



NBN Co Special Access Undertaking

Long Term Revenue Constraint Methodology
2018-19: Draft Determination

and

Price compliance reporting 2018-19

1 May 2020

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1. Introduction

In accordance with section 1E.1.2 of NBN Co's special access undertaking (the SAU), the ACCC has made a draft determination in relation to NBN Co's long term revenue constraint methodology (LTRCM) for the 2018-19 financial year.

In making the draft determination, the ACCC has considered the regulatory information submitted by NBN Co for 2018-19 and assessed the various components against the relevant requirements of the SAU. Based on this assessment, the ACCC has reached its draft position that 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, and that NBN Co's prices did not exceed maximum regulated prices in 2018-19.

We have previously recognised NBN Co's changing operating environment as it reaches the end of the National Broadband Network (NBN) rollout and expands its operations in the enterprise sector. We have also noted the importance of the LTRCM and other related arrangements to adapt and remain effective in light of this changing environment. Although we highlighted issues for further consideration as part of the 2018-19 LTRCM and beyond, due to the evolving situation regarding the COVID-19 pandemic we have decided to not pursue these matters within the current process. We will likely return to these issues in future LTRCM assessments and would appreciate views from industry about these and other relevant matters.

This report sets out the ACCC draft determination for the 2018-19 LTRCM and the reasons for reaching this draft decision.

1.1 LTRCM process

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

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

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

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

1.2 Evolution of NBN Co's operating environment

We have previously acknowledged that NBN Co is approaching the completion of the NBN rollout. This means that NBN Co will move to being focussed exclusively on service delivery as it enters a business-as-usual phase. Further, NBN Co has recently expanded its operations to include business-grade and enterprise services.

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

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

1.3 Submissions to preliminary view

We received one submission from Telstra in response to our preliminary view on expenditure compliance.² In its submission, Telstra raised a number of issues relating to the broader framework relating to NBN Co's cost recovery.

Telstra considered that the commercial weighted average cost of capital (WACC) used by NBN Co (6.2 per cent for 2018-19) is unreasonable due to the expected internal rate of return of 3.2 per cent. Telstra contends that the process uses a commercial WACC value due to the invalid assumption that NBN Co is a commercial enterprise. Therefore, Telstra considers that since NBN Co is not operating as a commercial business it should not be able to recover a commercial return on historical costs.

Telstra also argued that the size of the ICRA is larger than what a commercial company's would have been as NBN Co is prioritising low-density areas for rollout. Telstra considered that the combination of a large initial ICRA and a commercial rate of return would likely make the ICRA grow in perpetuity.

Finally, Telstra raised the issue of transparency and the possibility of cross-subsidising NBN Co's build into the enterprise market, which could result in unfair advantages for NBN Co in the enterprise market.³ Telstra supported our position that transparency is crucial to avoid negative effects on private investment in the enterprise market. Telstra proposed that transparency would be encouraged by breaking down LTRCM inputs for capital expenditure, operating expenditure, revenue and profitability measures by product, technology type, residential/enterprise and geographic area.

² Telstra, *Telstra submission to the 2018-19 Preliminary view*. (See attachment B for complete submission).

³ Telstra, *Telstra submission to the 2018-19 Preliminary view*, p. 3. (See attachment B for complete submission).

1.4 Recent developments

Although we recognise the importance of the LTRCM and related processes adapting to NBN Co's changing operating environment, we have decided not to pursue further changes to our approach to the LTRCM within the current process due to the evolving situation regarding the COVID-19 pandemic. This reflects the ACCC's broader position on regulatory matters during this period and is consistent with the ACCC's recent decision to pause its inquiries into NBN wholesale service standards and NBN access pricing.

The ACCC expects to resume consideration of the matters it highlighted in its 2018-19 preliminary view in future LTRCM processes. We also acknowledge the issues raised by Telstra in its submission in response to our preliminary view and its previous submissions from previous LTRCM processes.⁴

We note that the matters raised by Telstra are not confined directly to the 2018-19 LTRCM process and relate to the broader frameworks relating to cost recovery and transparency. We will consider the matters raised by Telstra further and outline our views in our final determination. We would welcome further submissions in response to this draft determination to allow other interested stakeholders a chance to provide their views on these and other relevant matters.

