



# NBN Co Special Access Undertaking

Long Term Revenue Constraint Methodology  
2016-17: Draft Determination

and

Price compliance reporting 2016-17

April 2018

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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 Australian Competition and Consumer Commission (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 2016-17 financial year.

The SAU contains the framework for regulating access to the National Broadband Network (NBN) until June 2040. Schedule 1E of the SAU establishes the LTRCM, which is a methodology for determining NBN Co's annual regulated revenue, regulated asset base and the account for accumulating initial unrecovered costs that NBN Co can recover later in the SAU period. The LTRCM is one of the various components of the SAU that combine to incentivise NBN Co to invest prudently and efficiently.

Under Schedule 1F of the SAU, NBN Co must submit certain regulatory information to the ACCC each year, including its proposed financial information and reports certifying its expenditure and procurement compliance. NBN Co is also required to certify that it has complied with the price controls in Schedule 1C of the SAU. NBN Co submitted its regulatory information for 2016-17 on 31 October 2017.

For the LTRCM determination, the ACCC must determine the values (and inputs to those values) for the:

- 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, and
- initial cost recovery account (ICRA) – an account for accumulating (and rolling forward) NBN Co's initial unrecovered costs.

The ACCC's draft LTRCM determination for 2016-17 is to accept NBN Co's proposed values (and the inputs to those values) for the ABBRR, RAB, and ICRA without modification, in accordance with clause 1E.1.2 of the SAU. The ACCC's reasons for accepting the proposed values are set out in sections 4 and 5 of this report.

Regarding price compliance, the ACCC is satisfied that NBN Co's prices for 2016-17 did not exceed the applicable maximum regulated prices in accordance with Schedule 1C of the SAU. The ACCC's reasons for this draft decision are outline in section 6 of this report.

The ACCC welcomes submissions on the 2016-17 draft LTRCM determination by 5pm on Friday 25 May 2018. After considering these submissions, the ACCC will release its final LTRCM determination for 2016-17 by 30 June 2018.

# 1. Introduction

## 1.1. Purpose

The Australian Competition and Consumer Commission (ACCC) accepted NBN Co's Special Access Undertaking (SAU) on 13 December 2013. The SAU establishes the framework for regulating access to the National Broadband Network (NBN) until June 2040. The SAU has a modular structure: Module 0 provides the overarching structure and applies for the full term of the SAU, Module 1 covers the initial regulatory period until 30 June 2023 and Module 2 covers the subsequent regulatory period from 1 July 2023 to 30 June 2040.

The SAU establishes the Long Term Revenue Constraint Methodology (LTRCM). The LTRCM is a methodology for determining NBN Co's annual regulated revenue, regulated asset base and the account for accumulating initial unrecovered costs that NBN Co can recover later in the SAU period. During Module 1, the LTRCM is one of the various components of the SAU that combine to provide NBN Co with incentives to incur only efficient expenditure and to price reasonably to promote the long-term interests of end users.<sup>1</sup> The LTRCM process gives NBN Co the opportunity to recover its prudent and efficient costs of supply, including an appropriate return on investment.

The SAU requires NBN Co to submit certain 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.<sup>2</sup> NBN Co must also certify that its prices have not exceeded the maximum regulated prices set in the SAU during the relevant financial year.<sup>3</sup> Following NBN Co's submission, the ACCC must make an LTRCM determination within 12 months of the end of the relevant financial year.<sup>4</sup>

This report outlines the ACCC's draft LTRCM determination and view on NBN Co's price compliance for the 2016-17 financial year. The ACCC is seeking stakeholder views on the LTRCM draft determination and will consider submissions before releasing the final LTRCM determination for 2016-17 by 30 June 2018.

## 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.

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<sup>1</sup> ACCC, [NBN Co Special Access Undertaking Final Decision](#), 13 December 2013, p. 11-12

<sup>2</sup> Schedule 1F of the SAU

<sup>3</sup> Schedule 1F.3 of the SAU

<sup>4</sup> Clause 1E.1.2 of the SAU

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 25 May 2018 to [nbn@acc.gov.au](mailto:nbn@acc.gov.au) and copy to:

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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 outlines the ACCC's draft assessment of NBN Co's expenditure compliance and reporting,
- Section 5 sets out the ACCC's draft assessment of NBN Co's financial information,
- Section 6 details the ACCC's draft assessment of NBN Co's price compliance, and
- Section 7 presents the ACCC's draft LTRCM determination for 2015–16.

