

NBN Co supplementary submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination

8 December 2014

Public Version

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1 Introduction

On 31 October 2014, NBN Co lodged the regulatory information it is required to lodge with the ACCC for the Financial Year 2013-14 under Schedule 1F of NBN Co's Special Access Undertaking (**SAU**), as accepted by the ACCC on 13 December 2013 (**Regulatory Information**). This Regulatory Information will be used by the ACCC in making its first LTRCM Determination under Schedule 1E of the SAU.

NBN Co lodged a range of supporting materials along with the Regulatory Information, including a supporting submission.

Noting that this is the first year of reporting under the SAU, NBN Co has prepared this supplementary submission to clarify (and in one case adjust) certain aspects of the Regulatory Information and supporting materials in relation to:

- Confidentiality – section 2;
- Expenditure Compliance Report – section 3;
- PricewaterhouseCoopers Reports – section 4;
- Statement of Operating Expenditure – section 5;
- Calculation of the risk free rate of interest – section 6; and
- Check of SFAA price lists – section 7.

The confidentiality status of the information contained in this supplementary submission has been determined consistent with the approach set out in Appendix A of NBN Co's 31 October 2014 supporting submission (which is based on the ACCC's April 2014 *Confidentiality Guideline for submitting confidential material to ACCC communications inquiries*).

Capitalised terms in this submission have the same meaning given to them in the SAU.

2 Confidentiality

2.1 PwC reports

2.1.1 Agreement between NBN Co and PwC

As noted in NBN Co's supporting submission¹, by agreement with PricewaterhouseCoopers (**PwC**), the PwC reports are not designed or prepared for public release. PwC agreed as part of its engagement that NBN Co could provide a copy of the reports to the ACCC, but only on the basis that PwC has no responsibility or liability to the ACCC, and PwC's agreement is required to disclose the reports to any third parties. As a consequence, NBN Co has identified each of the PwC reports as confidential.

NBN Co has consulted with PwC regarding the basis on which PwC would agree to its reports being made available to NBN access seekers. PwC has advised that, in addition to entering into appropriate confidentiality arrangements with NBN Co, an NBN access seeker would need to co-sign with NBN Co a Hold Harmless letter that PwC has prepared. This letter provides a mechanism to enable a third party to gain access to the PwC reports on the terms set out in the letter, subject to PwC's agreement. The letter's terms include that the third party is not entitled to rely on the PwC reports and that the third party must release and indemnify PwC from certain claims in connection with the reports.

NBN Co understands that Hold Harmless letters are commonly used in circumstances where the detailed scope of the engagement was defined and agreed by an assurance practitioner with its client, and only considered the needs of that client, such that the resulting assurance report may not be suitable for any other purpose. Essentially, Hold Harmless letters allow an assurance practitioner to manage its potential risk exposure to third parties.

Notwithstanding the above agreement between NBN Co and PwC, NBN Co notes that the PwC Limited Assurance Report on Price and Expenditure Compliance includes two appendices that contain information provided by NBN Co to PwC:

- Appendix A – Description of Internal Control Objectives and Procedures as provided by NBN Co Management; and
- Appendix B – NBN Co Management Representation Letter.

NBN Co considers that the control objectives (but not the control procedures, which are discussed further below) and the NBN Co Management Representation Letter provided by NBN Co to PwC can be made publicly available (separate from PwC's report) and these are included as appendices to this supplementary submission.

The NBN Co control procedures included in Appendix A to the PwC Limited Assurance Report on Price and Expenditure Compliance are confidential of particular sensitivity for the reasons described in NBN Co's supporting submission.²

2.1.2 Confidentiality arrangements for accessing the PwC reports

In its supporting submission³, NBN Co says that it may be prepared to make the PwC reports available (subject to redacting any information that is confidential of particular sensitivity), under appropriate confidentiality arrangements to NBN access seekers and relevant consultants retained by an NBN access seeker.

¹ NBN Co Submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination, 31 October 2014, pp. 18-19.

² NBN Co Submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination, 31 October 2014, pp. 19-20.

³ NBN Co Submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination, 31 October 2014, pp. 18-19.

