



**Australian
Competition &
Consumer
Commission**

**NBN Co Special Access Undertaking
Long Term Revenue Constraint Methodology
2014–15: Draft Determination**

and

Price compliance reporting 2014–15

March 2016



Australian Competition and Consumer Commission
23 Marcus Clarke Street, Canberra, Australian Capital Territory 2601
© Commonwealth of Australia 2016
ISBN 978-1-921973-73-4

This work is copyright. Apart from any use permitted by the Copyright Act 1968, no part may be reproduced without prior written permission from the Commonwealth, available through the Australian Competition and Consumer Commission. Requests and inquiries concerning reproduction and rights should be addressed to the Director Publishing, Australian Competition and Consumer Commission, GPO Box 3131, Canberra ACT 2601 or by email to publishing.unit@acc.gov.au.

www.accc.gov.au

Contents

List of abbreviations and acronyms	i
Executive Summary.....	1
1 Introduction	2
1.1 Purpose.....	2
1.2 Making submissions.....	2
1.3 Confidentiality.....	3
1.4 Next steps in this inquiry	3
2 Long Term Revenue Constraint Methodology and Price Compliance	4
2.1 Long Term Revenue Constraint Methodology	4
2.2 The ACCC's role in the LTRCM process	4
2.3 Process for making an LTRCM Determination	5
2.4 Price compliance and reporting	6
3 NBN Co's 2014–15 regulatory information	8
4 NBN Co's proposed amendment to the 2013–14 LTRCM Determination	10
4.1 NBN Co's request to amend the 2013-14 LTRCM Determination.....	10
4.2 Relevant SAU provisions	11
4.3 ACCC draft decision on NBN Co's proposed amendment	12
5 ACCC assessment of NBN Co's regulatory information for 2014–15.....	16
5.1 Assessment of expenditure compliance and reporting	16
5.2 Assessment of LTRCM financial information.....	20
5.3 Assessment of price compliance	27
6 The ACCC's LTRCM Draft Determination	29

List of abbreviations and acronyms

ABBRR	Annual Building Block Revenue Requirement
ACCC	Australian Competition and Consumer Commission
ACIPA	Annual Construction in Progress Allowance
CCA	<i>Competition and Consumer Act 2010 (Commonwealth)</i>
CFO	Chief Financial Officer
CIF	Cumulative Inflation Factor
CIP	Construction in Progress
CPI	Consumer Price Index
CPO	Chief Procurement Officer
ICRA	Initial Cost Recovery Account
LTRCM	Long Term Revenue Constraint Methodology
NBN	National Broadband Network
RAB	Regulatory Asset Base
SAU	Special Access Undertaking
SFAA	Standard Form Access Agreement
WBA	Wholesale Broadband Agreement

Executive Summary

This report sets out the Australian Competition and Consumer Commission's (ACCC) draft determination in relation to NBN Co's Long Term Revenue Constraint Methodology (LTRCM) and its view on NBN Co's price compliance for the 2014-15 financial year.

The LTRCM is a component of NBN Co's Special Access Undertaking (SAU), which forms part of the regulatory framework for the National Broadband Network (NBN). The SAU was accepted by the ACCC on 13 December 2013.

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

Schedule 1F of the SAU requires NBN Co to submit certain regulatory information for each financial year, including financial information required to determine the revenue NBN Co is allowed to earn via its long term revenue constraint. NBN Co is also required to certify that it has complied with the price controls set out in Schedule 1C of the SAU. NBN Co submitted this information on 30 October 2015, and it has been used by the ACCC to inform this draft determination.

The ACCC's draft LTRCM determination is to accept without modification NBN Co's proposed values (and the inputs to those values) for the Annual Building Block Revenue Requirement (ABBRR), Regulatory Asset Base (RAB) and Initial Cost Recovery Account (ICRA) in accordance with clause 1E.1.2 of NBN Co's SAU. The reasons for accepting the proposed values are set out in section 5 of this draft determination.

With regards to price compliance, the ACCC has made the draft decision that it is satisfied that NBN Co's prices for 2014-15 did not exceed the maximum regulated prices applicable at the relevant point in time in accordance with Schedule 1C of the SAU.

In its 2014-15 LTRCM submission, NBN Co requested an amendment to the ACCC's 2013-14 LTRCM Determination to correct for an inadvertent omission. The ACCC will consider NBN Co's proposed amendment as part of this LTRCM consultation process, particularly any submissions or comments received in response to this draft determination. The ACCC is of the preliminary view that it will accept NBN Co's proposed amendment for the reasons discussed in section 4. This will result in an adjustment to the ABBRR and ICRA values in the 2013-14 LTRCM Determination, and will subsequently impact the values in the ACCC 2014-15 LTRCM Determination.

The ACCC must make a final LTRCM Determination for 2014-15 by 30 June 2016.

The ACCC invites submissions from interested parties on the LTRCM Draft Determination for 2014-15 and the ACCC's preliminary view to accept NBN Co's proposed amendment to the 2013-14 LTRCM Determination by 5pm on Friday 15 April 2016.

1 Introduction

1.1 Purpose

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

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

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

This report sets out the ACCC's draft LTRCM determination and its view on NBN Co's price compliance for the 2014–15 financial year. The report is structured as follows:

- Section 2 describes the LTRCM process
- Section 3 provides an overview of the regulatory information submitted by NBN Co
- Section 4 discusses NBN Co's proposed amendment to the LTRCM determination for 2013–14
- Section 5 outlines the ACCC's draft assessment of NBN Co's LTRCM proposal, and
- Section 6 sets out the ACCC's draft LTRCM determination for 2014–15 for comment.

1.2 Making submissions

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

To foster an informed and consultative process, all submissions will be considered as public submissions and will be posted on the ACCC's website. Interested parties wishing to submit commercial-in-confidence material to the ACCC should submit both a public and a commercial-in-confidence version of their submission. The confidential version of the submission should clearly identify the commercial-in-confidence material by bookending the confidential material with an appropriate symbol of 'c-i-c'. The public version should ensure that all confidential material has been removed and replaced with 'c-i-c'. The ACCC has prepared guidelines for parties wishing to submit confidential information to communications inquiries.⁴

¹ Schedule 1F of the SAU.

² Schedule 1F.3 of the SAU.

³ Clause 1E.1.2 of the SAU.

⁴ Available at: <http://www.accc.gov.au/publications/communications-inquiries-submitting-confidential-material>

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

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

Please email submissions by **5pm Friday 15 April 2016** to nbn@acc.gov.au and copy to:

Scott Harding
Director
ACCC
Scott.Harding@acc.gov.au

Kim Hollis
Assistant Director
ACCC
Kimberley.Hollis@acc.gov.au

1.3 Confidentiality arrangements

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

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

1.4 Next steps in this inquiry

The ACCC invites submissions from interested parties until 15 April 2016. The ACCC will consider the issues raised in submissions before releasing a final determination for 2014–15. The ACCC's final LTRCM determination will be published by 30 June 2016 on the ACCC website at www.accc.gov.au.