## 2. LTRCM Process

### 2.1. Long Term Revenue Constraint Methodology

The LTRCM is a methodology for determining the revenue NBN Co can earn via its prices over the SAU term. In Module 1 of the SAU (the initial regulatory period), the LTRCM occurs on an *ex-post* basis. This occurs on an *ex-ante* basis in Module 2 (the subsequent regulatory period).

The ACCC must determine the following values (and the inputs to those values) as part of the LTRCM determination:

- 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, and
- initial cost recovery account (ICRA) – an account for accumulating (and rolling forward) NBN Co’s initial unrecovered costs.

We determine NBN Co’s RAB and ABBRR based on a range of financial inputs submitted by NBN Co, in accordance with the LTRCM mechanism set out in the SAU.

We use the ABBRR and NBN Co’s actual revenue (as defined in the SAU) to calculate the extent of unrecovered costs in each year. The ICRA captures the cumulative value of these unrecovered costs.

Once NBN Co commences earning 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).<sup>5</sup>

### 2.2. ACCC consideration of the LTRCM

The ACCC’s role in considering the LTRCM is to:

- assess whether NBN Co’s capital expenditure and operating expenditure meet the relevant requirements in the SAU for inclusion in the RAB and ABBRR,
- assess if the relevant LTRCM components have been calculated in accordance with the formulas set out in the SAU, and
- determine whether the 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 if those values are determined in accordance with Schedule 1D and Schedule 1E of the SAU.<sup>6</sup> The factors that the ACCC must consider when determining a substitute amount of capital or operating expenditure are set out in the SAU.<sup>7</sup>

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<sup>5</sup> Clause 1E.6.1 of the SAU

<sup>6</sup> Clause 1E.1.2(c)(iv) of the SAU

<sup>7</sup> See clauses 1D.3.2(d) and 1E8.2(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 amounts 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.



## 2.2.1. Assessment of expenditure

The ACCC must determine as part of its LTRCM assessment, whether NBN Co's capital and operating expenditure both meet the relevant requirements in the SAU for inclusion in the RAB and ABBRR.

### *Capital expenditure*

Capital expenditure may only be included in the RAB to the extent the ACCC is satisfied it meets the Prudent Cost Condition<sup>8</sup>, the Prudent Design Condition,<sup>9</sup> or was incurred in connection with the specific matters listed in clause 1D.3.2(a)(ii) of the SAU.

In a broad sense, 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'<sup>10</sup> (that is, generally, in accordance with NBN Co's procurement rules), or in an open and competitive market, or through another 'value for money' process. The SAU requires NBN Co's procurement rules contain processes that aim to generate an efficient and competitive outcome and that reflect good industry practice.

Capital expenditure meets the Prudent Design Condition if it is 'materially consistent' with the Network Design Rules<sup>11</sup> or a permitted variation, endorsed network change or ACCC approved network change to the Network Design Rules.<sup>12</sup>

The specific matters listed under 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, third party funded network changes; and expenditure incurred prior to the approval of the SAU on 13 December 2013.<sup>13</sup>

### *Operating expenditure*

Operating expenditure may only be included in the ABBRR to the extent that the ACCC is satisfied it meets certain requirements. These include, that it was: incurred in accordance with NBN Co's procurement processes (including in accordance with the procurement rules); incurred pursuant to a 'conforming contract'; procured in an open and competitive market; procured in a manner that is likely to achieve value for money;<sup>14</sup> or it was incurred in connection with the specific matters specified in clause 1E.8.2(a)(ii) of the SAU.

The specific matters listed under 1E.8.2(a)(ii) of the SAU are: the Telstra or Optus arrangements, interim satellite or transit arrangements, Tasmania tri-area service arrangements, trial sites, and third party funded network changes; expenditure incurred prior to the approval of the SAU on 13 December 2013; and expenditure required to address an urgent network issue or a force majeure event.

