFRA (\$'000 NOMINAL) – as per Clause 1E.5	
ICRA (start period) – as per Clause 1E.5.2	32,038,694
Unrecovered cost – as per Clause 1E.5.1	2,724,175
ICRA (end period) – as per Clause 1E.5.2	36,183,087
Carry forward revenue adjustment – as per Clause 1E.5.3	n/a