



NBN Co Special Access Undertaking

Long Term Revenue Constraint Methodology
2017-18: Draft Determination

and

Price compliance reporting 2017-18

April 2019

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List of abbreviations and acronyms

ABBRR	Annual Building Block Revenue Requirement
ACCC	Australian Competition and Consumer Commission
ACIPA	Annual Construction in Progress Allowance
AER	Australian Energy Regulator
ASA	Auditing Standard of Australia
ASAE	Australian Standard on Assurance Engagement
AVC	Access Virtual Circuit
CFO	Chief Financial Officer
CFRA	Carry Forward Revenue Adjustment
CIF	Cumulative Inflation Factor
CPI	Consumer Price Index
CSAS	Cell Site Access Service
EGM	Executive General Manager
FTTB	Fibre to the basement
FTTN	Fibre to the node
HFC	Hybrid Fibre Coaxial
ICRA	Initial Cost Recovery Account
IPPF	International Professional Practices Framework
LTRCM	Long Term Revenue Constraint Methodology
MRP	Maximum Regulated Price
NBN	National Broadband Network
NBN Co	NBN Co Limited
RAAM	Regulatory Accounting and Allocation Manual
RAB	Regulatory Asset Base
SAU	Special Access Undertaking
SFAA	Standard Form of Access Agreement
WBA	Wholesale Broadband Agreement

Executive Summary

Under NBN Co's Special Access Undertaking (SAU), the ACCC must make a Long Term Revenue Constraint Methodology (LTRCM) determination each year until 2023. This report sets out the ACCC's draft LTRCM determination and view on NBN Co's price compliance for the 2017-18 financial year.

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

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 2017-18 to the ACCC on 31 October 2018.

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 is based on an assessment of NBN Co's compliance with the prudence conditions and methods for calculating LTRCM values specified in the SAU.

The ACCC's draft determination is to accept without modification NBN Co's proposed values (and the inputs to those values) for the ABBRR, RAB, and ICRA in accordance with clause 1E.1.2 of NBN Co's SAU. The reasons for accepting the proposed values are set out in sections 5 and 6 of this report.

The ACCC is also satisfied that NBN Co's prices for 2017-18 did not exceed the maximum regulated prices, in accordance with Schedule 1C of the SAU. The reasons for this decision are outlined in section 7 of this report.

We have received two separate submissions from Telstra to the 2017-18 LTRCM process. These submissions largely focus on NBN Co's recent pricing incentives and behaviour, and the transparency of its revenues and costs, particularly in contestable enterprise markets. We respond to these submissions in section 4 of this report.

The ACCC welcomes submissions on the 2017-18 draft LTRCM determination by 5 pm on Friday 10 May 2019. After considering these submissions, the ACCC will release its final LTRCM determination for 2017-18 by 30 June 2019.

1. Introduction

1.1. Purpose

NBN Co's Special Access Undertaking (SAU) establishes the framework for regulating access to the National Broadband Network (NBN) until June 2040. The SAU also establishes the Long Term Revenue Constraint Methodology (LTRCM), which determines NBN Co's allowed annual regulated revenue, the value of its regulatory asset base, and accumulates the initial unrecovered costs that NBN Co may recover during the term of the SAU. The LTRCM process allows NBN Co to recover only its prudent and efficient costs, including an appropriate return on investment. In this way, it provides NBN Co incentives to incur only efficient expenditure.

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.¹ NBN Co must also certify that its prices have not exceeded the maximum regulated prices dictated by the SAU during the relevant financial year.² The ACCC must then make an LTRCM determination within 12 months of the end of the relevant financial year.³

This report outlines the ACCC's draft LTRCM determination for the 2017-18 financial year. We are seeking stakeholder views on this draft determination and will consider submissions before releasing our final LTRCM determination for 2017-18 by 30 June 2019.

1.2. Consultation

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.

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 10 May 2019 to nbn@acc.gov.au and copy to:

¹ Schedule 1F of the SAU.

² Schedule 1F.3 of the SAU.

³ Clause 1E.1.2 of the SAU.

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1.3. Confidentiality arrangements

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

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

1.4. Structure of this report

The structure of this report is as follows:

- Section 2 describes the LTRCM process
- Section 3 provides an overview of the regulatory information submitted by NBN Co
- Section 4 summarises the views presented in submissions received to date
- Section 5 outlines the ACCC's draft assessment of NBN Co's expenditure compliance and reporting
- Section 6 sets out the ACCC's draft assessment of NBN Co's financial information
- Section 7 details the ACCC's draft assessment of NBN Co's price compliance
- Section 8 presents the ACCC's draft LTRCM determination for 2017–18.