In this context, the factors that NBN Co will have regard to in deciding whether to make the reports available will include the following:

- Whether each of the relevant employees and consultants proposed by an NBN access seeker to have access:
 - require such access for the purpose of engaging in the preparation of submissions and associated reports to the ACCC as part of the 2013-14 LTRCM Determination process; and
 - do not face any conflict of interest in relation to the confidential information proposed to be disclosed to them.
- Whether, in addition to entering into appropriate confidentiality arrangements with NBN Co, the NBN access seeker co-signs together with NBN Co the Hold Harmless letter to PwC (as discussed in section 2.1.1 above).

In regard to the confidentiality arrangements themselves, NBN Co will be utilising the approach it used in 2013 during the SAU assessment process. This involves entering into two types of agreements:

- A confidentiality agreement between NBN Co and the relevant NBN access seeker – this places obligations on the NBN access seeker in respect of the non-disclosure and appropriate use and management of the confidential information; and
- Separate confidentiality agreements between NBN Co and each relevant employee and consultant of the NBN access seeker – these place obligations on each individual recipient of the confidential information.

NBN Co has template agreements prepared, and will make these available to an NBN access seeker as part of deciding whether to make the confidential information available.

2.2 Schedule 6 – access to confidential information

In the 2013-14 Regulatory Information, Schedule 6 sets out the Statement of Capital Expenditure, Disposals, Construction in Progress, Asset Lifetimes and Taxation Asset Lifetimes. Various aspects of Schedule 6 are identified as confidential, while others are identified as confidential of particular sensitivity.

With regard to the confidential information, NBN Co stated in its supporting submission⁴ that it is prepared to make this information available to employees and relevant consultants of an NBN access seeker, except where the relevant NBN access seeker is:

- in the process of negotiating significant arrangements with NBN Co; or
- an actual or potential competitor of NBN Co.

The reasons for these limitations are set out in the supporting submission.⁵

NBN Co intends to adopt a case-by-case approach to applying these limitations as part of assessing requests for access to the confidential information in Schedule 6. Given the nature of the limitations, it is infeasible to set out detailed assessment criteria that will be suitable in all circumstances.

Having said this, NBN Co would like to clarify that the exception related to “negotiating significant arrangements with NBN Co” is not intended to extend to any negotiation with an NBN access seeker in regard to purchasing NBN services, such as under WBA2 (FTTP and fixed wireless) or the S-WBA (interim satellite).

Provided an NBN access seeker is not subject to one or more of the limitations described above, NBN Co would apply the same approach in regard to confidentiality arrangements as described in section 2.1.2.

⁴ NBN Co Submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination, 31 October 2014, p. 17.

⁵ NBN Co Submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination, 31 October 2014, p. 17.

2.3 Schedule 7 – confidentiality obligations to third parties

In the Regulatory Information, Schedule 7 sets out the Statement of Operating Expenditure. Various aspects of Schedule 7 are identified as confidential of particular sensitivity, including a number of values under the “Reconciliation to NBN Co’s Audited General Purpose Financial Statement”. In its supporting submission, NBN Co explained that the reason for this particular treatment is that NBN Co has confidentiality obligations to third parties⁶.

To be more specific, the reasons in respect of each reconciling item identified as confidential of particular sensitivity are as follows:

- Licenced Assets and Property Assets under Finance Leases – this item relates predominantly to the Telstra Arrangements. To the extent that this item captures other Licenced Assets and Property Assets under Finance Leases, the associated values have been redacted to protect the commercial sensitivity of the values related to the Telstra Arrangements.
- Migration payments – this item relates predominantly to the Optus Arrangements. To the extent that this item captures other Migration Payments, the values of those payments have been redacted to protect the commercial sensitivity of the values related to the Optus Arrangements.

Aside from Telstra and Optus, NBN Co does not have confidentiality obligations to any other third parties in relation the values in Schedule 7 under the “Reconciliation to NBN Co’s Audited General Purpose Financial Statement”.

2.4 LTRCM Spreadsheet – public version

As part of the supporting materials, NBN Co provided a public version of the LTRCM Spreadsheet that sets out the calculation of the ABBRR, the RAB and the ICRA pursuant to the SAU. This public version is redacted to the same extent as Schedule 6 – Statement of Capital Expenditure, Disposals, Construction in Progress, Asset Lifetimes and Taxation Asset Lifetimes.

As noted in NBN Co’s supporting submission⁷, the public version of the LTRCM Spreadsheet does not contain formulas. This is because the confidential version of the LTRCM Spreadsheet is a linked series of worksheets, with the input data flowing through the formulas to determine the LTRCM outputs. Although the formulas themselves are not confidential (being set out in Schedules 1D and 1E of the SAU), without the confidential input data, the formulas (as specified in the confidential version of the LTRCM Spreadsheet) do not work and the LTRCM outputs cannot be calculated.