1.5 Structure of report

This report outlines the ACCC's LTRCM draft determination for the 2018-19 financial year. The structure of the report is as follows:

- Section 2 sets out NBN Co's submission of regulatory information.
- Section 3 sets out the ACCC's draft assessment of NBN Co's expenditure compliance and reporting.
- Section 4 sets out the ACCC's draft assessment of NBN Co's financial information.
- Section 5 sets out the ACCC's draft assessment of NBN Co's price compliance.
- Section 6 sets out the ACCC's draft determination for 2018-19.

1.6 Consultation

We are seeking stakeholder views on this draft determination and will consider submissions before releasing our final LTRCM determination for 2018-19 by 30 June 2020.

The ACCC encourages industry participants and other interested parties to make submissions to this draft determination, including providing 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

⁴ See ACCC, *2017-18 LTRCM draft determination*, p. 12-14 for the ACCC's response to concerns Telstra has raised previously.

wishing to submit commercial-in-confidence material to the ACCC should submit both a public and a commercial-in-confidence version of their submission. The confidential version of the submission should clearly identify the commercial-in-confidence material by bookending the confidential material with an appropriate symbol of 'c-i-c'. The public version should ensure that all confidential material has been removed and replaced with 'c-i-c'.

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

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

Please email submissions by 5pm on Friday 29 May 2020 to nbn@acc.gov.au and copy to:

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2. NBN Co's 2018-19 regulatory information

On 31 October 2019, NBN Co submitted its regulatory information to the ACCC as required under Schedule 1F of the SAU. The submission consisted of:

- NBN Co's actual financial information – based on NBN Co's reported statutory accounts, which are consistent with the definitions in the SAU
- NBN Co's proposed financial information – NBN Co's proposed values (and relevant inputs to those values) for the ABBRR, RAB and ICRA
- an expenditure compliance report signed by NBN Co's CFO certifying that NBN Co's expenditure complies with the SAU requirements
- a procurement compliance report signed by NBN Co's Acting Executive General Manager (EGM) Procurement, certifying that NBN Co's procurement rules comply with the SAU requirements⁵
- a price compliance report signed by NBN Co's CFO, certifying that NBN Co's prices comply with the requirements of the SAU.

To support its submission, NBN Co also lodged three independent assurance reports from PricewaterhouseCoopers (PwC), a price compliance spreadsheet, a LTRCM spreadsheet and a copy of its chart of accounts. The public versions of NBN Co's regulatory information is available on the ACCC website.⁶

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

Table 2.1: Summary of NBN Co's financial information, 2017-18 and 2018-19 (nominal)⁷

	2017-18 (\$'000)	2018-19 (\$'000)	Percentage Change
Operating expenditure	4 322 534	4,454,260	3%
Capital expenditure	6 148 060	5,766,682	-6%
Construction in progress (start of period)	3 739 873	3,182,847	-15%
Interest expense	69 905	351,672	403%
Revenue	1 978 206	2,824,879	43%

⁵ NBN Co, *2018-19 Regulatory Information – Actual and Proposed Financial Information*, p. 15. 'The role of Chief Procurement Officer for the purposes of this Procurement Rules Compliance Report is currently fulfilled by NBN Co's Acting Executive General Manager Procurement [name removed], as successor to the Chief Procurement Officer role.'

⁶ ACCC, *NBN Co – Special Access Undertaking, NBN Co's regulatory information*. see <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2018-19>

⁷ These figures have been rounded to whole numbers. Note, figures have also been rounded throughout the document where appropriate.

Unrecovered costs	4 558 368	4,846,872	6%
RAB (end of period)	19 379 004	23,330,671	20%
ABBRR	6 536 574	7,671,752	17%
ICRA (end of period)	19 405 530	25,458,678	31%

Source: NBN Co, *LTRCM spreadsheet 2018-19*

3. Assessment of expenditure compliance and reporting

3.1. SAU requirements

Expenditure compliance

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

- capital expenditure proposed for inclusion in the RAB was incurred in accordance with the prudent cost condition and the prudent design condition
- 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 its EGM Procurement. This report must certify that NBN Co's procurement rules satisfy the SAU requirements for the relevant financial year.