2. LTRCM Process

2.1. Long Term Revenue Constraint Methodology

The LTRCM is a methodology that determines the amount of revenue that NBN Co can earn over the SAU term. During the initial regulatory period⁴, Module 1 of the SAU applies, which allows NBN Co to provide the ACCC with regulatory information on an *ex-post* basis. During the subsequent regulatory period⁵, Module 2 of the SAU applies, which means NBN Co must provide this information on an *ex-ante* basis.

As part of its LTRCM determination, the ACCC must determine the following values (and the inputs to those values):

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

We base our determination on the financial information NBN Co submits to us as part of the LTRCM process. We use the ABBRR and NBN Co’s actual revenue to calculate the extent of unrecovered costs in each year. The ICRA captures the cumulative value of these unrecovered costs. NBN Co is allowed to earn revenue exceeding its ABBRR until the value of the ICRA reaches zero, though NBN Co will still be subject to the price controls set out in the SAU.⁶

2.2. ACCC consideration of the LTRCM

The ACCC’s role in making its LTRCM determination is to:

- determine whether capital expenditure and operating expenditure meet the relevant requirements in the SAU for inclusion in the RAB and ABBRR, respectively
- assess if the relevant LTRCM components have been calculated in accordance with the formulas set out in the SAU, and
- determine whether NBN Co has complied with price controls over the course of the financial year.

The ACCC may determine LTRCM values that are different from the values submitted by NBN Co, provided those values are determined in accordance with Schedule 1D and Schedule 1E of the SAU.⁷ The SAU sets out the factors the ACCC must consider when determining a substitute amount of capital or operating expenditure.⁸

⁴ The period from the time the ACCC accepted NBN Co’s SAU on 13 December 2013, until 30 June 2023.

⁵ The period from 1 July 2023 until the expiry of the SAU on 30 June 2040.

⁶ Clause 1E.6.1 of the SAU.

⁷ Clause 1E.1.2(c)(iv) of the SAU.

⁸ See clauses 1D.3.2(d) and 1E.8.2(c) of the SAU. For example, a substitute amount of capital expenditure determined by the ACCC must meet the Prudent Design Condition and must be consistent with capital expenditure that has been included in the RAB in respect of any prior financial year, having regard to the relative amount of capital expenditure incurred in those years, the relative cost of goods and services in those years, any relevant differences in the scale and scope of the relevant assets, the NBN Co Corporate Plan and any other matter the ACCC considers relevant.

Assessment of expenditure

As part of its assessment of NBN Co's regulatory information, the ACCC must determine whether NBN Co's capital and operating expenditure meet the relevant requirements in the SAU for inclusion in the RAB and ABBRR. This is primarily an assessment of whether NBN Co has processes and controls in place to ensure that its expenditure meets the SAU requirements. These requirements are outlined below.

Capital expenditure

Capital expenditure incurred in a financial year may only be included in the RAB to the extent that the ACCC is satisfied that it meets the prudent cost condition⁹, the prudent design condition¹⁰, or that it was incurred in connection with the specific matters listed in clause 1D.3.2(a)(ii) of the SAU.

Capital expenditure will meet the prudent cost condition if the expenditure was incurred in connection with the design, engineering and construction of the relevant assets under a 'conforming contract'¹¹ (that is, generally, in accordance with the procurement rules); or in an open and competitive market; or through another 'value for money' process. The SAU requires NBN Co to develop procurement rules that establish procurement processes that seek to generate an efficient and competitive outcome and reflect good industry practice.

Capital expenditure will meet the prudent design condition if the expenditure is 'materially consistent' with the network design rules¹² or a permitted variation, endorsed network change or ACCC approved network change to the network design rules.¹³

The specific matters listed in clause 1D.3.2(a)(ii) of the SAU are the Telstra or Optus arrangements, interim satellite or transit arrangements, Tasmanian tri-area service arrangements, trial sites, and third-party funded network changes.¹⁴

Operating expenditure

Operating expenditure may only be included in the calculation of the ABBRR to the extent that the ACCC is satisfied that it was:

- incurred in accordance with NBN Co's procurement processes
- incurred pursuant to a conforming contract
- procured in an open and competitive market
- procured in a manner that is likely to achieve value for money¹⁵, or
- incurred in connection with the specific matters specified in clause 1E.8.2(a)(ii) of the SAU.

The specific matters listed under clause 1E.8.2(a)(ii) of the SAU are the Telstra or Optus arrangements, interim satellite or transit arrangements, Tasmanian tri-area service

⁹ Clause 1D.4 of the SAU.