2 Long Term Revenue Constraint Methodology and Price Compliance

2.1 Long Term Revenue Constraint Methodology

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

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

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

The LTRCM sets out a mechanism for determining NBN Co's RAB and ABBRR based on a range of financial inputs that must be submitted by NBN Co. The ABBRR is in turn used, together with NBN Co's actual revenue (as defined in the SAU), to calculate the extent of unrecovered costs in each year, the cumulative value of which is captured in the ICRA. Once NBN Co begins to earn sufficient revenue each year to meet its annual revenue requirement, the SAU permits NBN Co to recover more than its annual revenue requirement until the ICRA reaches zero (subject to the price controls set out in the SAU).⁵

2.2 The ACCC's role in the LTRCM process

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

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

- it meets the Prudent Cost Condition⁶ – broadly speaking, capital expenditure meets the Prudent Cost Condition if it was incurred in connection with the design, engineering and construction of the relevant assets under a 'conforming contract'⁷ (that is, generally, in accordance with the procurement rules); or in an open and competitive market; or through another 'value for money' process. The SAU requires NBN Co to develop procurement rules that establish procurement processes that seek to generate an efficient and competitive outcome and reflect good industry practice; and
- it meets the Prudent Design Condition⁸ – capital expenditure meets the Prudent Design Condition if it is 'materially consistent' with the Network Design Rules⁹ or a

⁵ See clause 1E.6.1 of the SAU.

⁶ See clause 1D.3.2(a)(i)(A)

⁷ Clause 1D.4.1(a)(i)(B) contains additional requirements where there is a material change of circumstances affecting the Conforming Contract.

⁸ See clause 1D.3.2(a)(i)(B)

permitted variation, endorsed network change or ACCC approved network change to the Network Design Rules,¹⁰ or

- capital expenditure was incurred in connection with the specific matters listed in clause 1D.3.2(a)(ii) of the SAU – that is, capital expenditure is considered to be prudent under the SAU if it relates to: the Telstra or Optus arrangements, interim satellite or transit arrangements, Tasmanian tri-area service arrangements, trial sites, or third party funded network changes; or was incurred prior to the approval of the SAU on 13 December 2013.¹¹

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

- it was incurred in accordance with NBN Co's procurement processes (including in accordance with the Procurement Rules), was incurred pursuant to a 'conforming contract', was procured in an open and competitive market, or was procured in a manner that is likely to achieve value for money,¹² or
- it was incurred in connection with the specific matters specified in clause 1E.8.2(a)(ii) of the SAU – that is, operating expenditure is considered to be prudent under the SAU if it relates to: the Telstra or Optus arrangements, interim satellite or transit arrangements, Tasmania tri-area service arrangements, trial sites, or third party funded network changes; or was incurred prior to the approval of the SAU on 13 December 2013; or it was required to address an urgent network issue or a force majeure event.

The ACCC's role is to assess whether NBN Co has incurred its expenditure in accordance with these criteria, and that the relevant LTRCM components have been calculated in accordance with the formulas set out in the SAU, and to determine whether those expenditures (as set out in NBN Co's LTRCM proposal) should be included in the LTRCM determination. The ACCC may determine LTRCM values that are different from the values submitted by NBN Co, provided those values are determined in accordance with Schedule 1D and Schedule 1E of the SAU.¹³ The SAU includes provisions which set out the factors to consider when determining a substitute amount of capital or operating expenditure.¹⁴

2.3 Process for making an LTRCM Determination

The SAU includes a number of requirements that apply to the ACCC in making an LTRCM Determination.

Preliminary view

Within 40 business days of receiving NBN Co's regulatory information, the ACCC must notify NBN Co of its preliminary view on the extent to which the ACCC intends to determine a

⁹ The document describes the design of NBN Co's network and network components. Capital expenditure must be in accordance with the Network Design Rules in order to be included in the Regulated Asset Base, in addition to meeting the 'Prudent Cost' condition. The Network Design Rules were updated on 30 June 2015.

¹⁰ Clause 1D.6 of the SAU.

¹¹ Schedule 1D of the SAU.

¹² See clauses 1E.8.2(a)(i) and 1E.8.3.

¹³ See clause 1E.1.2(c)(iv) of the SAU.

¹⁴ See clauses 1D.3.2(d) and 1E.8.2(c). For example, a substitute amount of capital expenditure determined by the ACCC must meet the Prudent Design Condition and must be consistent with capital expenditure that has been included in the RAB in respect of any prior financial year, having regard to the relative amounts of capital expenditure incurred in those years, the relative cost of goods and services in those year, 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.

substitute amount of capital expenditure or operating expenditure in making the LTRCM determination.¹⁵

On 22 December 2015, the ACCC provided its preliminary view to NBN Co that it does not intend to determine a substitute amount of capital expenditure in accordance with clause 1D.3.2(d) or a substitute amount of operating expenditure in accordance with clause 1E.8.2(c) of the SAU. The ACCC's preliminary view is available on the ACCC website.¹⁶

Consultation and publication of decisions

The ACCC must publish an LTRCM determination on its website for each financial year in the Initial Regulatory Period no later than 12 months after the end of the financial year to which that LTRCM determination relates. The LTRCM determination for 2014-15 must be made by 30 June 2016.

Prior to publishing an LTRCM determination, the ACCC must publish a draft LTRCM determination and its reasons for the draft determination. The ACCC must consult with NBN Co and other persons the ACCC considers appropriate. In making its final determination, the ACCC must consider any submissions that are received within the time limit specified by the ACCC.

This report sets out the ACCC's draft LTRCM determination for 2014–15 and the ACCC's reasons for the draft determination. The publication of this report also commences public consultation with NBN Co and other stakeholders.

ACCC powers to seek additional information

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

- determine the ABBRR, RAB, ICRA and the values of inputs to each of these values
- assess the matters contained in an expenditure compliance report
- assess compliance of NBN Co's Procurement Rules with the requirements for these rules set out in the SAU
- determine NBN Co's compliance with the price schedule set by the SAU.

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

2.4 Price compliance and reporting

One of the features of the SAU is to set binding price caps, which provide long term pricing commitments to NBN Co's customers. The price controls act in conjunction with the LTRCM to provide incentives to ensure access seekers are not subject to unreasonable prices and to incentivise NBN Co to incur efficient expenditure. There are a number of pricing provisions in the SAU, the most important being an annual price increase limit of the Consumer Price Index (CPI) less 1.5 per cent.¹⁷

By 31 October each year, NBN Co must submit a Price Compliance Report to the ACCC. The Price Compliance Report includes certification from NBN Co's Chief Financial Officer (CFO)

¹⁵ Clause 1E.1.2(c)(vii) of the SAU

¹⁶ See: <http://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2014-15>

¹⁷ Schedules 1C.5 and 2B.2

that the prices charged during the preceding financial year did not exceed the maximum regulated prices set by the SAU.

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

3 NBN Co's 2014–15 regulatory information

To enable the ACCC to conduct its LTRCM assessments during the Initial Regulatory Period, NBN Co is required to submit certain information to the ACCC by 30 June and 31 October every year for the first 10 years of the SAU.

On 30 June 2014, NBN Co submitted its forecast financial information for 2014-15, comprising:

- capital expenditure, by asset type
- operating expenditure
- disposals, by asset type, and
- the opening and closing balance of construction in progress (capital expenditure that has not yet been placed in service).¹⁸

On 30 October 2015, NBN Co submitted an LTRCM proposal to the ACCC as required under Schedule 1F of the SAU. NBN Co's LTRCM proposal consists of the following material:

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

To support its submission, NBN Co also lodged three independent assurance reports from PricewaterhouseCoopers (PwC), a price compliance spreadsheet, an LTRCM spreadsheet and a copy of NBN Co's Chart of Accounts. Public versions of NBN Co's regulatory information have been published on the ACCC's website.¹⁹

In its 2014-15 LTRCM submission, NBN Co has also requested an amendment to the ACCC's 2013-14 LTRCM Determination to correct for an inadvertent omission. This is discussed further in section 4 of this report.

Table 3.1 summarises the key financial information submitted by NBN Co for the 2014-15 LTRCM Determination. The values proposed by NBN Co in Table 3.1 are based on the current LTRCM Determination for 2013-14. However, if the ACCC is to accept NBN Co's proposed amendment to the 2013–14 LTRCM Determination, some of the values in Table 3.1 will change. NBN Co has provided additional financial information to show the relevant values in the event of the amendment.