3.2. NBN Co's LTRCM submission

Expenditure compliance report

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

NBN Co has not reported any exceptions in relation to its capital expenditure and operating expenditure and has proposed that all capital expenditure and operating expenditure incurred over the 2018-19 financial year be included in the RAB and ABBRR respectively. The expenditure compliance report uses qualifying language to provide negative assurance conclusions to indicate that nothing has come to the author's attention that caused them to believe that the assurance requirements have not been met.⁸

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

- performing process walkthroughs with relevant staff
- confirming end-to-end process maps
- identifying relevant control objectives and control procedures
- testing of control design and effectiveness.⁹

NBN Co's internal audit work was based on the Australian Standard on Assurance Engagements (ASAE) 3150: Assurance Engagements on Controls (January 2016), which provides guidance for identifying the nature of the procedures which are conducted at a minimum in a limited assurance engagement and the additional procedures that are conducted in a reasonable assurance engagement.¹⁰

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

⁸ Negative assurance is a technique commonly used by auditors to provide a representation that particular facts are believed to be accurate since no conflicting/contrary evidence has been found. NBN Co has had regard to Australian Standard on Assurance Engagement (ASAE) 3150 "Assurance Engagements on Controls" in developing the qualifying language in the certification. Further, NBN Co has submitted that PwC's independent assurance report audit has been conducted under (ASAE) 3150. See NBN Co, *2018-19 Regulatory information - Supporting submission*, p. 15.

⁹ NBN Co, *NBN supporting submission to the ACCC – 2018-19 Regulatory Information and LTRCM Determination*, p. 12. See <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2018-19>

¹⁰ Ibid.

period meets the relevant prudency conditions and should be included in the RAB and ABBRR, respectively.¹¹

Procurement rules compliance report

NBN Co has submitted a procurement rules compliance report signed by its EGM Procurement, which certifies that procurement rules met the relevant conditions as set out in the SAU over the course of the 2018-19 financial year. NBN Co has not reported any exceptions in relation to this report.¹²

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.¹³ This is the same certification and wording as used in previous years.

3.3. 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 the 2018-19 financial year, though it did use some qualifying language in expressing its negative assurance conclusion.¹⁴ Therefore, the ACCC considered a number of other supporting materials in determining the extent to which the certification is reliable. This included consideration of the:

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

Adequate procurement rules

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.¹⁵

¹¹ Ibid, p. 15.

¹² Ibid, p. 16.

¹³ Ibid, p. 16. See also footnote 30 for a detailed explanation of NBN Co's use of qualifying language and negative assurance.

¹⁴ See footnote 30 for a detailed explanation of NBN Co's use of qualifying language and negative assurance.

¹⁵ Clause 1D.5.2 of the SAU.

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

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.

Processes and controls operating effectively

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

NBN Co has completed an internal audit at the request of the CFO to review, document and test underlying business processes along with the design and operating effectiveness of controls relating to Capital Expenditure and Operating Expenditure prudency to satisfy prudent design condition and capital expenditure prudent cost condition (and equivalent for Operating Expenditure).¹⁶

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

NBN Co tested 271 samples to confirm the operating effectiveness of the Prudent Design and Prudent Cost controls for the 2018-19 financial year and the sampling methodology was consistent with the approach taken in the previous financial year. For each control procedure, the internal audit staff identified, recorded and reviewed relevant supporting documents for applicability and appropriate authorisation. Supporting documents included procurement records, contracts, purchase orders and network design components.

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

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

¹⁶ See NBN Co's 2018-19 LTRCM supporting submission, p. 12-15 for more detail on its internal audit processes. A high-level summary of NBN Co's internal audit process is provided in the '*Processes and controls operating effectively*' section of the paper.

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 2018 to 30 June 2019, nbn's Procurement Rules satisfied the requirements in clause 1D.5.1 of the SAU.¹⁷ The report did however include some qualifying language in expressing negative assurance conclusions.¹⁸

NBN Co last updated its procurement rules for the period 23 February 2018 to 30 June 2018. The procurement rules were updated in Purchasing Rules v1.3, which included a documentation and approval process for unusual (and currently unforeseen) circumstances where it may be appropriate to apply the purchasing rules with some specific variations.¹⁹

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

¹⁷ NBN Co, *Submission of Regulatory information 2018-19*, p. 16.

¹⁸ See footnote 30 for a detailed explanation of NBN Co's use of qualifying language and negative assurance.

¹⁹ ACCC, *2017-18 LTRCM draft determination*, p. 18.