¹⁰ Clause 1D.6 of the SAU.

¹¹ Clause 1D.4.1(a)(i)(B) of the SAU contains additional requirements where there is a material change of circumstances affecting the conforming contract.

¹² This document describes the design of NBN Co's network and network components. Capital expenditure must be incurred in accordance with the network design rules to be included in the RAB, in addition to meeting the 'prudent cost condition'. The network design rules were updated on 29 June 2018.

¹³ Clause 1D.6 of the SAU.

¹⁴ Schedule 1D of the SAU.

¹⁵ Clause 1E.8.2(a)(i) and 1E.8.3 of the SAU.

arrangements, trial sites, and third-party funded network changes; and expenditure required to address an urgent network issue or a *force majeure* event.

Calculation of LTRCM components

The ACCC's assessment of NBN Co's regulatory information includes a verification that the correct inputs and formulas have been used and applied in determining the proposed values of the LTRCM components. As part of its submission to the ACCC, NBN Co prepares an LTRCM spreadsheet that sets out the calculations of NBN Co's proposed ABBRR, RAB and ICRA values. The ACCC must check that NBN Co has extracted the correct values of capital expenditure, operating expenditure, construction in progress and revenue from the relevant LTRCM schedules before applying the formulas set out in the SAU.

The ACCC must also check the values of the cumulative inflation factor and the rate of return used in LTRCM calculations. The cumulative inflation factor is equal to the product of the percentage change in June quarter CPI published for each financial year from the commencement of the SAU¹⁶; and the rate of return is equal to the risk free rate of interest with a 350 basis point risk premium.¹⁷

Price compliance and reporting

The SAU sets binding caps on the prices NBN Co may charge its customers. Under the SAU, NBN Co may increase the prices set out in its Wholesale Broadband Agreement (WBA) price list by a maximum of CPI minus 1.5 per cent.¹⁸ As part of its submission, NBN Co must submit a price compliance report to the ACCC, which includes a certification from NBN Co's Chief Financial Officer (CFO) that the prices charged in the preceding financial year did not exceed the maximum regulated prices. At any time, the ACCC may request information from NBN Co that is reasonably necessary to determine NBN Co's compliance with Schedule 1C of the SAU.

2.3. Process for making an LTRCM determination

Under the SAU, the ACCC is required to undertake a number of steps in making an LTRCM determination. This is explained below.

ACCC preliminary view

Within 40 business days of receiving NBN Co's regulatory information, the ACCC must provide NBN Co with a preliminary view as to whether it intends to determine a substitute amount of capital expenditure or operating expenditure in making the LTRCM determination.¹⁹

On 17 December 2018, the ACCC notified NBN Co that it does not intend to determine a substitute amount of capital expenditure or operating expenditure. This preliminary view is available on the ACCC website.²⁰

¹⁶ Clause 1E.9.4(b) of the SAU.

¹⁷ Clause 1E.7.1 of the SAU.

¹⁸ Schedules 1C.5 and 2B.2 of the SAU.

¹⁹ Clause 1E.1.2(c)(vii) of the SAU.

²⁰ See <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2017-18>.

Draft and final determinations

The ACCC must publish a draft LTRCM determination and outline the reasons why it has reached its draft determination. Following the release of the draft determination, the ACCC must consult with NBN Co and accept submissions from stakeholders. After considering the submissions, the ACCC must make a final determination. The final determination must be published on the ACCC website no later than 12 months after the end of the financial year to which the determination relates. Therefore, the final determination must be made and published by 30 June 2019.

Powers to seek additional information

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

- determine the values of the ABBRR, RAB, ICRA and the values of the inputs to each of these LTRCM components²¹
- assess the matters contained in the expenditure compliance report²²
- assess compliance of NBN Co's procurement rules²³
- determine NBN Co's price compliance²⁴

NBN Co must comply with any ACCC request pertaining to the above matters and respond within the ACCC's specified timeframes.

For the purposes of this draft determination, the ACCC has not requested any additional information from NBN Co.

²¹ Clause 1F.1.7 of the SAU.

²² Clause 1F.2.2 of the SAU.

²³ Clause 1F.2.3(b) of the SAU.

²⁴ Clause 1F.3(b) of the SAU.

3. NBN Co's 2017-18 regulatory information

On 31 October 2018, NBN Co submitted its regulatory information to the ACCC as required under Schedule 1F of the SAU. The submission consists 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 Executive General Manager (EGM) Procurement, certifying that NBN Co's procurement rules comply with the SAU requirements
- a price compliance report signed by NBN Co's CFO, certifying that NBN Co's prices comply with the requirements of the SAU.