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<sup>8</sup> Clause 1D.3.2(a)(i)(A) of the SAU

<sup>9</sup> Clause 1D.3.2(a)(i)(B) of the SAU

<sup>10</sup> 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

<sup>11</sup> This 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 2017.

<sup>12</sup> Clause 1D.6 of the SAU

<sup>13</sup> Schedule 1D of the SAU

<sup>14</sup> Clauses 1E.8.2(a)(i) and 1E.8.3 of the SAU.

## **2.2.2. Calculation of LTRCM components**

The ACCC's assessment of NBN Co's LTRCM submission also includes checking the inputs and calculations NBN Co has used to determine its proposed values for the LTRCM components. The ACCC must assess whether they have been prepared in accordance with the formulas outlined in the SAU.

NBN Co's submission includes an LTRCM spreadsheet, which sets out the underlying calculations of NBN Co's proposed ABBRR, RAB and ICRA values. The ACCC's checks include confirming that NBN Co has correctly extracted capital expenditure, operating expenditure, construction in progress and revenue from the relevant LTRCM schedules before inputting them into these formulas.

The ACCC must also check two other LTRCM inputs. These include: the cumulative inflation factor which involves taking the cumulative product of the percentage change in June quarter CPI published for each financial year from the commencement of the SAU, relative to the first financial year;<sup>15</sup> and the rate of return used in LTRCM calculations which is the risk free rate of interest with a 350 basis point risk premium.<sup>16</sup>

The ACCC then confirms the calculation of the ABBRR, RAB and ICRA values using these inputted values in accordance with the formulas contained in the SAU.

## **2.2.3. Price compliance and reporting**

The SAU sets binding caps on the prices NBN Co can charge its customers. These price controls, together with the LTRCM, provide incentives for NBN Co to incur expenditure efficiently and to price reasonably to promote the long-term interests of end users. The pricing provisions in the SAU include an annual limit on price increases of the Consumer Price Index (CPI) minus 1.5 per cent.<sup>17</sup>

NBN Co must submit a Price Compliance Report to the ACCC by 31 October each year. The report includes certification from NBN Co's Chief Financial Officer (CFO) 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 from NBN Co at any time reasonably necessary for the ACCC 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.

### **2.3.1. ACCC 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 substitute amount of capital expenditure or operating expenditure in making the LTRCM determination.<sup>18</sup>

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<sup>15</sup> Clause 1E.9.4(b) of the SAU

<sup>16</sup> Clause 1E.7.1 of the SAU

<sup>17</sup> Schedules 1C.5 and 2B.2 of the SAU

<sup>18</sup> Clause 1E.1.2(c)(vii) of the SAU

On 21 December 2017, 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.<sup>19</sup>

### **2.3.2. Draft and final determinations**

The ACCC is required under the SAU to publish a draft LTRCM determination along with reasons for this draft determination. The ACCC then consults with NBN Co and other parties considered appropriate. The ACCC is then required to make a final LTRCM determination after considering all submissions it receives.

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 ACCC is required to make the LTRCM determination for 2016-17 by 30 June 2018.

### **2.3.3. Powers to seek additional information**

The ACCC may request additional information from NBN Co at any time, if the information is considered necessary to:

- determine the ABBRR, RAB, ICRA and the values of inputs to each of these values,<sup>20</sup>
- assess the matters contained in an expenditure compliance report,<sup>21</sup>
- assess compliance of NBN Co's Procurement Rules with the requirements for these rules set out in the SAU,<sup>22</sup> or
- determine NBN Co's compliance with the price schedule set by the SAU.<sup>23</sup>

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

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<sup>19</sup> See: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2016-17>

<sup>20</sup> Clause 1F.1.7 of the SAU

<sup>21</sup> Clause 1F.2.2 of the SAU

<sup>22</sup> Clause 1F.2.3(b) of the SAU

<sup>23</sup> Clause 1F.3(b) of the SAU

### 3. NBN Co's 2016-17 regulatory information

Under Schedule 1F of the SAU, NBN Co is required to submit certain information to the ACCC each year during the initial regulatory period to enable the ACCC to conduct its LTRCM assessment. NBN Co must submit this information by 31 October following the end of the relevant financial year.