4. Assessment of LTRCM financial information

4.1. SAU requirements

NBN Co is required to submit forecasts of certain information (Forecast Financial Information) by no later than 30 June prior to the commencement of each financial year during the initial regulatory period. This financial information must include forecasts of capital expenditure by asset type, operating expenditure, disposals by asset type and the opening and closing value of construction in progress.²⁰

Forecast financial information

On 29 June 2018, NBN Co submitted its forecast financial information for the 2018-19 financial year. This submission consisted of:

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

NBN Co's forecast financial information is confidential.

Actual financial information

By 31 October after the end of each financial year of the initial regulatory period, NBN Co must provide to the ACCC a report that sets out actual financial information for the previous financial year. This includes the values of the June quarter CPI, capital expenditure, revenue, operating expenditure, disposals, interest expense, accounting and tax asset lifetimes, the risk free rate, and the nominal rate of return.²¹

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.²²

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
- unrecovered cost.

²⁰ Clause 1F.1.2 of the SAU.

²¹ Clause 1F.1.3(a) of the SAU.

²² Clause 1F.1.3(b) of the SAU.

4.2. NBN Co's LTRCM submission

Basis of preparation

NBN Co maintains a Regulatory Accounting and Allocation Manual (RAAM), which provides NBN Co's staff with detailed instructions on the principles, guidelines and templates to use when preparing the LTRCM reports. The RAAM also explains the cases where NBN Co will apply an alternate accounting treatment (that is, where it will report in a way that is not consistent with Australian Accounting Standards in order to meet SAU requirements). NBN Co updates the RAAM annually and considered no updates were necessary in respect of the 2018-19 financial year.²³

NBN Co's 2018-19 LTRCM submission included a copy of its Chart of Accounts, with notes showing how the accounts are mapped to the RAAM. NBN Co's regulatory information includes a statement by NBN Co's CFO declaring that:

- the RAAM has been appropriately updated to reflect changes in NBN Co's business or structure and to meet the financial reporting requirements of the SAU.
- Schedules 6 to 9 have been prepared in accordance with the principles of the RAAM dated 27 August 2018 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.²⁴

Actual and proposed financial information

As part of its submission of regulatory information, NBN Co has provided the ACCC with its actual and proposed financial information for the 2018-19 financial year. This information included:

- Schedule 6 – Statement of Capital Expenditure, Disposals, Construction in Progress, Asset Lifetimes and Taxation Asset Lifetimes
- Schedule 7 – Statement of Operating Expenditure
- Schedule 8 – Statement of Interest Expense
- Schedule 9 – Statement of Revenue
- Schedule 10 – Statement of LTRCM and RAB items
- 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 is available on the ACCC website.²⁵

²³ NBN Co, *Submission of regulatory information*, p. 7. .

²⁴ NBN Co, *Submission of regulatory information*, p. 12.

²⁵ ACCC, *NBN Co – Special Access Undertaking, NBN Co's regulatory information*. See here <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2018-19>

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

4.3. ACCC draft position

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

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

Financial information reporting

In assessing whether NBN Co’s proposed LTRCM values have been calculated in accordance with the SAU, the ACCC has considered: NBN Co’s actual and proposed financial information; NBN Co’s LTRCM spreadsheet 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 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),²⁶ which sets out the variances between forecast and actual financial information, and the reasons for these variances.²⁷ The statement helps the ACCC to understand the reasons for any significant differences between forecast and actual expenditure.

The ACCC has reviewed the statement of material variances and is satisfied that it does not raise any significant concerns regarding the variances between 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.²⁸

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 4.1: RAB calculation, 2018-19 (real)

	2018-19 (\$'000)
RAB opening (real)	18,161,385
Add real capital expenditure	5,319,614
Less real disposal	-
Less real straight line depreciation	(1,959,064)
RAB closing (real)	21,521,935
Cumulative inflation factor	1.084
RAB closing (nominal)	23,330,671

Capital expenditure

As noted in sections 4.3 and 5.3 above, the ACCC is satisfied that the information provided by NBN Co is reasonable for demonstrating that it has processes and controls in place to ensure that the capital expenditure used in its RAB calculations is in accordance with the prudence conditions set out in the SAU.

Disposals

There were no disposals during the 2018-19 financial year.

²⁶ In accordance with clause 1F.1.3(b) of the SAU.

²⁷ The statement of material variances has been classified as 'confidential of particular sensitivity'

²⁸ In accordance with clause 1D.2.1 of the SAU

Depreciation

The method of depreciation used in the calculation of the value of the RAB is straight-line depreciation²⁹ using asset lives that are consistent with NBN Co's audited accounts. The ACCC has verified that NBN Co has applied the correct formula for depreciation in its LTRCM spreadsheet, and is satisfied that it is consistent with the requirements of the SAU.