However, in the interest of transparency, the public version of the Revised LTRCM Spreadsheet that NBN Co has lodged along with this supplementary submission (see the discussion in section 6 below) includes all of the formulas used in the confidential version, except in regard to the following items, which have been converted to values to avoid any changes to the LTRCM outputs – the totals for Nominal Capital Expenditure, Assets Received for Nil Consideration, Nominal Disposals, Net Real Capex, Net Nominal Capex, Real Straight Line Depreciation and Nominal Tax Depreciation.

⁶ NBN Co Submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination, 31 October 2014, p. 20.

⁷ NBN Co Submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination, 31 October 2014, p. 18.

3 Expenditure Compliance Report

In its supporting submission, NBN Co stated that the NBN Co CFO's certification set out in the Expenditure Compliance Report is informed by a range of investigations and testing of the relevant processes and controls. To be more specific, the CFO engaged NBN Co's Internal Audit function to review, document and test the underlying end-to-end business processes and the design / operating effectiveness of controls relating to key elements of SAU compliance.

NBN Co Internal Audit based its work on the Australian Standard on Assurance Engagements ASAE 3000: *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*. ASAE 3000 covers engagements to provide assurance on design, implementation and operating effectiveness of internal controls.

First, NBN Co undertook a series of cross functional workshops involving relevant Subject Matter Experts (**SMEs**) to confirm the end-to-end process underpinning Expenditure Compliance. The resulting process maps were documented by NBN Co Internal Audit and reconfirmed by the business SMEs.

Secondly, based on the end-to-end processes, NBN Co identified the relevant controls, which are comprised of control objectives and control procedures. (Note that these control objectives and control procedures were provided to PwC and are included as part of their Limited Assurance Report in regard to the design / effectiveness of the controls applicable to Expenditure Compliance – see section 2.1.1 above in regard to the confidentiality of that Report and the NBN Co information it contains.)

If a control is determined to have been adequately designed (Test of Design), it is then subjected to testing to ensure that it is operating as designed (Test of Effectiveness). The inherent risks within the NBN Co control environment may be mitigated through multiple controls; however not all of these controls need necessarily be tested. The methodology used by NBN Co Internal Audit requires the application of the auditor's professional judgment to determine the controls with the highest potential impact on risk mitigation.

Thirdly, an appropriate sample was selected to enable control testing.

NBN Co Internal Audit's sampling methodology is based on generally accepted internal audit sampling criteria. 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 – 2320:3 - Audit Sampling).⁸

As described in the IPPF Practice Advisory – 2320:3 - Audit Sampling, judgmental sampling is based on the auditor's professional judgment, and confirms a condition that is reasonably thought to exist. In the current context, the condition to be confirmed is that the relevant controls over Expenditure Compliance that NBN Co has in place (and incorporate NBN Co's Network Design Rules and Procurement Rules) are operating effectively.

Prior to the execution of controls testing, NBN Co Internal Audit determined the sample size and control procedures to be tested. This is based on a risk assessment of the processes and controls to be tested, which includes considering any prior internal audit testing coverage as it relates to the relevant processes and controls.

NBN Co Internal Audit has determined sample size guidance with reference to IPPF Practice Advisory 2320:3 - Audit Sampling. Determining sample size requires the exercise of professional judgement and is influenced by the frequency of the control activity (i.e. how many times per day, month or year a control has to operate). NBN Co's sampling methodology is consistent with those used by the Internal Audit practices of Australia's largest audit and assurance firms and international Auditing Standards.

⁸ IPPF Practice Advisory – 2320:3 - Audit Sampling is available from: [http://www.iaa.nl/Sitefiles/PA_2320-3%20\(1\).pdf](http://www.iaa.nl/Sitefiles/PA_2320-3%20(1).pdf)

On the basis that the controls relevant to Expenditure Compliance were operating multiple times daily, NBN Co Internal Audit determined that a judgmental sample of 30 relevant transactions would be sufficient to confirm the operating effectiveness of those controls. In making this determination, it is important to emphasise that the sample size takes into account relevant prior information; that is, prior to any sample testing being conducted, the end-to-end process had been confirmed with relevant SMEs and the design of each control had been tested (the Test of Design noted above). Conditional on this prior information, and provided that no exceptions were identified for any of 30 sampled transactions, there would be a low likelihood that the controls relevant to Expenditure Compliance would not be operating effectively.