¹⁸ This forecast financial information has been classified as 'confidential of particular sensitivity'.

¹⁹ See: <http://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2014-15>

Table 3.1 Summary of NBN Co financial information (nominal, \$'000)

	2014–15
Operating expenditure	1 591 220
Capital expenditure	2 166 854
Construction in progress (closing)	2 315 416
Interest expense	59
Revenue	163 867
RAB (closing)	4 818 889
ABBRR	2 218 490
ICRA - closing	6 236 825

The ACCC has set out its preliminary assessment of NBN Co's proposed amendment in section 4 of this report and its views on NBN Co's regulatory information in section 5.

4 NBN Co's proposed amendment to the 2013–14 LTRCM Determination

4.1 NBN Co's request to amend the 2013-14 LTRCM Determination

In its LTRCM submission for 2014-15, NBN Co requested that the ACCC amend the 2013-14 LTRCM Determination to correct for an error by NBN Co in the regulatory information it submitted to the ACCC. NBN Co explained that it inadvertently omitted the value for 'working inventory' from its opening value of 'construction in progress' in its regulatory information for 2013-14.²⁰ The 2013-14 LTRCM determination was the first LTRCM determination undertaken by the ACCC. It applied to the 2013-14 financial year as well as the years prior to the commencement of the SAU. NBN Co's proposed amendment affects the LTRCM values in both the 2012-13 and 2013-14 financial years.

NBN Co has advised that working inventory comprises equipment held by NBN Co before being released into particular construction projects. NBN Co proposes that working inventory should form part of the construction in progress allowance. NBN Co has further clarified that working inventory is distinct from 'spares inventory', which consists of equipment held for network maintenance purposes and is reflected in capital expenditure. As such, working inventory was not otherwise reflected in any other aspect of the LTRCM.

In the 2013-14 LTRCM Determination, the ACCC accepted NBN Co's proposed values for the ABBRR, RAB and ICRA based on an assessment of the regulatory information provided by NBN Co. The Annual Construction in Progress Allowance (ACIPA) that forms part of the ABBRR was calculated for each financial year from 2008-09 to 2013-14 with reference to the opening value of construction in progress, but this value inadvertently omitted working inventory. The cumulative effect of including working inventory in construction in progress is that the closing value of the ICRA as at 30 June 2014 increases by \$6.4 million. This effectively means that NBN Co will be able to recover additional revenue in later stages of the project lifecycle. The RAB values are unaffected as a result of including working inventory in construction in progress.

Table 4.1 shows the current values of ABBRR and ICRA based on the 2013–14 LTRCM Determination, which excludes working inventory.

Table 4.1 Current values of ABBRR and ICRA excluding working inventory (\$'000)

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
ABBRR	139	82 255	335 551	599 568	1 015 902	1 681 744	2 218 490
ICRA - closing	139	82 407	425 296	1 060 024	2 128 102	3 899 511	6 236 825

Table 4.2 shows the proposed values of ABBRR and ICRA if working inventory was to be included. Table 4.2 also shows the difference between the current values and the proposed values. As can be seen in the table, the closing value of ICRA will be affected for the 2012–13 and 2013–14 financial years. The total impact on the ICRA closing value as at 2013–14 would be \$6.437 million. If the proposed values were to be adopted for the purposes of the 2014–15 LTRCM Determination, the closing balance of the ICRA would be \$6.903 million higher for 2014–15.

²⁰ NBN submission to the ACCC – 2014-15 Regulatory Information and LTRCM Determination: Public version, 30 October 2015, p.19.

Table 4.2 Proposed values of ABBRR and ICRA including working inventory (\$'000)

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
ABBRR	139	82 255	335 551	599 568	1 017 657	1 686 301	2 218 490
ABBRR change	0	0	0	0	1 755	4 557	0
ICRA – closing	139	82 407	425 296	1 060 024	2 129 857	3 905 948	6 243 728
ICRA change	0	0	0	0	1 755	6 437	6 903

To assist the ACCC in its consideration of the proposed amendment, NBN Co provided a reconciliation in its supporting submission. The reconciliation shows how the value of working inventory for each of the financial years 2008-09 to 2013-14 can be calculated from the Statement of Capital Expenditure, Disposals, Construction in Progress, Asset Lifetimes and Taxation Asset Lifetimes (Schedule 6) for each of those years.

4.2 Relevant SAU provisions

Amending an LTRCM Determination

Under clause 1E.1.3(a) of the SAU, the ACCC may (but is not required to) amend or revoke an LTRCM Determination no later than 12 months after the date of such a LTRCM determination if the ACCC considers that there is a material error or deficiency in the LTRCM determination of one or more of the following kinds:

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

If the ACCC revokes an LTRCM determination under clause 1E.1.3, the ACCC must make a new LTRCM determination in substitution for the revoked LTRCM determination to apply for the financial year in respect of which the revoked LTRCM determination was to apply.²¹ The substituted LTRCM determination must only vary from the revoked LTRCM determination to the extent necessary to correct the relevant error or deficiency.²²

The ACCC may only revoke and substitute an LTRCM determination under clause 1E.1.3 if the ACCC has first consulted with NBN Co and such other persons as the ACCC considers appropriate.²³

SAU requirements regarding construction in progress

The SAU states that construction in progress will be consistent with the values in NBN Co's audited accounts and will not include any allowance for interest during construction.²⁴ The SAU further states that construction in progress will be included in the calculation of the ACIPA, to the extent the ACCC is satisfied that the capital expenditure incurred in connection with the relevant asset not yet placed in service meets the requirements of clause 1D.3 (with all

²¹ Clause 1E.1.3(b) of the SAU.

²² Clause 1E.1.3(c) of the SAU.

²³ Clause 1E.1.3(d) of the SAU.

²⁴ Clause 1D.2.4(a) of the SAU.

references to capital expenditure in those clauses being read as references to construction in progress).²⁵ The ACIPA will be included in the calculation of the ABBRR.

Clause 1D.3 sets out the SAU requirements for inclusion of capital expenditure in the RAB. Clause 1D.3 specifies that expenditure must meet the Prudent Cost Condition (in accordance with clause 1D.4) and the Prudent Design Condition (in accordance with clause 1D.6) or meet the other conditions specified in clause 1D.3.2(a)(ii).²⁶

4.3 ACCC draft decision on NBN Co's proposed amendment

Power to amend the LTRCM Determination

The ACCC is of the view that it may amend the LTRCM Determination on this occasion. The ACCC accepted the values proposed by NBN Co in its 2013-14 regulatory submission, and as a consequence the value of construction in progress in the 2013-14 LTRCM Determination does not include working inventory. The ACCC has the power under clause 1E.1.3(a) of the SAU to address this.

Draft decision to accept NBN Co's proposed amendment

The ACCC has assessed NBN Co's proposal to amend the 2013–14 LTRCM Determination to include working inventory in the context of the SAU requirements and has formed the preliminary view that it will accept NBN Co's proposed amendment in this instance.

Inclusion of working inventory in construction in progress

The ACCC understands that construction in progress is used to calculate the ACIPA, which accounts for the financing costs associated with capital expenditure relating to assets that are not yet in service. The ACCC has considered NBN Co's explanation for the omission of working inventory and the description of the account. The ACCC is of the view that the description provided by NBN Co appears to be consistent with the nature of items that would be included in the construction in progress account as the working inventory expenditure relates to assets that are not yet in service.