Additionally, NBN Co has submitted three independent reports from PricewaterhouseCoopers (PwC), a price compliance spreadsheet, an LTRCM spreadsheet and a copy of its chart of accounts. Public versions of NBN Co's regulatory information are available on the ACCC website.²⁵

The table below provides a summary for the key financial information submitted by NBN Co. The table also shows the corresponding values for the 2016-17 LTRCM determination.

Table 3.1: Summary of NBN Co's financial information, 2016-17 and 2017-18 (nominal)

	2016-17 (\$'000)	2017-18 (\$'000)	Percentage change
Operating expenditure	3 726 986	4 322 534	16%
Capital expenditure	6 026 916	6 148 060	2%
Construction in progress (start of period)	3 991 030	3 739 873	-6%
Interest expense	5	69 905	1 398 000%
Revenue	1 001 002	1 978 206	98%
Unrecovered costs	4 056 114	4 558 368	12%
RAB (end of period)	14 369 643	19 379 004	35%
ABBRR	5 057 117	6 536 574	29%
ICRA (end of period)	14 014 956	19 405 530	38%

Source: LTRCM spreadsheet 2017-18

²⁵ See <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2017-18>.

4. Submissions to the LTRCM process

While we had not yet called on stakeholders to make any submissions in the process, the ACCC received two separate submissions from Telstra to the LTRCM process.²⁶

The ACCC received Telstra's first submission on 21 December 2018, shortly after the release of the preliminary view. This submission did not comment specifically on the preliminary view. Rather, it raised three broader issues, two of which relate to NBN Co's pricing incentives and behaviour, and one that relates to the transparency of NBN Co's costs and revenues.

Telstra acknowledges that the ACCC may not be able to address these issues through the LTRCM process, but notes that it is important for the ACCC to be aware of these broader issues.²⁷ The ACCC agrees with this assessment. While the matters contained in Telstra's submissions are not of direct relevance to this draft determination, we provide comments on these matters below.

Pricing issues

The first matter raised in Telstra's first submission is that the regulatory regime and building block revenue model does not provide any meaningful pricing constraint on NBN Co.²⁸ Telstra argues that wholesale prices are too high, creating additional risk to continued investment, innovation, and diversity in available fixed broadband services. Telstra is also concerned that the operation of the initial cost recovery account means that the revenue constraints of the SAU are not likely to constrain NBN Co's pricing behaviour in the short to medium-term. Further, Telstra notes that the current low retail margins are unsustainable.

The second matter Telstra has raised is that the regulatory framework is not delivering stable and predictable wholesale prices.²⁹ Telstra puts forward the position that the maximum regulated prices and the price caps in the SAU were intended to deliver predictable and stable wholesale pricing. Instead, the predominant NBN Co offers in the market are discounted offers, which can be removed or altered by NBN Co in a manner that would result in a significant effective increase in price. Telstra has requested that the ACCC clarify its position on whether it considers NBN Co's bundles to be discounts or NBN offers.

The ACCC is continuing to monitor NBN Co's pricing practices and its use of discounts. We will also be closely monitoring the lower-speed tier segment of the market to ensure that end-users are not facing a price shock from migrating from a legacy service to an NBN service. This was a key objective we sought to achieve when we accepted the SAU in 2013. The revenue constraints set out in the SAU are not currently binding, and are not likely to become binding for many years. However, we note that this is consistent with our expectations of how the revenue constraints would operate. Once the value of the ICRA reaches zero, the revenue controls are expected to become a binding constraint.

We also note that from 2023, when Module 2 of the SAU comes into effect, the ACCC's assessment of expenditure will change to a periodic forward-looking approach. After the commencement of Module 2, the ACCC will have more flexibility in the way it assesses NBN Co's expenditure. The SAU also provides price controls that set out maximum regulated

²⁶ Public versions of Telstra's submission are accessible on the ACCC website. See: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2017-18>.

²⁷ Telstra, *Re: Regulatory regime applying to nbn co and Long Term Revenue Constraint Methodology 2017-18 review*, 21 December 2018, p.2.

²⁸ *Ibid.*

²⁹ *Ibid.*, p.1.

prices and restricts the extent to which NBN Co can increase the prices of its services year-on-year. However, these controls only apply to NBN offers.

As stated in our public statement³⁰, released on 2 November 2018 shortly after NBN Co withdrew its proposed SAU variation, products established through discount notices are not NBN offers under the SAU. While we are pleased to see that end-users have experienced improvements in service speeds with the introduction of NBN Co's discounts, we continue to have concerns that several key SAU provisions that were intended to create incentives on NBN Co do not apply in relation to discounts. We will continue to work with NBN Co on a way forward that addresses these concerns.