The population source for the sample is the General Ledger Transaction Report from 13 December 2013 to 30 June 2014. From this, NBN Co Internal Audit selected 30 transactions to test the Expenditure Compliance controls. These cover a range of suppliers and contracts across the following expenditure types:

- Capital Expenditure (17 items):
 - network capex (15 items covering Fibre, Fixed Wireless, Satellite and Transit);
 - non-network capex (2 items); and
- Operating Expenditure (13 items).

The contracts to which the expenditure relates account for a significant percentage of total expenditure (excluding amounts automatically deemed prudent under the SAU⁹) over the period 13 December 2013 to 30 June 2014.

Fourthly, NBN Co undertook end-to-end walkthroughs for each of the sample items, to confirm all aspects of the process underpinning Expenditure Compliance. This involved identifying a transaction from the General Ledger and tracing it through the end-to-end process identified by the SME's. In relation to 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.

The supporting documentation was examined to determine whether it was of sufficient standing to meet what is generally termed "a re-performance standard"; that is, if required another auditor could independently re-perform the test and arrive at the same result.

If an omission had been identified in relation to a primary control, a secondary (mitigating) control may have been relied on and tested for its design and operating effectiveness. NBN Co may also have undertaken further testing, which may have involved increasing the sample size.

Based on NBN Co Internal Audit's sample testing, no exceptions were identified regarding the Expenditure Compliance Report.

⁹ The relevant categories of expenditure that are automatically deemed prudent are set out in clause 1D.3.2(a)(ii) and clause 1E.8.2(a)(ii) in regard to Capital Expenditure and Operating Expenditure, respectively.

4 PwC Reports

4.1 PwC Report on Schedules 6 to 9

4.1.1 Basis of preparation

In PwC's reasonable assurance report on Schedules 6 to 9 (covering the Actual Financial Information), reference is made to [CiC starts]

[CiC ends]

4.1.2 Limits of materiality

In providing its audit opinion on Schedules 6 to 9, PwC refers to [CiC starts]

[CiC ends]

4.2 PwC Report on Schedules 12 and 14 – Price and Expenditure Compliance

The PwC Report on Schedules 12 and 14 is a Limited Assurance Report on the design effectiveness of the control procedures applicable to Price and Expenditure Compliance.

PwC was provided with the relevant control objectives, control procedures and end-to-end process maps by NBN Co.

[CiC starts]

[CiC ends]

5 Statement of Operating Expenditure

In the Schedule 7 – Statement of Operating Expenditure (as set out in the SAU – Regulatory Information, PDF file), NBN Co provides two different breakdowns of Operating Expenditure between the SAU's deemed prudent categories (in both cases the breakdown is confidential of particular sensitivity).

- The first breakdown provides Operating Expenditure in each of the deemed prudent categories over the period 2008-09 to 2013-14. Although, for SAU purposes, all Operating Expenditure incurred prior to the SAU Commencement Date is deemed prudent and automatically included in the calculation of the ABBRR, this breakdown is to facilitate ready comparisons between the amount of Operating Expenditure incurred in connection with each deemed prudent category for each Financial Year before and after the SAU Commencement Date (as is set out in Note (a) to Schedule 7). Effectively, this breakdown is provided for information purposes only.
- The second breakdown is the same as the first breakdown but recognises that all Operating Expenditure incurred prior to the SAU Commencement Date is deemed prudent and automatically included in the calculation of the ABBRR. As such, this is the breakdown that is relevant to the application of the SAU prudence conditions. As set out in Note (b) to Schedule 7, the SAU commenced on 13 December 2013, which does not align with standard accounting periods. To account for this, NBN Co has accounted for the SAU commencement as if it occurred on 1 December 2013, being the closest period start to the SAU Commencement Date.

6 Calculation of risk free rate of interest

The calculation of the risk free rate of interest is set out in clauses 1E.7.1(b) and 1E.7.1(c) of the SAU. Amongst other matters, these clauses require that the calculation be based on:

- “annualised” yields on Commonwealth Government securities with a maturity of 10 years, using the indicative mid rates published by the Reserve Bank of Australia (RBA); and
- if there are no Commonwealth Government securities with a maturity of 10 years on a day in the relevant period (being the 20 Business Days of the preceding Financial Year), “interpolating on a straight line basis” from the two Commonwealth Government securities closest to the 10 year term and which also straddle the 10 year expiry date.