Consistency with NBN Co's audited accounts

Under the SAU, the value of construction in progress must be consistent with the values in NBN Co's audited accounts. The ACCC understands that for statutory accounting purposes, the value of assets in the course of construction is recognised in the carrying amount of property, plant and equipment. However, to meet the SAU reporting requirements, NBN Co reports construction in progress as a separate aggregate value at the start and end of each financial year in its LTRCM financial information. While working inventory is presented differently in NBN Co's financial statements compared to its LTRCM submission, the ACCC understands that the underlying values used for construction in progress are consistent with NBN Co's audited accounts. This is supported by the statement by NBN Co's CFO that declares that Schedule 6 has been reconciled with the audited general purpose financial statements. Based on the advice and declaration from NBN Co, the ACCC is satisfied that the proposed value of working inventory should be consistent with NBN Co's audited accounts.

²⁵ Clause 1D.2.4(c) of the SAU.

²⁶ Clause 1D.3.2(a)(ii) allows the inclusion of capital expenditure of the expenditure was incurred between the Cost Commencement Date and the SAU Commencement Date or was incurred in connection with the NBN Co Interim Satellite Network, the Interim Transit Arrangements, the Telstra Arrangements, the Optus Arrangements, the Tasmania Tri-Area Service Arrangements, the First Release Trial Sites or Third Party Funded Network Changes.

Compliance with the Prudent Cost and Design Conditions

The ACCC considers that it is reasonable to include the value of the working inventory account in construction in progress to the extent that it meets the requirements set out in clause 1D.3 of the SAU.

The ACCC's 2013-14 LTRCM Determination accepted without modification NBN Co's proposed values (and the inputs to those values) for the ABBRR, RAB and ICRA. The ACCC accepted these values on the basis that it was satisfied that these values were in accordance with the relevant prudency provisions of the SAU. In making this assessment, the ACCC relied on NBN Co's compliance reports, supporting submission and independent audit and assurance reports from PwC.

The ACCC understands that working inventory expenditure would have been subject to the same procurement processes and controls as other items of construction in progress that were included in the 2013-14 LTRCM Determination. However, working inventory was not included because of a misunderstanding regarding the description of the account. The ACCC understands that the value of working inventory was identified as a balancing item in the reconciliation between NBN Co's audited accounts (which included working inventory) and NBN Co's regulatory information (which excluded working inventory), but was not included due to the misunderstanding. Following further clarification regarding the nature of transactions included in the working inventory account, NBN Co became aware that it should have been included for the purposes of reporting under the SAU.

In its submission of regulatory information for 2014-15, NBN Co has demonstrated that the value of working inventory can be reconciled with the regulatory information submitted by NBN Co. The ACCC has considered this reconciliation along with the assessment of compliance with the prudency provisions in the SAU and is satisfied that the proposed value of working inventory complies with the relevant prudency requirements.

NBN Co's amended LTRCM calculations

The ACCC has checked the calculations provided by NBN Co in its submission and the additional LTRCM spreadsheet, which recalculates the ABBRR and ICRA values for the period from 2008-09 to 2014-15 with the inclusion of working inventory. The ACCC has also worked through the reconciliation provided by NBN Co in Table 4 of its submission, and is satisfied that the movement in working inventory derived from Schedule 6 corresponds with the value in the additional LTRCM spreadsheet.

On the basis that the ACCC considers that the inclusion of working inventory would be consistent with the relevant clauses in the SAU, and that the ACCC has not identified any errors in NBN Co's proposed amendment calculations, the ACCC has formed the preliminary view that it will accept NBN Co's proposed amendment. Therefore, the ACCC's draft decision on NBN Co's proposed amendment is to include working inventory for the years 2008-09 to 2013-14. The effect of this proposed amendment is shown in Table 4.3. The ACCC has prepared the 2014-15 LTRCM Draft Determination on this basis.

As shown in Table 4.3, the inclusion of working inventory increases the amount of revenue NBN Co is allowed to recover over time. The ACIPA increases to account for the financing costs associated with the expenditure on working inventory. This increase is added to the ABBRR, which results in a larger unrecovered cost in both 2012-13 and 2013-14. The unrecovered cost is then carried forward each year in the ICRA.

Table 4.3 Amended 2013-14 LTRCM Determination for consultation

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
June Qtr CPI (annual % change)	-	1.4%	3.1%	3.5%	1.2%	2.4%	3.0%

Cumulative inflation factor	-	0.891	0.904	0.932	0.965	0.977	1.000
Rate of Return – as per clause 1E.7.1							
Risk free rate	-	6.699%	5.675%	5.404%	5.224%	3.009%	3.578%
Nominal rate of return	-	10.199%	9.175%	8.904%	8.724%	6.509%	7.078%

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Regulatory Asset Base (\$'000 Real) – as per clause 1D.2.1							
Real RAB (start period)	-	-	-	8 411	280 613	726 286	1 612 525
Real Capital Expenditure	-	-	8 411	273 580	507 876	1 059 300	1 596 522
Real Disposals	-	-	-	-	-	-	-
Real Straight Line Depreciation	-	-	-	1 378	62 204	173 061	307 909
Real RAB (end period)	-	-	8 411	280 613	726 286	1 612 525	2 901 139

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Regulatory Asset Base (\$'000 Nominal) – as per clause 1D.2.2							
Nominal RAB (start period)	-	-	-	7 601	261 506	700 852	1 574 878
Nominal Straight Line Depreciation	-	-	-	1 284	60 026	169 021	307 909
Nominal RAB (end period)	-	-	7 601	261 506	700 852	1 574 878	2 901 139

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
ABBRR (\$'000 Nominal) – as per clause 1E.4.1							
Return on capital	-	-	-	677	22 814	45 621	111 467
Nominal Regulatory Depreciation	-	-	-	1 014	56 862	152 267	260 417
Nominal Opex	-	139	82 255	330 865	499 419	778 673	1 215 514
Net Tax Allowance	-	-	-	-	-	-	-
ACIPA (original 2013-14 determination)	-	-	-	2 996	20 473	39 340	94 345
ACIPA (amended determination)	-	-	-	2 996	20 473	41 096	98 902
ABBRR (original 2013-14 determination)	-	139	82 255	335 551	599 568	1 015 902	1 681 744
ABBRR (amended determination)	-	139	82 255	335 551	599 568	1 017 657	1 686 301

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Taxation Calculations (\$'000 NOMINAL) - as per Clause 1E.9.3							
Nominal Revenue	-	-	-	-	1 944	16 824	60 958
+Value of Assets Received for Nil Consideration	-	-	-	-	-	122 854	67 251
-Nominal Operating Expenditure	-	139	82 255	330 865	499 419	778 673	1 215 514
-Nominal Tax Depreciation	-	-	-	1 245	57 929	164 904	300 744
-Interest Expense	-	-	0	0	15	123	1
Taxable Profit	-	(139)	(82 256)	(332 110)	(555 420)	(804 023)	(1 388 050)
Tax Loss Carried Forward (Start period)	-	-	(139)	(82 395)	(414 505)	(969 924)	(1 773 947)
Tax Loss Carried Forward (End period)	-	(139)	(82 395)	(414 505)	(969 924)	(1 773 947)	(3 161 997)
Net Tax Allowance	-	-	-	-	-	-	-

Year	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
ICRA and CFRA (\$'000 NOMINAL) – as per Clause 1E.5							
ICRA (start period) (original 2013-14 determination)	-	-	139	82 407	425 296	1 060 024	2 128 102
ICRA (start period) (amended determination)	-	-	139	82 407	425 296	1 060 024	2 129 857
Unrecovered Cost (original 2013-14 determination)	-	139	82 255	335 551	597 625	999 078	1 620 786
Unrecovered Cost (amended determination)	-	139	82 255	335 551	597 625	1 000 833	1 625 343
ICRA (end period) (original 2013-14 determination)	-	139	82 407	425 296	1 060 024	2 128 102	3 899 511
ICRA (end period) (amended determination)	-	139	82 407	425 296	1 060 024	2 129 857	3 905 948
Carry Forward Revenue Adjustment	-	n/a	n/a	n/a	n/a	n/a	n/a