Cumulative inflation factor

The cumulative inflation factor (CIF) is an index used for converting values from real to nominal and vice versa. The CIF is equivalent to the cumulative product of the percentage change in June quarter CPI published for each financial year from the commencement of the SAU.³⁰ The ACCC is satisfied that NBN Co has calculated and applied the CIF correctly.

Annual building block revenue requirement components

The annual building block revenue requirement (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 4.2: ABBRR calculation, 2018-19 (nominal)

	2018-19 (\$'000)
Return on capital	1,204,626
Add regulatory depreciation	1,815,015
Add operating expenditure	4,454,260
Add net tax allowance	-
Add annual construction in progress allowance	197,850
ABBRR	7,671,752

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

²⁹ Consistent with clause 1E.9.1 of the SAU.

³⁰ See clause 1E.9.4(b) of the SAU.

of the SAU. Therefore, we are satisfied with NBN Co's proposed value for return on capital.

Regulatory depreciation

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

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

Operating expenditure

Consistent with the ACCC's assessment of operating expenditure compliance, we are satisfied that the information provided by NBN Co 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 prudence conditions set out in the SAU.

Net tax allowance

Net tax allowance is not applicable for the 2018-19 financial year as NBN Co is currently in a loss-making position.

Annual construction in progress allowance

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

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

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

Initial cost recovery account components

The value of the ICRA is determined by calculating the difference between the ABBRR and the amount of revenue realised by NBN Co through access prices over the course of the financial year. This unrecovered cost amount is added to the ICRA balance from the previous year, which is capitalised and carried forward.³²

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

³¹ See clause 1E.10.1 of the SAU.

³² See Clause 1E.5 of the SAU.

Table 4.3: Unrecovered cost calculation, 2018-19 (nominal)

	2018-19 (\$'000)
ABBRR	7 671 752
Less revenue	(2,824,879)
Unrecovered cost	4 846 872

* Table does not balance due to rounding

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.³³

Table 4.4: ICRA calculation, 2018-19 (nominal)

	2018-19 (\$'000)
ICRA from previous period	19 405 530
Add unrecovered cost	4 846 872
ICRA closing*	25,458,678

* Includes capitalisation of ICRA from previous period

Roll forward of ICRA

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

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

³³ 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.

5. Assessment of price compliance

5.1. 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), and that prices complied with the requirements of Schedule 1C (NBN Offers and Other Charges).³⁴

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

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

5.2. NBN Co's LTRCM submission

NBN Co submitted its price compliance report and a price compliance spreadsheet as part of its regulatory information submission for the 2018-19 financial year.³⁵

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 2018 to 30 June 2019 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.³⁶

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

- identification of the price lists that applied under Wholesale Broadband Agreement 3 (WBA3) (for fibre, long term satellite and fixed wireless), and the Cell Site Access Service (CSAS) (in respect of the CSAS) over the relevant period;
- verification of these price lists, including any changes made in the relevant period, for consistency with Schedule 1C of the SAU; and
- work performed by NBN Co's internal audit of relevant processes and controls via process walkthroughs and detailed testing – NBN Co considered this audit reviewed, documented and tested the underlying end-to-end business processes and the design and operating effectiveness of controls relating to price compliance.

Consistent with the language used in the expenditure compliance report and the procurement rules compliance report, NBN Co has advised that any such investigation and testing is subject to inherent limitations, and that there is an unavoidable risk that

³⁴ See SAU Schedule 1C and 1F.3.

³⁵ ACCC website, <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2018-19>

³⁶ See footnote 30 for a detailed explanation of NBN Co's use of qualifying language and negative assurance.

they may not detect some deficiencies.³⁷ 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.³⁸

Throughout the 2018-19 financial year, NBN Co made a number of changes to its price list. The high-level changes relating to the WBA3 price list include:

- the introduction of the recurring charge for both the V-NNI and NNI Link over the NBN Co Fibre Network, NBN Co FTTB Network, NBN Co FTTN Network, NBN Co FTTC Network, NBN Co HFC Network and the NBN Co Wireless Network
 - the introduction of a non-recurring charge for the: V-NNI Activation, NNI Link Activation, NNI Link Modification across the same access technologies as above.
- the introduction of non-recurring charges for certain changes made to appointments over the appointments over the NBN Co Fibre Network, NBN Co FTTB Network, NBN Co FTTN Network, NBN Co FTTC Network and the NBN Co HFC Network.
- the introduction of the recurring charge for Wireless Plus on the NBN Co Wireless Network.
- a number of charges over Enterprise Ethernet.
- the introduction of six new CVC TC-4 speed tiers on the satellite network.
- the removal of the de-installation of the Australian Broadband Guarantee (ABG) or National Satellite Service (NSS) equipment charge in relation to the satellite network.³⁹

Consistent with the approach taken last year, NBN Co has not lodged an independent assurance report by PwC on the effectiveness of its control procedures to ensure price compliance. The ACCC agrees that there is limited (if any) 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.

5.3. ACCC draft position

Following consideration of NBN Co's price compliance report and supporting submission, the ACCC is satisfied that NBN Co's prices in 2018-19 did not exceed the MRPs set out in Schedule 1C of the SAU, and that NBN Co has met its price compliance obligations in the SAU. Further, we consider that most of NBN Co's services are currently supplied at prices well below the MRPs specified in the SAU, as well as those specified in the WBA3.⁴⁰

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

³⁷ NBN Co, *2018-19 Regulatory Information - Supporting submission*, p. 17. Available here: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2018-19>

³⁸ ACCC website. Available here: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2018-19>

³⁹ NBN Co, *2018-19 Regulatory Information - Supporting submission*, p. 17-19.

⁴⁰ ACCC, *Inquiry into NBN access pricing – position paper*, p. 5. The ACCC is considering aspects of NBN pricing including use of discounts as part of the inquiry into NBN access pricing: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/inquiry-into-nbn-access-pricing/position-paper>

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.

6. 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 2018-19 LTRCM draft determination. We derived these values from NBN Co's submission of regulatory information.⁴¹

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.⁴²

Table 6.1: 2018-19 LTRCM Draft Determination⁴³

Year	2018-19
CPI and Cumulative Inflation Factor	
June Quarter CPI (annual percentage change) – as per Attachment C to the SAU	1.593%
Cumulative Inflation Factor – as per Clauses 1E.9.4(b) and (c)	1.084
Rate of return – as per Clause 1E.7.1	
Risk free rate of interest – as per Clause 1E.7.1(b) and (c)	2.716%
Nominal rate of return – as per Clause 1E.7.1(a)	6.216%
Regulatory Asset Base (\$'000 REAL) – as per Clause 1D.2.1	
Real RAB (start period) – as per Clause 1D.2.1(a) and (b)	18 161 385
Real capital expenditure	5 319 614
Real disposals	-
Real straight line depreciation	1 959 064
Real RAB (end period) – as per Clause 1D.2.1(b)	21 521 935
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	19,379,004
Nominal straight line depreciation (as per Clause 1E.9.1(b))	2,123,707
Nominal RAB (end period) – as per Clause 1D.2.2	23,330,671
ABBRR (\$'000 NOMINAL) – as per Clause 1E.4.1	
Return on capital	1 204 626
Nominal regulatory depreciation – as per clause 1E.9.1(c)	1 815 015
Nominal operating expenditure	4 454 260
Net tax allowance	-
Annual construction in progress allowance – as per Clause 1E.10	197,850
ABBRR	7,671,752
Taxation calculations (\$'000 NOMINAL) – as per Clause 1E.9.3	
Nominal revenue	2 824 879

⁴¹ In accordance with Clause 1E.1.2(c)(vi) of the SAU.

⁴² Clause 1E.1.2(a) of the SAU.

⁴³ The clause references in this table refer to the formulas in the SAU. Note: figures have been rounded.

Add value of assets received for nil consideration	141,252
Less nominal operating expenditure	4,454,260
Less nominal tax depreciation	2 058 752
Less interest expense	351 672
Taxable profit – as per Clause 1E.9.3	(3 898 552)
Tax loss carried forward (Start period) – as per Clause 1E.9.3	(13 878 209)
Tax loss carried forward (End period) – as per Clause 1E.9.3	(17 776 762)
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	19 405 530
Unrecovered cost – as per Clause 1E.5.1	4 846 872
ICRA (end period) – as per Clause 1E.5.2	25 458 678
Carry forward revenue adjustment – as per Clause 1E.5.3	n/a