Transparency

The third matter raised in Telstra's first submission related to NBN Co's entry into contestable enterprise markets, which raises concerns of cross-subsidisation between contestable and non-contestable products.³¹ Telstra submits that NBN Co should be subject to a more rigorous and transparent regulatory accounting framework that requires separate and public accounting for costs and revenue by product, technology and geography, and that provides transparency over cost allocation in relation to common costs between contestable and non-contestable activities.

Telstra argues that the information currently required from NBN Co as part of the LTRCM process is inadequate to enable any assessment of whether cross-subsidisation occurs between contestable and non-contestable products. As part of its submission, Telstra included an attachment³² that proposes an example of the type of information the ACCC could request from NBN Co to provide additional oversight of NBN Co's activities in contestable markets.³³

To further inform Telstra's input to the 2017-18 LTRCM process, Telstra entered into a confidentiality arrangement with NBN Co to access a confidential version of NBN Co's LTRCM spreadsheet.³⁴ Telstra made a second submission to the ACCC on 13 February 2019 based on this information. Telstra submits that this information does not provide clarity on capital costs by customer type, geography, product or shared costs by technology, and it does not provide clarity on operational costs or revenue beyond total expenditure and total revenue.³⁵ Telstra argue that since this information does not assist in understanding the efficiency of NBN Co's cost allocation and the extent of any cross-subsidisation between contestable and non-contestable activities, a more rigorous and transparent regulatory accounting framework is necessary.³⁶

At this stage, we have not formed a view on the necessity and utility of Telstra's suggestion for a more rigorous regulatory accounting framework. While there may be benefits to having increased transparency over NBN Co's expenditure, it is important to first identify the objective and likely benefits that would be achieved through additional transparency and to

³⁰ See <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-sau-variation-2017/withdrawal>.

³¹ Telstra, *Re: Regulatory regime applying to nbn co and Long Term Revenue Constraint Methodology 2017-18 review*, 21 December 2018, p.3.

³² *Ibid*, p.5

³³ Telstra proposes that NBN Co prepare and publish regulatory accounts that provide transparency over: capital expenditure, operating expenditure, revenue and appropriate profitability measures, with this information presented by residential and enterprise customers, by product, by technology type, and by geographic areas. Telstra also propose that the ACCC should receive 'building block' cost components for each category and details of direct and indirect (shared) costs for each category.

³⁴ Telstra, *Re: Regulatory regime applying to nbn co and Long Term Revenue Constraint Methodology 2017-18 review*, 13 February 2019, p.1.

³⁵ *Ibid*.

³⁶ *Ibid*

focus the regulatory accounting framework accordingly. Further, these benefits will need to be balanced against the costs associated with the additional reporting burden, which is likely to be material.

The ACCC agrees with the principle that NBN Co should not be able to use its position as a provider of regulated services to obtain an advantage in the supply of services in competitive markets. However, it is important to note that under the SAU framework, all revenue collected from services in the contestable enterprise markets is factored into the LTRCM calculations, which reduces the revenue requirement from the residential market.

We will consider this matter further and encourage stakeholders to put forward their views through submissions to this draft determination.

5. Assessment of expenditure compliance and reporting

5.1. SAU requirements

Expenditure compliance

As part of its submission of regulatory information to the ACCC, NBN Co must submit to the ACCC a report signed by NBN Co's 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 NBN Co's 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.

5.2. NBN Co's LTRCM submission

Expenditure compliance report

NBN Co has submitted an expenditure compliance report signed by NBN Co's 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 2017-18 financial year be included in the RAB and ABBRR respectively. The expenditure compliance report uses qualifying language to clarify the basis on which NBN Co's CFO provides the certification and expressed negative assurance conclusions.³⁷

Consistent with practices in previous years, 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. 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.³⁸

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.³⁹

Independent assurance reports

Consistent with previous years, NBN Co has 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 is unqualified in nature and complements the certification from NBN Co's CFO.

NBN Co submits 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.⁴⁰

Procurement rules compliance report

As part of its submission of regulatory information, NBN Co has submitted a procurement rules compliance report signed by NBN Co's EGM Procurement⁴¹, which certifies that NBN Co's procurement rules met the relevant conditions as set out in the SAU over the course of the 2017-18 financial year. NBN Co has not reported any exceptions in relation to this report.⁴²

NBN Co submits 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. The same certification and wording was used in previous years. NBN Co also

³⁷ Negative assurance conclusions note that nothing has come to the author's attention that causes them to believe that the requirements have not been met.