5 ACCC assessment of NBN Co's regulatory information for 2014–15

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

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

5.1 Assessment of expenditure compliance and reporting

SAU requirements

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

NBN Co must develop Procurement Rules to establish procurement processes that, in broad terms, generate an efficient and competitive outcome and reflect good industry practice.²⁷ The SAU also requires NBN Co to provide a copy of its Procurement Rules to the ACCC within 30 days after the SAU commencement date and within 30 days after NBN Co makes any material amendments to the Procurement Rules.²⁸

NBN Co must also submit certain compliance reports to the ACCC each year during the Initial Regulatory Period to inform the ACCC's LTRCM decision. By 31 October each year during the Initial Regulatory Period, NBN Co must submit the following:

- Expenditure Compliance Report – a report signed by NBN Co's CFO (or delegate) which certifies that, in relation to the financial year, the capital and operating expenditure proposed for inclusion in the RAB and ABBRR respectively meet the specified criteria, which includes compliance with the Prudent Design and Prudent Cost conditions.²⁹ Where capital expenditure or operating expenditure does not meet the specified criteria, the CFO (or delegate) must propose a substitute amount of capital expenditure or operating expenditure for the ACCC's consideration.
- Procurement Rules Compliance Report – a report signed by NBN Co's CPO (or authorised delegate) certifying that, in relation to that financial year, NBN Co's Procurement Rules satisfied the procurement rule requirements set out in clause 1D.5.1 of the SAU.³⁰

NBN Co's LTRCM submission

Expenditure Compliance Report

On 30 October 2015, NBN Co provided the ACCC with an Expenditure Compliance Report pursuant to clause 1F.2.1(a) of the SAU. The report is signed by NBN Co's CFO and certifies

²⁷ Clause 1D.5.1 of the SAU

²⁸ Clause 1D.5.2 of the SAU.

²⁹ Clause 1F.2 of the SAU.

³⁰ Clause 1F.2.3 of the SAU.

that NBN Co's proposed capital and operating expenditure complies with the relevant expenditure conditions set out in the SAU.

NBN Co's CFO has not reported any exceptions in relation to either capital expenditure or operating expenditure and, as such, NBN Co proposes that all capital expenditure and all operating expenditure incurred during the 2014-15 financial year should be included in the RAB and ABBRR, respectively.

The Expenditure Compliance Report includes some qualifying language to make clear the basis on which the certification is provided and expresses negative assurance conclusions.³¹ NBN Co submits that it has had regard to ASAE 3000 'Assurance Engagements Other Than Audits or Reviews of Historical Financial Information' in developing the qualifying language in the certification.³²

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

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

NBN Co has provided further detail on its internal audit work in its supporting submission. The approach taken was largely the same as in 2013-14, except for a change to the sampling methodology for undertaking its controls testing. NBN Co's internal audit staff significantly increased its sample sizes for its tests of effectiveness over Prudent Design and Prudent Cost control procedures and focussed on testing the operation of controls within the period.

Independent assurance reports

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

Similar to NBN Co, PwC conducted its work in accordance with ASAE 3000 'Assurance Engagements Other than Audits or Reviews of Historical Financial Information'. NBN Co noted that the ASAE 3000 standard was recently revised 'to provide more robust guidance, including clear objectives, more detailed requirements and application material for planning, performing and reporting'. The current PwC's Limited Assurance Report reflects the revised ASAE 3000 standard.

NBN Co submits that its Expenditure Compliance Report, taken together with the PwC 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 prudence conditions and should be included in the RAB and ABBRR, respectively.³³

Procurement Rules Compliance Report

On 30 October 2015, NBN Co provided a Procurement Rules Compliance Report in accordance with clause 1F.2.3(a) of the SAU. The report is signed by NBN Co's CPO and

³¹ 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.

³² ASAE 3000 is the Australian Standard on Assurance Engagements. It covers engagements to provide assurance on design, implementation and operating effectiveness of internal controls.

³³ NBN Co, *NBN Co submission to the ACCC – 2014-15 Regulatory Information and LTRCM Determination*, 30 October 2015, p.15.

certifies that NBN Co has developed and maintained Procurement Rules that contain a competitive tendering and procurement process which satisfy a number of conditions. These conditions are the following:

- the process must generate an efficient and competitive outcome between the tender participants
- there must be a clear process for the calling and conducting of tenders and NBN Co should assess and award tenders to successful participants which meet the reasonable requirements of procedural fairness and good industry practice
- if NBN Co decides to approve a tender that is not the lowest price tender, this must be appropriately justified
- NBN Co must ensure that the basis for undertaking the works and services is in accordance with good industry practice and the basis of payment for works and services must be clearly specified, and
- NBN Co must ensure that there is a process for managing contracts that complies with good industry practice and which seeks to achieve value for money and the lowest total cost of ownership.³⁴

The CPO's certification included some qualifying language to make clear the basis on which the certification is provided. The certification expresses negative assurance conclusions:

'Based on my knowledge, and on the basis that nothing has come to my attention that causes me to believe anything to the contrary, during the period 1 July 2014 to 30 June 2015 the Procurement Rules satisfied the requirements in clause 1D.5.1.'

Similar to the qualifying language used in the Expenditure Compliance Report, NBN Co submits that it has had regard to ASAE 3000 'Assurance Engagements Other Than Audits or Reviews of Historical Financial Information' in developing the qualifying language in the Procurement Rules Compliance Report certification.

ACCC draft decision on NBN Co's expenditure compliance

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

The ACCC accepts that the Expenditure Compliance Report was provided by the required date. The Expenditure Compliance Report did not identify any exceptions during the period from 1 July 2014 to 30 June 2015, however, it is subject to some qualifying language and expresses negative assurance conclusions. Therefore, the ACCC considers that NBN Co's supporting materials are an important consideration in determining the extent to which the ACCC can rely on the certification.

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

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

To assess the adequacy of NBN Co's procurement rules, the ACCC has checked that NBN Co's Procurement Manual and Buying Guide comply with the relevant requirements in the SAU. The ACCC has also considered NBN Co's Procurement Rules Compliance Report, which is discussed further below.

³⁴ Clause 1D.5.1. of the SAU.

To determine whether there are processes and controls in place to encourage compliance with the prudence conditions in the SAU, the ACCC has relied on PwC's assurance report regarding the design of controls applicable to capital expenditure and operating expenditure. The ACCC understands that PwC tested whether NBN Co has adequate controls in place to ensure that capital and operating expenditure is incurred in accordance with the Prudent Design and Prudent Cost conditions. As PwC provided an unqualified opinion, the ACCC is satisfied that NBN Co has processes and procedures in place that support compliance with the prudence conditions in the SAU.

In assessing whether NBN Co has complied with these processes and procedures, the ACCC has considered the additional information provided by NBN Co in its supporting submission regarding its internal audit work. The internal audit approach was largely the same as in 2013-14, except for a change to NBN Co's sampling methodology for undertaking its controls testing. The ACCC has sought to understand the change to NBN Co's sampling methodology and has discussed with NBN Co staff about the change in its approach. The ACCC accepts that there are various different ways that internal audit staff could approach the work that informs the CFO's certification and the approach undertaken by NBN Co is likely to provide a cumulative view of the effectiveness of NBN Co's controls over time.