In respect of these two aspects (annualisation and interpolation), NBN Co has made amendments to its calculation of the risk free rate of interest in the LTRCM Spreadsheet. These amendments are described below together with the flow on changes to the values for the nominal rate of return, the ABBRR and the ICRA proposed in the Regulatory Information lodged on 31 October 2014.

6.1 Annualisation of RBA indicative mid rates

In the LTRCM Spreadsheet lodged on 31 October 2014, the risk free rate of interest to be applied in each Financial Year is calculated using the indicative mid rates for Commonwealth Government Securities as reported by the RBA, without adjustment. However, these indicative mid rates are, as explained by the RBA, “obtained by doubling an effective or true half-yearly rate”.¹⁰ Although this approach to reporting the yield on an annual basis is conventional, it is not a mathematically precise means of annualising a half-yearly rate.

Therefore, NBN Co has amended its calculation of the risk free rate of interest by applying the following annualisation formula to the indicative mid rates reported by the RBA and before applying any of the other calculation steps described in clauses 1E.7.1(b) and 1E.7.1 (c) of the SAU.

$$Y^{ann} = \left(1 + \frac{Y^{rep}}{2}\right)^2 - 1$$

where:

Y^{ann} is the annualised yield

Y^{rep} is the reported yield from the RBA

This amended calculation is included in the Revised LTRCM Spreadsheet.

6.2 Interpolation

In the LTRCM Spreadsheet lodged on 31 October 2014, the calculation of the risk free rate of interest to be applied in each Financial Year involves a formula that seeks to interpolate for each day in the relevant period (being the 20 Business Days of the preceding Financial Year) from the two Commonwealth Government securities closest to the 10 year term and which also straddle the 10 year expiry date.

NBN Co has amended the interpolation formula so that the calculation applies on a straight line basis. That is, given two bonds that mature at times t_1 and t_2 , and have annualised yields to maturity B_1 and B_2 , the straight line interpolation formula for estimating the annualised yield to maturity of a hypothetical bond that matures at time T (where $t_1 < T < t_2$) is as follows:

¹⁰ <http://www.rba.gov.au/mkt-operations/resources/tech-notes/pricing-formulae.html>

$$B_1 + (T - t_1) \left(\frac{B_2 - B_1}{t_2 - t_1} \right)$$

This amended calculation is included in the Revised LTRCM Spreadsheet.

6.3 Impact on nominal rate of return, ABBRR and ICRA

Given the annualisation and interpolation amendments to the calculation of the risk free rate of interest described above, NBN Co has updated the values for the nominal rate of return, ABBRR and ICRA for each Financial Year between the Cost Commencement Date (9 April 2009) and the First Financial Year (2013-14). The revised values are set out below (see Table 1).

The cumulative impact of the change is relatively small – it increases the closing value of the revised ICRA in 2013-14 by \$1.4 million (0.03 per cent).

Table 1: Revised values for risk free rate, nominal rate of return, ABBRR and ICRA (Nominal \$'000 except where stated otherwise)

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Risk free rate of interest	6.699%	5.675%	5.404%	5.224%	3.009%	3.578%
<i>As submitted</i>	6.593%	5.666%	5.362%	5.186%	2.898%	3.616%
Nominal rate of return	10.199%	9.175%	8.904%	8.724%	6.509%	7.078%
<i>As submitted</i>	10.093%	9.166%	8.862%	8.686%	6.398%	7.116%
ABBRR						
	139	82,255	335,551	599,568	1,015,902	1,681,744
<i>As submitted</i>	139	82,255	335,534	599,379	1,014,452	1,682,853
ICRA – closing						
	139	82,407	425,296	1,060,024	2,128,102	3,899,511
<i>As submitted</i>	139	82,407	425,244	1,059,616	2,125,041	3,898,154

The updated values are included in the Revised LTRCM Spreadsheet and in the Revised Schedule 10 Statement of RAB and LTRCM items¹¹ lodged along with this supplementary submission.

¹¹ In the Revised Schedule 10 Statement of RAB and LTRCM items, NBN Co has also made a presentational change to specify the values for 'June Quarter CPI', 'Risk Free Rate', 'Nominal Rate of Return' and 'Corporate Tax Rate' to three decimal places. The initial SAU - Regulatory Information specified these values rounded to the nearest whole number.