³⁸ NBN Co, *nbn submission to the ACCC – 2017-18 Regulatory Information and LTRCM Determination*, 31 October 2018, p.12.

³⁹ *ibid.*

⁴⁰ *ibid.*, p.15.

⁴¹ NBN Co's EGM Procurement is the successor to the Chief Procurement Officer role at NBN Co.

⁴² *ibid.*, p.15.

notes that its investigations are necessarily subject to inherent limitations, and that there is an unavoidable risk that they may not detect deficiencies.⁴³

5.3. 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 2017-18 financial year, though it did use some qualifying language in expressing its negative assurance conclusion. Therefore, the ACCC considered a number of other supporting materials in determining the extent to which the certification is reliable. This includes 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 ACCC has reviewed NBN Co's procurement guidelines 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. The PwC report expresses an unqualified limited assurance conclusion.

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 submissions regarding its internal work.

NBN Co advised that it identified the relevant control objectives and procedures⁴⁴ and revised these from the previous year to take into account:

⁴³ *ibid.*

- general updates to operating procedures and changes in roles and responsibilities
- introduction of additional technology types (e.g. FTTC) as part of the transition to the multi-technology mix
- increased auditor and management understanding of the controls that warrant detailed testing of effectiveness
- updates to reflect the different versions of the procurement rules used during the period
- amalgamation of two control procedures to reflect updated NBN Co processes.

NBN Co's internal audit sampling methodology is based on generally accepted internal audit sampling criteria.⁴⁵ 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 255 samples for the 2017-18 financial year.

NBN Co's internal audit staff undertook testing for each of the sample items to confirm they were operating as designed. Further, 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 reports submitted by NBN Co, which provide a further independent check of NBN Co's relevant processes and controls. Taking into account all of this information, the ACCC is of the view that NBN Co's expenditure complies with the relevant prudence conditions.

Procurement compliance

The ACCC considers that NBN Co has provided a procurement rules compliance report that satisfies the requirements of the SAU.

The report did not identify any exceptions for the 2017-18 financial year, though it did include some qualifying language in expressing negative assurance conclusions.

NBN Co advised, from 1 July 2017 to 27 August 2017, the procurement rules comprised of the Procurement Guidelines v1.1, which came into effect on 28 November 2016, and was provided to the ACCC on 22 December 2016. From 28 August 2017 to 22 February 2018, the procurement rules consisted of the Purchasing Rules v1.2, which included updated 'value' thresholds aligned with new business processes. From 23 February 2018 to 30 June 2018, the procurement rules were updated to comprise of the 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.

⁴⁴ Control objectives are included in Appendix A of NBN Co's supporting submission. NBN Co has classified control procedures as 'confidential of particular sensitivity'. The reasons for this classification are set out in Appendix B of NBN Co's supporting submission.

⁴⁵ In general, NBN Co's internal audit staff use 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).

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

6. Assessment of LTRCM financial information

6.1. SAU requirements

Forecast financial information

During the initial regulatory period, prior to the commencement of the new financial year, NBN Co must submit to the ACCC its forecasts of particular financial information for that financial year. This financial information must include forecasts of capital expenditure, operating expenditure, disposals, and the opening and closing values of construction in progress.⁴⁶

On 30 June 2017, NBN Co submitted its forecast financial information for the 2017-18 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

As part of its submission of regulatory 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.⁴⁷ 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.⁴⁸

Proposed financial information

By 31 October, after the end of each financial year of the initial regulatory period, NBN Co must provide to the ACCC its proposed values for that financial year of the:

- annual building block revenue requirement and the inputs to this value
- opening and closing values of the RAB (nominal and real)
- opening and closing values of the ICRA (nominal and real)
- opening and closing value of construction in progress
- unrecovered cost.

If the net tax allowance is positive, NBN Co must also provide the proposed impact of dividend imputation franking credits and the applicable corporate tax rate.

⁴⁶ Clause 1F.1.2 of the SAU.

⁴⁷ Clause 1F.1.3(a) of the SAU.

⁴⁸ Clause 1F.1.3(b) of the SAU.

6.2. 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.

NBN Co's 2017-18 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.

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 2017-18 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 are available on the ACCC website.

Independent assurance reports

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

- 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.

6.3. 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 Schedules 1D and 1E of the SAU. Therefore, the ACCC's proposes to accept the values proposed by NBN Co without amendment. The reasons are set out below.

Financial information reporting

In assessing whether NBN Co's proposed LTRCM values have been calculated in accordance with Schedules 1D and 1E of the SAU, the ACCC has considered NBN Co's actual and proposed financial information, NBN Co's LTRCM spreadsheet, and the reasonable assurance reports from PwC relating to this financial information.