The ACCC also recognises that NBN Co's audit sample sizes were significantly larger in 2014-15 than in 2013-14. In 2013-14, NBN Co only tested a sample of 30 transactions across all controls. In 2014-15, NBN Co indicated that its internal audit staff tested 18 control procedures, with a total sample of 232 transactions. The sample size for each control procedure was determined based on the frequency of the control operating. For example, for controls that operate multiple times each day, a sample of 30 was selected, whereas for controls that only operate annually, a sample size of one was selected. NBN Co used a 'judgemental' approach to selecting the sample and has advised that the samples have been selected to cover a wide cross-section of transactions. The ACCC considers that the larger sample size will help to provide more robust audit results. The ACCC is satisfied that the information provided by NBN Co is reasonable for the purposes of demonstrating that it has procedures and processes in place to enable compliance with the prudence conditions and procurement rules set out by the SAU.

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

The ACCC is satisfied that NBN Co provided the ACCC with a Procurement Rules Compliance Report by the required date. The Procurement Rules Compliance Report did not identify any exceptions during the period from 1 July 2014 to 30 June 2015. However, the Procurement Rules Compliance Report is subject to some qualifying language and only expresses negative assurance conclusions.

In order to be satisfied with NBN Co's Procurement Compliance Report, the ACCC has considered the material in NBN Co's supporting submission that describes the factors that have informed the CPO's certification. NBN Co submits that the CPO's certification in the Procurement Rules Compliance Report was based on a number of investigations. These investigations found that as at 1 July 2014, the procurement rules comprised the Procurement Manual v19 and Buying Guide v2.0. On 1 August 2014, both the Procurement Manual and Buying Guide were updated. A further immaterial change to the Buying Guide was made on 18 March 2015.

The ACCC was provided with NBN Co's Procurement Manual v19 and Buying Guide v2.0 in December 2013. These documents were assessed by the ACCC at that time as being compliant with clause 1D.5.1 of the SAU. The ACCC was also provided with updated versions of the documents on 18 August 2014, which was within the 30 day timeframe required by clause 1D.5.2 of the SAU. The ACCC has considered these amendments and is of the view that they are consistent with the relevant provisions of the SAU.³⁵

³⁵ NBN Co was not required to submit the amendment to the Buying Guide on 18 March 2015 to the ACCC as the amendment was considered to be immaterial.

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

5.2 Assessment of LTRCM financial information

SAU requirements

Reporting requirements

NBN Co is required to submit NBN Co's forecasts or estimates of certain information (Forecast Financial Information) by no later than 30 June prior to the commencement of each financial year during the Initial Regulatory Period. The Forecast Financial Information includes capital expenditure by asset type, operating expenditure, disposals by asset type and the opening and closing value of construction in progress.³⁶

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

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

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

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

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

³⁶ Clause 1F.1.2 of the SAU

³⁷ Clause 1F.1.3 of the SAU.

Provisions regarding the calculation of LTRCM values

The ACCC must issue an LTRCM determination for each financial year in the Initial Regulatory Period that specifies the ABBRR, RAB and ICRA including the inputs to each of those values in accordance with Schedule 1D and 1E of the SAU. In making this determination, the ACCC must have regard to the regulatory information submitted by NBN Co under Schedule 1F of the SAU.

During the initial cost recovery period, the RAB will be rolled forward on an annual basis to reflect additions through capital expenditure and deductions through regulatory depreciation and asset disposals in accordance with Schedule 1D. The ABBRR for each year will be calculated by adding operating expenditure, return on assets (calculated by multiplying the opening RAB for that year by the cost of capital), regulatory depreciation, tax allowance and annual construction in progress allowance. All components of the ABBRR are determined in accordance with Schedule 1E. Any shortfall in revenue relative to the ABBRR in any given financial year will be capitalised in an ICRA and subsequently recovered in later financial years of the initial cost recovery period. The process for determining the ICRA is also specified in Schedule 1E.

NBN Co's LTRCM submission

NBN Co's approach to SAU financial reporting

NBN Co has prepared its financial information in accordance with its Regulatory Accounting and Allocation Manual (RAAM). The RAAM provides detailed instructions on the principles, guidelines and templates to be used when preparing the LTRCM reports. This includes an explanation of when NBN Co will use an approach to reporting that is not consistent with Australian Accounting Standards in order to meet SAU requirements (that is, it will apply an Alternate Accounting Treatment). NBN Co provided the ACCC with a copy of its RAAM for 2014-15 in June 2015. In its LTRCM submission, NBN Co also provided the ACCC with a copy of its Chart of Accounts with notes to show how the accounts are mapped to the RAAM.

NBN Co provided a statement by NBN Co's CFO on 30 October 2015, which declares that the RAAM has been appropriately updated to meet the financial reporting requirements of the SAU and that Schedules 6-9 have been prepared in accordance with the principles of the RAAM and have been reconciled with the audited general purpose financial statements. The statement also declares that Schedule 10 has been prepared in accordance with the reporting requirements of the SAU.

Forecast Financial Information

On 30 June 2014, NBN Co submitted its Forecast Financial Information for the 2014-15 financial year. The Forecast Financial Information consists of the following two schedules:

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

The Forecast Financial Information submitted by NBN Co is confidential.

Actual and Proposed Financial Information

On 30 October 2015, NBN Co provided the ACCC with its Actual and Proposed Financial Information for the 2014-15 financial year. The financial information submitted by NBN Co consists of six schedules:

- Schedule 6 – Statement of Capital Expenditure, Disposals, Construction in Progress, Asset Lifetimes and Taxation Asset Lifetimes

- Schedule 7 – Statement of Operating Expenditure
- Schedule 8 – Statement of Interest Expense
- Schedule 9 – Statement of Revenue
- Schedule 10 – Statement of LTRCM and RAB items, and
- Schedule 11 – Statement of Material Operating Expenditure, Capital Expenditure and Construction in Progress Variances.

This information was accompanied by an LTRCM spreadsheet, which provided the underlying calculations of NBN Co's proposed RAB, ABBRR and ICRA values. NBN Co provided two versions of the LTRCM spreadsheet – one based on the current 2013–14 LTRCM Determination and another based on NBN Co's proposed amendment to the 2013–14 Determination as described in section 4 of this report. A public version of NBN Co's LTRCM proposal is available on the ACCC website.

Independent assurance reports

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

- a reasonable assurance audit report for the regulatory financial information submitted by NBN Co (Schedules 6-9). PwC's audit opinion for this work was unqualified and complements the audit of NBN Co's general purpose financial statements.
- factual findings of agreed upon procedures for NBN Co's Actual Financial Information and Proposed Financial Information (Schedule 10). The agreed upon procedures consisted of checking that the relevant input values were extracted correctly from Schedules 6 to 9 into the LTRCM Spreadsheet and that the relevant LTRCM calculations are undertaken in accordance with the SAU in order to arrive at the output values in Schedule 10.

ACCC draft decision regarding financial information

The ACCC is satisfied that NBN Co has met its reporting requirements with regards to its LTRCM financial information. Having reviewed the materials in NBN Co's LTRCM submission, the ACCC considers that NBN Co has calculated its proposed values for the RAB, ABBRR and ICRA in accordance with the formulas set out in Schedules 1D and 1E of the SAU. Therefore, the ACCC has made the draft decision to accept the values proposed by NBN Co without amendment. The reasons for the ACCC's draft decision are explained further below.

Financial information reporting

In assessing whether NBN Co's proposed LTRCM values have been calculated in accordance with Schedules 1D and 1E of the SAU, the ACCC has considered NBN Co's Actual Financial Information and Proposed Financial Information. The ACCC has also had regard to a spreadsheet that NBN Co has prepared that sets out the calculations used by NBN Co to determine its proposed values for the RAB, ABBRR and ICRA and the reasonable assurance reports from PwC in regards to this financial information.