7 Check of SFAA price lists

In its supporting submission¹², NBN Co provided a check of the SFAA price lists against the relevant SAU Maximum Regulated Prices (MRPs) for the period 13 December 2013 to 30 June 2014.

In the last column of the table setting out the results of the checking process, NBN Co provided some brief explanatory comments in the following situations:

- where an NBN Offer or Other Charge was introduced during the period but did not have an MRP set out in the SAU;
- where an item in an SFAA Price List was in existence at SAU commencement but did not have an MRP set out in the SAU; and
- where the description of the charge for an item in an SFAA Price List is different to that for the relevant NBN Offer or Other Charge in the SAU.

Further explanation regarding each of these situations is provided below together with relevant examples.

NBN Co notes that the Price Compliance Report lodged by NBN Co in accordance with clause 1F.3 of the SAU is concerned with whether the prices for each NBN Offer or Other Charge did not exceed, at any time during the Financial Year, the MRP applicable to that NBN Offer or Other Charge (as determined under Schedule 1C of the SAU).

However, as identified above, there can be situations in which an item in an SFAA Price List was in existence at SAU commencement but did not have an MRP set out in the SAU. These situations are outside the scope of the SAU's price controls (as discussed further in section 6.2 below) and therefore also outside the scope of the Price Compliance Report.

7.1 NBN Offer or Other Charge introduced during the period but does not have an MRP in the SAU

The MRPs for NBN Offers and Other Charges are determined under clause 1C.5.1 of the SAU. This clause deals with all scenarios in which MRPs need to be determined, including where an NBN Offer or Other Charge was introduced during the period but did not have an MRP set out in the SAU. In this case, clause 1C.5.1(e) of the SAU provides that the MRP for the period is the initial price for that NBN Offer or Other Charge introduced by NBN Co.

There are two relevant examples of this situation over the period from 13 December 2013 to 30 June 2014.

- Introduction of Enhanced Fault Rectification Service Options on 30 April 2014 – None of the three new options is an NBN Offer set out in clause 1C.1.2; however, two of the options (Enhanced-12 24/7 and Enhanced-8 24/7) are on the SAU's list of Initial Products (Attachment D to the Main Body) so their introduction was not subject to Schedule 1I of the SAU. In respect of the third option, Enhanced-8, NBN Co consulted on its proposed introduction via the Product Development Forum, as required by Schedule 1I of the SAU. The consultation included the proposed pricing of Enhanced-8, as required by clause 11.3.4 of the SAU.

¹² NBN Co Submission to the ACCC – 2013-14 Regulatory Information and LTRCM Determination, 31 October 2014, pp. 22-40.

- Introduction of CVC (TC-4), customised CVC (Interim Satellite Service) – this new NBN Offer is also not set out in clause 1C.1.2. It was introduced as part of a package of improvements to the Interim Satellite Service on 12 June 2014 that included a significant capacity upgrade and improved capacity management. The customised CVC is not on the SAU's Initial Product List (and consequently does not have an MRP set out in the SAU). Hence, NBN Co consulted on its proposed introduction via the Product Development Forum, and this consultation included the proposed pricing.

7.2 Item in an SFAA Price List at SAU commencement but not included as an NBN Offer or Other Charge in the SAU

There are a number of items in SFAA Price Lists that were in existence at SAU commencement but were not included in the SAU along with an MRP.

The consequence of being excluded in this way is that the relevant charge is not regulated via the SAU's price controls. Rather, as stated by the ACCC in the context of the July 2013 draft Notice to Vary the SAU, this leaves the matters to be "settled through commercial negotiation between NBN Co and access seekers".¹³

There are a small number of examples of this situation over the period from 13 December 2013 to 30 June 2014. In each case, the relevant charge is set at the level commercially agreed with NBN access seekers in the context of WBA2 or S-WBA.