Assurance

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

The reasonable assurance audit of the actual financial information provides the ACCC with assurance that NBN Co has prepared the LTRCM financial information in Schedules 6-9 in accordance with the RAAM. PwC's unqualified audit opinion complements the existing auditing of NBN Co's general purpose financial statements. 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)⁴⁹, which sets out the variances between forecast and actual financial information, and the reasons for these variances.⁵⁰ The statement helps the ACCC to understand the reasons for any significant differences between forecast and actual expenditure. Following a review of the statement, we are satisfied that there are no significant concerns regarding the variances in capital and operating expenditure.

Regulatory asset base components

The RAB represents the value of NBN Co's capital investment at a particular point in time. It is calculated by rolling forward the balance of the RAB from the previous financial year, then adding capital expenditure less disposals and regulatory depreciation during the financial year.⁵¹

⁴⁹ In accordance with clause 1F.1.3(b) of the SAU.

⁵⁰ The statement of material variances has been classified as 'confidential of particular sensitivity'.

⁵¹ In accordance with clause 1D.2.1 of the SAU.

After checking NBN Co's RAB calculation, we are 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, 2017-18

	2017-18 (\$'000)
RAB opening (real)	13 746 569
Add real capital expenditure	5 761 766
Less real disposal	-
Less real straight line depreciation	(1 346 949)
RAB closing (real)	18 161 385
Cumulative inflation factor	1.067
RAB closing (nominal)	19 379 004

Capital expenditure

As noted in 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 prudency conditions set out in the SAU.

Disposals

There were no disposals during the 2017-18 financial year,

Depreciation

The method of depreciation used in the calculation of the value of the RAB is straight-line depreciation⁵², 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.⁵³ 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.

After checking the calculations in the LTRCM spreadsheet, we are satisfied that the formulas used in the spreadsheet meet the requirements of Schedule 1E of the SAU. The ABBRR components are set out in Table 5.2 below.

⁵² Consistent with clause 1E.9.1 of the SAU.

⁵³ See clause 1E.9.4(b) of the SAU.

Table 5.2: ABBRR calculation, 2017-18 (nominal)

	2017-18 (\$'000)
Return on capital	853 268
Add regulatory depreciation	1 138 698
Add operating expenditure	4 322 534
Add net tax allowance	-
Add annual construction in progress allowance	222 073
ABBRR	6 536 574

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.

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

In line with the ACCC's assessment of operating expenditure compliance in section 5, the ACCC is 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 2017-18 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.⁵⁴

⁵⁴ See clause 1E.10.1 of the SAU.

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 initial cost recovery account (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.⁵⁵

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, 2016-17 (nominal)

	2017-18 (\$'000)
ABBRR	6 536 574
Less revenue	(1 978 206)
Unrecovered cost	4 558 368

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. The ACCC remains of the view that it is appropriate to exclude interest income from regulated revenue for the LTRCM determination.⁵⁶

Table 5.4: ICRA calculation, 2016-17 (nominal)

	2017-18 (\$'000)
Capitalised ICRA from prior period	14 014 956
Add unrecovered cost	4 558 368
ICRA closing	19 405 530

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 (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.

⁵⁵ See Clause 1E.5 of the SAU.

⁵⁶ 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.

7. Assessment of price compliance

7.1. SAU requirements

NBN Co's submission of regulatory information must include a Price Compliance Report, signed by its CFO (or an authorised delegate) certifying that the prices of the supply of its services did not exceed the maximum regulated prices set by Schedule 1C of the SAU for that financial year. NBN Co must also provide to the ACCC such other information that NBN Co considers is reasonably necessary for the ACCC to assess NBN Co's compliance with Schedule 1C of the SAU.

7.2. NBN Co's LTRCM submission

As part of its submission of regulatory information, NBN Co provided the ACCC with a price compliance report and a price compliance spreadsheet for the 2017-18 financial year.⁵⁷

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 2017 to 30 June 2018 satisfied the relevant requirements in Schedule 1C of the SAU. The report does not identify any exceptions. The report includes some qualifying language in expressing negative assurance conclusions, similar in nature to the expenditure compliance report and the procurement rules compliance report.

The price compliance report was informed by a range of investigations and testing conducted by NBN Co, including:

- identification of the price lists that applied under Wholesale Broadband Agreement 2 (WBA2) and Wholesale Broadband Agreement 3 (WBA3) (for fibre, long term satellite and fixed wireless), and the Cell Site Access Service (CSAS) Interim Agreement 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
- work performed by NBN Co's internal audit of relevant processes and 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 they may not detect some deficiencies.⁵⁸ NBN Co's price compliance spreadsheet sets out its analysis of its price compliance. The ACCC has published both the price compliance report and price compliance spreadsheet on the ACCC website.