Assurance

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

The reasonable assurance audit of the actual financial information provides the ACCC with assurance that NBN Co has prepared the LTRCM financial information in Schedules 6-9 in

accordance with the RAAM. PwC’s audit opinion was unqualified and complements the existing auditing of NBN Co’s general purpose financial statements. The ACCC considers that this PwC report provides independent verification that NBN Co’s financial statements have been accurately adjusted in accordance with the Alternate Accounting Treatments specified in the RAAM.

The agreed upon procedures performed by PwC with respect to the LTRCM and RAB information provide the ACCC with some additional comfort that NBN Co’s statement of LTRCM and RAB items includes information that has been extracted and calculated correctly.

Statement of material variances

On 30 October 2015, NBN Co submitted a statement of material variances (Schedule 11) which sets out the variances between the Forecast and Actual Financial Information for operating expenditure, capital expenditure and construction in progress. It also sets out the reasons for these variances.³⁸

This is the first financial year that NBN Co has lodged a statement of material variances with the ACCC. This statement shows the variance between Forecast Financial Information and Actual Financial Information for capital expenditure, operating expenditure and construction in progress. NBN Co was not required to lodge this statement with respect to the 2013–14 financial year because NBN Co was not required to lodge Forecast Financial Information until 30 June of the first full Financial Year of the Initial Regulatory Period (that is, 2014–15).³⁹

The ACCC is satisfied that NBN Co has met its reporting requirement to provide a statement of material variances under clause 1F.1.3(b) of the SAU. The statement helps the ACCC to understand the reasons for any significant differences between forecast and actual expenditure. The ACCC has reviewed the statement of material variances and is satisfied that it does not raise any significant concerns for the ACCC regarding the magnitude of capital and operating expenditure.

Regulatory Asset Base components

The RAB is the value of capital investment made by NBN Co, and the RAB equation determines how that value will change over time. In accordance with Schedule 1D of the SAU, the RAB is calculated by rolling forward the balance of the RAB from the prior year, then adding capital expenditure less disposals and regulatory depreciation. The ACCC has checked NBN Co’s calculations with respect to the RAB and is satisfied that they comply with the relevant SAU provisions. The RAB components are set out in Table 5.1 below.

Table 5.1 RAB calculation (\$’000)

RAB calculation	2014-15
RAB opening (real)	2 901 139
Add real capital expenditure	2 134 603
Less real disposals	-
Less real straight line depreciation	(288 575)
RAB closing (real)	4 747 167
Cumulative inflation factor	1.015
RAB closing (nominal)	4 818 889

Note: the RAB closing balance is subject to rounding.

³⁸ The statement of material variances has been classified as ‘confidential of particular sensitivity’.

³⁹ Clause 1F.1.2 of the SAU.

Capital expenditure

Based on our assessment of capital expenditure compliance in section 5.1, the ACCC is satisfied that the capital expenditure proposed by NBN Co in its RAB calculations meets the prudence conditions set out in the SAU.

Disposals

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

Depreciation

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

The ACCC understands that NBN Co undertook a review of the useful lives of its assets in accordance with NBN Co's accounting policies and Australian Accounting Standard requirements during the year. NBN Co has advised the ACCC that any revised useful lives have been adopted for the reporting of its regulatory information. The ACCC has reviewed the useful lives reported by NBN Co and notes that the changes only affect a small number of assets. The remainder of asset lives used for the purposes of the LTRCM depreciation calculations are consistent with those used last year.

Cumulative inflation factor

The cumulative inflation factor (CIF) is used to convert real values to nominal values, and vice versa. The CIF is calculated as the product of the June Quarter Consumer Price Index (CPI) published for each financial year from the commencement of the SAU, relative to the first financial year. The ACCC has checked the June Quarter CPI for 2015 and NBN Co's calculation of the cumulative inflation factor, and is satisfied that the CIF has been calculated and applied correctly.

ABBRR components

The ABBRR represents the amount of revenue that NBN Co would be required to earn in order to recover its costs (including a return on its previous capital investments) in a particular year. It consists of the sum of NBN Co's return on previous capital investment, regulatory depreciation, operating expenditure, net tax allowance and the annual construction in progress allowance. The ACCC has checked the calculations in the LTRCM Spreadsheet and confirmed that the formulas used in the spreadsheet are as set out in Schedule 1E of the SAU. The ABBRR components are set out in Table 5.2 below.

Table 5.2 ABBRR calculation (nominal, \$'000)

	2014-15
Return on capital	210 314
<i>Add regulatory depreciation</i>	249 103
<i>Add operating expenditure</i>	1 591 219
<i>Add net tax allowance</i>	-
<i>Add annual construction in progress allowance</i>	167 853
ABBRR	2 218 490

Return on capital

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

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

Regulatory depreciation

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

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

Operating expenditure

Operating expenditure can be included in the ABBRR to the extent that it meets the prudence conditions and was incurred in accordance with NBN Co's Procurement Rules. NBN Co's proposed value for operating expenditure is provided in Schedule 7 of NBN Co's submission. Based on our assessment of operating expenditure compliance in section 5.1, the ACCC is satisfied that the amount of operating expenditure proposed by NBN Co meets the requirements of the SAU and can be included in the ABBRR.

Net tax allowance

The ACCC acknowledges that NBN Co is currently in a loss-making position and therefore the net tax allowance is not applicable for the 2014-15 LTRCM Determination.

Annual construction in progress allowance

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

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

The ACCC has checked NBN Co's proposed annual construction in progress allowance and is satisfied that it has been calculated in accordance with clause 1E.10.1 of the SAU.

Initial cost recovery account components

The ICRA is determined by calculating the difference between the ABBRR and the amount of revenue actually earned by NBN Co via access prices in that year. This 'unrecovered cost'

amount is added to the ICRA balance from the previous year, which is capitalised and carried forward.⁴⁰

Table 5.3 Unrecovered cost calculation (nominal, \$'000)

	2014-15
ABBRR	2 218 490
Less revenue	(163 867)
Unrecovered cost	2 054 623

Revenue

The value proposed for revenue by NBN Co is set out in Schedule 9 of NBN Co's submission. It is the same value included in NBN Co's audited general purpose financial statements, except for an adjustment to remove interest income. The ACCC considered the case for including interest income in detail in its 2013-14 Draft LTRCM Determination.⁴¹ The ACCC remains of the view that it is appropriate to exclude interest income from regulated revenue from the current determination.

Table 5.4 ICRA calculation (nominal, \$'000)

	2014-15
Capitalised ICRA from prior period	4 189 105
Add unrecovered cost	2 054 623
ICRA closing	6 243 728

Capitalised ICRA from prior period

The closing balance of the ICRA account in the prior year is capitalised and carried forward into the current financial period and added to the unrecovered cost from the current year. The cost of capital rate is the same as that used to calculate the return on capital for the purposes of the ABBRR and annual construction in progress allowance (discussed above). The ACCC has checked NBN Co's calculation of the capitalised ICRA balance and is satisfied that the proposed ICRA closing balance for 2014-15 has been calculated in accordance with the relevant provisions in Schedule 1E of the SAU.

NBN Co's proposed amendment to the 2013-14 LTRCM Determination

The ACCC's LTRCM Draft Determination for 2014–15 incorporates NBN Co's proposed amendment to the 2013–14 LTRCM Determination, as discussed in section 4 of this report. The ACCC welcomes comments on the proposed amendment as part of this consultation process. If, after considering submissions, the ACCC decides not to accept NBN Co's proposed amendment to the 2013–14 LTRCM Determination, the values in Table 5.5 would apply in relation to the ICRA values.