On 31 October 2017, NBN Co submitted an LTRCM proposal to the ACCC for 2016-17 (the regulatory information). NBN Co's regulatory information consists of:

- NBN Co's actual financial information, based on NBN Co's reported statutory accounts that are consistent with the definitions in the SAU,
- NBN Co's proposed financial information, which consists of proposed values for the ABBRR, RAB, ICRA and the inputs to those values,
- an Expenditure Compliance Report, which is signed by NBN Co's CFO and certifies that NBN Co's expenditure complies with the requirements of the SAU,
- a Procurement Compliance Report, which is signed by NBN Co's Executive General Manager (EGM) Procurement and certifies that NBN Co's Procurement Rules comply with the requirements of the SAU, and
- a Price Compliance Report, which is signed by NBN Co's CFO and certifies that NBN Co's prices comply with the requirements of the SAU.

NBN Co has also submitted three independent reports from PricewaterhouseCoopers (PwC), a price compliance spreadsheet, an LTRCM spreadsheet and a copy of its Chart of Accounts. The ACCC has published public versions of NBN Co's regulatory information on the ACCC website.<sup>24</sup>

We have summarised the key financial information submitted by NBN Co for the 2016-17 LTRCM determination in Table 3.1 below. The table also shows the corresponding values for the 2015-16 LTRCM determination and the percentage change for comparison purposes.

**Table 3.1: Summary of NBN Co's financial information, 2015-16 and 2016-17 (nominal)**

	2015-16 (\$'000)	2016-17 (\$'000)	Percentage change
Operating expenditure	2 259 775	3 726 986	65%
Capital expenditure	4 523 444	6 026 916	33%
Construction in progress (start of period)	3 482 834	3 991 030	15%
Interest expense	247	5	-98%
Revenue	421 455	1 001 002	138%
Unrecovered costs	2 777 273	4 056 114	46%
RAB (end of period)	8 944 763	14 369 643	61%
ABBRR	3 198 728	5 057 117	58%
ICRA (end of period)	9 428 175	14 014 956	49%

Source: LTRCM spreadsheet 2016-17

<sup>24</sup> See: <https://www.accc.gov.au/regulated-infrastructure/communications/national-broadband-network-nbn/nbn-co-special-access-undertaking/ltrcm-2016-17>

## 4. Assessment of expenditure compliance and reporting

### 4.1. SAU requirements

As outlined in Section 2.2.1 of this document, both capital and operating expenditure may only be included in the RAB and ABBRR to the extent the ACCC is satisfied the expenditure meets the relevant requirements in the SAU.

#### 4.1.1. Expenditure compliance

NBN Co's regulatory information must include an Expenditure Compliance Report signed by NBN Co's CFO (or authorised delegate). The report certifies that both the capital and operating expenditure figures proposed for inclusion in the RAB and ABBRR for the relevant financial year meets the SAU criteria, including the Prudent Design and Prudent Cost conditions. Where capital expenditure or operating expenditure does not meet the SAU criteria, the CFO (or delegate) must propose a substitute amount of capital or operating expenditure for the ACCC's consideration.

#### 4.1.2. Procurement Rules

NBN Co must also develop Procurement Rules that establish procurement processes in accordance with 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 meets reasonable requirements of procedural fairness and good industry practice,
- any decision to approve a tender that is not the lowest price tender is appropriately justified,
- the basis for undertaking the works and services is in accordance with good industry practice and the basis of payment for works and services is clearly specified; and
- there is a process for managing contracts that is in line with good industry practice and that seeks to achieve value for money and the lowest total cost of ownership.

NBN Co is required to provide a copy of its Procurement Rules to the ACCC within 30 days following the SAU commencement date and 30 days of NBN Co making any material amendment to the Procurement Rules.

NBN Co's regulatory information must include a Procurement Rules Compliance Report signed by its EGM Procurement. The report certifies that NBN Co's Procurement Rules satisfy the SAU requirements for the relevant financial year.