- Restoration Charge – the ACCC specifically proposed excluding this charge from the SAU in its Notice to Vary, but it is included in WBA2.
- Subsequent Installation of Power Supply with Battery Backup – this is a one-off (currently \$0) charge. NBN Co did not include this charge in the SAU; however, it is included in WBA2.
- Additional feasibility study for NBN Co Building Entry Service and Additional post-installation inspection for NBN Co Building Entry Service – these are one off charges (labour rate and materials) related to the set-up for the NBN Co Building Entry Service (which is included in the SAU). NBN Co did not include them in the SAU; however, they are included in WBA2.
- AVC (TC-1) recurring charge symmetrical (CIR) 0.06 Mbps (Interim Satellite Service) – the S-WBA Price List sets out a charge for this item but if it is ordered there is a credit applied of exactly the same amount. NBN Co did not include a separate charge for this item in the SAU because it is instead provided for as part of the 6/1 Mbps Asymmetric AVC Offer on the NBN Co Interim Satellite Network, as described in clause 1C.2.2 of the SAU. It should be noted that the item is separately included in the SAU's Initial Product List (in Attachment D to the Main Body of the SAU).
- Initial Standard Installation, Initial Non-Standard Installation, Subsequent Installation, AVC Modification (site visit required), AVC Activation on existing equipment (Interim Satellite Service) – given the necessarily complicated nature of the definitions that underlie these charges, together with the interim nature of the service to which they relate, NBN Co did not include them in the SAU; however, they are included in the S-WBA.

¹³ ACCC, Variation of NBN Co Special Access Undertaking – response to submissions, July 2013, p. 67.

- Travel Charges (Interim Satellite Service) – the Interim Satellite Service involves visiting sites that are often in quite remote areas. For this reason, the S-WBA includes a range of Travel Charges that may apply in particular situations. The Price List in the S-WBA makes clear that these Travel Charges may apply in addition to various other charges. Given the somewhat complicated nature of the Travel Charges, together with the interim nature of the service to which they relate, NBN Co did not include them in the SAU.

7.3 Description of the charge for an item in an SFAA Price List is different to that for the relevant NBN Offer or Other Charge in the SAU

In some cases, the description of the charge for an item in an SFAA Price List is different to that for the relevant NBN Offer or Other Charge in the SAU. In such cases, it is important to focus on substance rather than form (that is, how the charge is defined in the dictionaries of the SAU and the relevant SFAA rather than what the charge is called). In addition, it is important to note that the SAU's price controls relate to Maximum Regulated Prices and NBN Co can choose to set Prices below that level if it so chooses.

There are a number of examples of this situation over the period from 13 December 2013 to 30 June 2014.

- Subsequent Installation (WBA2) – in the SAU, the MRP in respect of this Other Charge is expressed as Hourly Labour Rate charged for a minimum amount equivalent to 3.67 hours, plus cost of materials. Given that the Hourly Labour Rate is initially defined as \$75 per hour, the minimum amount is \$275.25.

In WBA2, the Price for this Other Charge is expressed as \$270.00 + Labour Rate + Materials over and above Initial Standard Installation. In practical terms, this charge would comprise a minimum amount of \$270 (i.e. less than the minimum amount expressed in the SAU), plus the cost of labour and materials to the extent that those costs exceed \$270.

It is important to note that the WBA2 charge description includes the words “over and above Initial Standard Installation” whereas the SAU charge description does not. This description reflects that NBN Co would only charge more than \$270 in the case of a Subsequent Installation that does not meet the definition of an Initial Standard Installation. Importantly, this charge would be determined as described above, i.e. with reference to the Hourly Labour Rate plus cost of materials, and only to the extent that those costs exceeded \$270.

As such, the WBA2 charge would always be the same or lower than the relevant Maximum Regulated Price and therefore is consistent with the SAU.

- Rearrangement / Modification (Interim Satellite Service) – Rearrangement / Modification is defined in the S-WBA in almost identical terms to how Equipment Modification is defined in the SAU. In view of this, the SAU's Maximum Regulated Price is applicable. Although it would be clearer if the S-WBA charge were named consistent with the SAU, this is a matter of form rather than substance.

Appendix A Control objectives provided to PwC – Price and Expenditure Compliance

A.1 Price compliance

Control Objective 1: Process controls are in place to ensure that the price for the supply of each NBN Offer and/or Other Charge published on the NBN Co website does not exceed the Maximum Regulated Price applicable to that NBN Offer and/or Other Charge, as defined in the 'NBN Co Special Access Undertaking' accepted 13 December 2013.

Control Objective 2: Control are on place to ensure that changes to Other Charges provided on an “hourly labour rate” or “hourly labour rate plus cost of materials basis” follow an indexation process or are periodically reset by reference to relevant rates charged to NBN Co by its contractors and that materials for these charges are charged at cost.