Throughout the 2017-18 financial year, NBN Co made a number of changes to its price list. The main changes relating to the WBA2 price list include:

- the introduction of five new AVC TC-2 speed tiers on the FTTP network
- the introduction of two new AVC TC-1 speed tier on the HFC network
- the introduction of six new CVC TC-4 speed tiers on the satellite network

⁵⁷ Pursuant to clause 1F.3(a) of the SAU.

⁵⁸ NBN Co, *nbn submission to the ACCC – 2017-18 Regulatory Information and LTRCM Determination*, p.17.

- 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.

The WBA3 price list replaced the WBA2 price list on 17 November 2017. Changes made at that time, or over the period to 30 June 2018 include:

- the removal of the application of a number of charges (for example, the removal of the service qualification enquiry charge in relation to the FTTP, fixed wireless, FTTB, FTTN, and HFC networks)
- clarification that the voiceband reinstatement charge and transition reversal charge are two separate charges, in relation to the FTTN and FTTB networks
- the introduction of NBN Co Ethernet over the FTTC 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 (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. We note that there are provisions in the SAU that allow the ACCC to seek additional assurance in future years if required.

7.3. Submissions

As discussed in section 4, Telstra has made two submissions to the 2017-18 LTRCM process. In its first submission, Telstra raises two issues that are of relevance to NBN Co's pricing incentives and behaviour. These matters relate to broader pricing matters, which Telstra acknowledges are not of direct relevance to the current LTRCM process. As such, these matters did not influence the ACCC's decision on NBN Co's price compliance.

7.4. ACCC draft position

Following consideration of the price compliance report and NBN Co's supporting submission, the ACCC is satisfied that NBN Co's prices in 2017-18 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.

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.

8. 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 2017-18 Draft Determination. We derived these values from NBN Co's submission of regulatory information.⁵⁹ 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.⁶⁰

Table 7.1: 2017-18 LTRCM Draft Determination⁶¹

Year	2017-18
CPI and Cumulative Inflation Factor	
June Quarter CPI (annual percentage change) – as per Attachment C to the SAU	2.078%
Cumulative Inflation Factor – as per Clauses 1E.9.4(b) and (c)	1.067
Rate of return – as per Clause 1E.7.1	
Risk free rate of interest – as per Clause 1E.7.1(b) and (c)	2.438%
Nominal rate of return – as per Clause 1E.7.1(a)	5.938%
Regulatory Asset Base (\$'000 REAL) – as per Clause 1D.2.1	
Real RAB (start period) – as per Clause 1D.2.1(a) and (b)	13 746 569
Real capital expenditure	5 761 766
Real disposals	-
Real straight line depreciation	1 346 949
Real RAB (end period) – as per Clause 1D.2.1(b)	18 161 385
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	14 369 643
Nominal straight line depreciation (as per Clause 1E.9.1(b))	1 437 255
Nominal RAB (end period) – as per Clause 1D.2.2	19 379 004
ABBRR (\$'000 NOMINAL) – as per Clause 1E.4.1	
Return on capital	853 268
Nominal regulatory depreciation – as per clause 1E.9.1(c)	1 138 698
Nominal operating expenditure	4 322 534
Net tax allowance	-
Annual construction in progress allowance – as per Clause 1E.10	222 073
ABBRR	6 536 574

⁵⁹ In accordance with Clause 1E.1.2(c)(vi) of the SAU.

⁶⁰ Clause 1E.1.2(a) of the SAU.

⁶¹ The clause references in this table refer to the formulas in the SAU.

Taxation calculations (\$'000 NOMINAL) – as per Clause 1E.9.3	
Nominal revenue	1 978 206
<i>Add</i> value of assets received for nil consideration	233 896
<i>Less</i> nominal operating expenditure	4 322 534
<i>Less</i> nominal tax depreciation	1 396 821
<i>Less</i> interest expense	69 905
Taxable profit – as per Clause 1E.9.3	(3 577 158)
Tax loss carried forward (Start period) – as per Clause 1E.9.3	(10 301 051)
Tax loss carried forward (End period) – as per Clause 1E.9.3	(13 878 209)
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	14 014 956
Unrecovered cost – as per Clause 1E.5.1	4 558 368
ICRA (end period) – as per Clause 1E.5.2	19 405 530
Carry forward revenue adjustment – as per Clause 1E.5.3	n/a