⁴⁰ Clause 1E.5 of the SAU.

⁴¹ ACCC, *NBN Co SAU LTRCM 2013-14 Draft Determination and Price Compliance Reporting 2013-14*, February 2015, p.24.

Table 5.5 Alternative values for ICRA if amendment is not accepted by ACCC

Year	2014–15
ICRA and CFRA (\$'000 NOMINAL) – as per Clause 1E.5	
ICRA (start period) – as per Clause 1E.5.2	3 899 511
Unrecovered cost -as per Clause 1E.5.1	2 054 623
ICRA (end period) – as per Clause 1E.5.2	6 236 825
Carry forward revenue adjustment – as per Clause 1E.5.3	n/a

5.3 Assessment of price compliance

SAU requirements

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

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

NBN Co's LTRCM submission

On 30 October 2015, NBN Co provided the ACCC with a Price Compliance Report and a price compliance spreadsheet, pursuant to clause 1F.3(a) of the SAU for the period from 1 July 2014 to 30 June 2015. NBN Co also submitted an independent assurance report to complement NBN Co's Price Compliance Report and supporting information in its supplementary submission.

The Price Compliance Report provides CFO certification that the pricing of NBN Offers and Other Charges, over the period from 1 July 2014 to 30 June 2015, satisfied the relevant requirements in Schedule 1C of the SAU. The report does not identify any exceptions. Similar to the Expenditure Compliance Report and the Procurement Rules Compliance Report, this report includes some qualifying language and expresses negative assurance conclusions.

NBN Co has advised that the certification in the Price Compliance Report was informed by a range of investigations and testing. This included identifying the price lists that applied under the relevant wholesale broadband agreements over the relevant period, and checking these price lists for consistency with Schedule 1C of the SAU. This analysis was set out in a price compliance spreadsheet, which was also submitted to the ACCC.

NBN Co indicated that there have been only a small number of changes to the price lists during 2014-15. This included a reduction in prices for CVC TC-1, TC-2 and TC-4 to \$17.50 per Mbps per month in respect of the NBN Co Fibre Network, NBN Co Wireless Network, NBN Co Interim Satellite Network and NBN Co FTTB Network.⁴² NBN Co also provided the ACCC with a list of products (and their prices) that are not currently contained in Schedule IC of the SAU.

In addition, NBN Co lodged an independent assurance report by PwC on NBN Co's internal controls in relation to price compliance. PwC's limited assurance opinion is unqualified in nature and complements the NBN Co CFO's certification.

⁴² On 1 February 2015, NBN Co reduced the price of CVC from \$20.00 (as set out in the SAU) to \$17.50 Mbps per month.

ACCC draft decision on price compliance

The ACCC has considered the Price Compliance Report and supporting materials provided by NBN Co and is satisfied that NBN Co's prices for 2014-15 did not exceed the maximum regulated prices applicable at the relevant point in time in accordance with Schedule 1C of the SAU.

The ACCC is satisfied that the Price Compliance Report provides some assurance that NBN Co has key control procedures in place to ensure that the prices for NBN Offers and Other Charges did not exceed the applicable maximum regulated price during the year. This is supported by ACCC analysis of the price compliance spreadsheet provided by NBN Co. The ACCC has reviewed the prices in this spreadsheet and has compared the listed prices with the pricing provisions in the SAU. The ACCC did not identify any instances where the listed prices exceeded the applicable maximum regulated price.

The ACCC found that there were some prices listed in the spreadsheet that were for new products. These new products do not have a price specified in the SAU. The ACCC recognises that NBN Co has the ability to determine the prices for new products.⁴³ However, the ACCC may initiate a price review if it considers that it is appropriate in order to ensure that these new prices are set in a manner that promotes competition and the efficient use of the network.⁴⁴ The ACCC will continue to monitor NBN Co's new product prices to ensure that access seekers are not subject to unreasonable prices and to incentivise NBN Co to incur expenditure efficiently.

The ACCC considers that PwC's limited assurance review of NBN Co's price controls provides independent assurance that NBN Co has procedures in place to ensure that its prices do not exceed the maximum regulated prices in the SAU. Therefore, the ACCC is satisfied that NBN Co has met its price compliance obligations in the SAU.

⁴³ NBN Co, SAU, December 2013, clause 1C.1.4

⁴⁴ NBN Co, SAU, December 2013, clause 1G.3.1

6 The ACCC's LTRCM Draft Determination

For the 2014-15 financial year, the ACCC is required to consult on an LTRCM Draft Determination in respect of the ABBRR, RAB, ICRA and the values of the inputs to each of those values.⁴⁵ For the reasons set out in this document, the ACCC has determined the values in Table 6.1 for the purposes of the ACCC's LTRCM Draft Determination for 2014–15. These values have been taken or derived from the information provided by NBN Co in its submission of regulatory information.⁴⁶

Table 6.1 2014–15 LTRCM Draft Determination⁴⁷

Year	2014–15
CPI and Cumulative Inflation Factor	
June Quarter CPI (annual percentage change) – as per Attachment C to the SAU	1.511%
Cumulative Inflation Factor - as per Clauses 1E.9.4(b) and (c)	1.015

Year	2014–15
Rate of Return – as per Clause 1E.7.1	
Risk free rate of interest - as per Clause 1E.7.1(b) and (c)	3.749%
Nominal rate of return - as per Clause 1E.7.1(a)	7.249%

Year	2014–15
Regulatory Asset Base (\$'000 REAL) – as per Clause 1D.2.1	
Real RAB (start period) - as per Clause 1D.2.1(a) and (b)	2 901 139
Real capital expenditure	2 134 603
Real disposals	-
Real straight line depreciation	288 575
Real RAB (end period) - as per Clause 1D.2.1(b)	4 747 166

Year	2014–15
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	2 901 139
Nominal straight line depreciation (as per Clause 1E.9.1(b))	292 935
Nominal RAB (end period) - as per Clause 1D.2.2	4 818 889

⁴⁵ Clause 1E.1.2(a) of the SAU.

⁴⁶ In accordance with Clause 1E.1.2(c)(vi)

⁴⁷ The clause references in this table refer to the formulas in the SAU.

Year	2014–15
ABBRR (\$'000 NOMINAL) - as per Clause 1E.4.1	
Return on capital	210 314
Nominal regulatory depreciation – as per clause 1E.9.1(c)	249 103
Nominal operating expenditure	1 591 219
Net tax allowance	-
Annual construction in progress allowance – as per Clause 1E.10	167 853
ABBRR	2 218 490

Year	2014–15
Taxation calculations (\$'000 NOMINAL) - as per Clause 1E.9.3	
Nominal revenue	163 867
<i>Add</i> value of assets received for nil consideration	117 429
<i>Less</i> nominal operating expenditure	(1 591 219)
<i>Less</i> nominal tax depreciation	(288 228)
<i>Less</i> interest expense	(59)
Taxable profit – as per Clause 1E.9.3	(1 598 210)
Tax loss carried forward (Start period) – as per Clause 1E.9.3	(3 161 997)
Tax loss carried forward (End period) – as per Clause 1E.9.3	(4 760 207)
Net tax allowance – as per Clause 1E.9.3	-

Year	2014–15
ICRA and CFRA (\$'000 NOMINAL) – as per Clause 1E.5	
ICRA (start period) – as per Clause 1E.5.2	3 905 948
Unrecovered cost -as per Clause 1E.5.1	2 054 623
ICRA (end period) – as per Clause 1E.5.2	6 243 728
Carry forward revenue adjustment – as per Clause 1E.5.3	n/a