Control Objective 3: Controls are in place to ensure any changes to Zero-Priced NBN Offers or Other Charges associated with the supply of NBN Offers are subject to appropriate notice to Access Seekers and the ACCC and consultation is undertaken with Access Seekers where relevant. Changes will be the Maximum Regulated Price for the NBN Offer or Other Charge only after the expiry of the notice period.

Control Objective 4: Controls are in place to ensure access to the Content Management System (CMS) is appropriately restricted to ensure no unauthorised changes to prices are made.

A.2 Expenditure Compliance – Prudent Design Condition

Control Objective 5: Controls are in place to ensure that all Network Capital Expenditure costs are substantially consistent with or within the scope of the Network Design Rules (version dated 18 September 2012), or a Permitted Variation, or and Endorsed Network Change or a Network Change as otherwise determined or permitted by the ACCC.

Control Objective 6: Controls are in place to ensure that all necessary Permitted Variations and Endorsed Network Changes captured during Product Development and Solution Development processes are verified for validity and processed in a timely manner.

Control Objective 7: Controls are in place to ensure all key network design verifications and approvals are provided by authorised personnel.

A.3 Expenditure Compliance – Capital Expenditure Prudent Cost Condition (and equivalent for Operating Expenditure)

Control Objective 8: Controls are in place to ensure that the procurement of supplier contracts and associated expenditure is sourced in accordance with the guiding principles in the Buying Guide (version 2.0, dated 1 Aug 2013) and Procurement Manual (version 19.0, dated 8 January 2014) and that supplier contracts contain appropriate clauses.

Control Objective 9: Controls are in place to ensure that only valid purchase requisitions and purchase orders are created and approved in accordance with the relevant NBN Co delegations of authority.

Control Objective 10: Controls are in place to ensure that goods/services received are appropriately receipted and/or accrued for.

Control Objective 11: Controls are in place to monitor supplier contract expenditure.

Appendix B NBN Co Management Representation Letter provided to PwC



30 October 2014

Corinne Best
Partner
PricewaterhouseCoopers
Darling Park
201 Sussex Street
Sydney NSW 1171

Dear Corinne

MANAGEMENT REPRESENTATION LETTER

Representation letter for ASAE 3000 Engagement - Special Purpose Report on the Effectiveness of Controls for NBN Co

This representation letter is provided in connection with your limited assurance engagement to report on the design effectiveness of NBN Co Limited's (NBN Co) controls over the Criteria defined in Appendix A as at 30 June 2014, set forth in NBN Co's description of controls, for the purpose of expressing an opinion on the fair presentation of the description of the system and suitability of the design of controls to achieve the control objectives.

We confirm that, to the best of our knowledge and belief, having made such enquiries as we considered necessary for the purpose of appropriately informing ourselves:

Description of the system

1. We have fulfilled our responsibilities, as set out in the terms of the engagement dated 22 October 2014, for the preparation of the description of the system, including the completeness, accuracy and method of presentation of that description we have a reasonable basis for making that assertion.
2. We have identified the risks that threaten achievement of the control objectives stated in the description of the system, and designed and implemented controls to provide reasonable assurance that those risks will not prevent achievement of the control objectives stated in the description of the system, and therefore the stated control objectives will be achieved.
3. The description of the system set out in the report fairly presents the system for Price Compliance and Expenditure Compliance as at 30 June 2014.
4. The controls related to the control objectives stated in the accompanying description were suitably designed as at 30 June 2014.

Information provided

5. We have provided you with:

PHONE (02) 9926 1900 FAX (02) 9926 1901
EMAIL info@nbnco.com.au WEB www.nbnco.com.au

LEVEL 11, 100 ARTHUR STREET, NORTH SYDNEY NSW 2060

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- a. access to all information of which we are aware that is relevant to the purposes of your engagement such as records, documentation and other matters;
 - b. additional information that you have requested from us for the purpose of the assurance engagement; and
 - c. unrestricted access to persons within NBN Co from whom you determined it necessary to obtain evidence.
6. We have disclosed to you:
- a. all known instances of non-compliance or suspected noncompliance with laws and regulations, fraud or suspected fraud and uncorrected deviations attributable to NBN Co that may affect the design of controls, relevant to the Criteria;
 - b. all control design deficiencies of which we are aware; and
 - c. any events subsequent to 30 June 2014 that could have a significant effect on your report.

Yours sincerely,



Stephen Rue
Chief Financial Officer