### 4.2. NBN Co's LTRCM submission

#### 4.2.1. Expenditure Compliance Report

NBN Co's regulatory information included an Expenditure Compliance Report for 2016-17, pursuant to clause 1F.2.1(a) of the SAU. This report contains certification from NBN Co's CFO 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 and, as such, NBN Co proposes that all capital and operating expenditure incurred during the 2016-17 financial year be included in the RAB and ABBRR respectively. The Expenditure Compliance Report includes some qualifying language to clarify the basis on which NBN Co's CFO provides the certification and expresses negative assurance conclusions.<sup>25</sup>

As in previous years, NBN Co has advised that the CFO's certification in the Expenditure Compliance Report has been informed by a range of investigations and testing of the relevant processes and controls by NBN Co's internal audit staff. These included:

- performing process walkthroughs with relevant staff,
- confirming end-to-end process maps,
- identifying relevant control objectives and control procedures, and
- testing control design and effectiveness.<sup>26</sup>

NBN Co's internal audit staff based their work on the new Australian Standard on Assurance Engagement (ASAE) 3150: *Assurance Engagements on Controls* (January 2016). NBN Co submits that 'ASAE 3150 provides guidance for identifying the nature of the procedures which are conducted at a minimum in a limited assurance engagement and the additional procedures which are conducted in a reasonable assurance engagement'.<sup>27</sup>

#### **4.2.2. Independent assurance reports**

As in previous years, NBN Co engaged PwC to perform an independent limited assurance review in relation to the design of controls applicable to capital and operating expenditure prudence. PwC's report expresses an unqualified opinion and complements the certification from NBN Co's CFO. PwC also conducted its work in accordance with the new ASAE 3150: *Assurance Engagements on Controls*.

NBN Co submits that the Expenditure Compliance Report, alongside the PwC limited assurance report, provides an appropriate basis for the ACCC to be satisfied that all capital and operating expenditure incurred by NBN Co in 2016-17 meets the prudence conditions and should be included in the RAB and ABBRR respectively.<sup>28</sup>

#### **4.2.3. Procurement Rules Compliance Report**

In its regulatory information, NBN Co submitted a Procurement Rules Compliance Report in accordance with clause 1F.2.3(a) of the SAU. The report contains a certification from NBN Co's EGM Procurement<sup>29</sup> that NBN Co has developed and maintained Procurement Rules that satisfy the relevant conditions in clause 1D.5.1 of the SAU. NBN Co does not report any exceptions in relation to the Procurement Rules Compliance Report.<sup>30</sup>

NBN Co submits that the Procurement Rules Compliance Report includes some qualifying language to clarify the basis on which NBN Co's EGM Procurement provides the certification

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<sup>25</sup> 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.

<sup>26</sup> NBN Co, *nbn submission to the ACCC – 2016-17 Regulatory Information and LTRCM Determination*, 31 October 2017, p. 12

<sup>27</sup> *ibid*

<sup>28</sup> *ibid*, p. 15

<sup>29</sup> NBN Co's EGM Procurement is the successor to the NBN Co's Chief Procurement Officer role at NBN Co. In NBN Co's 2015-16 LTRCM submission, the Procurement Rules Compliance Report was signed by NBN Co's CFO, being a person responsible for the performance of the Chief Procurement Officer function of NBN Co. For the 2013-14 and 2014-15 LTRCM submissions, the report was signed by the Chief Procurement Officer.

<sup>30</sup> *ibid*, p. 16

and expresses negative assurance conclusions. NBN Co also notes that its investigations and testing are necessarily subject to inherent limitations and there is an unavoidable risk they may not detect deficiencies.<sup>31</sup>

### 4.3. ACCC draft decision

#### 4.3.1. Expenditure compliance

The ACCC has assessed NBN Co's expenditure compliance by considering the Expenditure Compliance Report signed by NBN Co's CFO, PwC's limited assurance reports and NBN Co's supporting submission. The ACCC's draft decision is that NBN Co's expenditure has complied with the relevant prudency conditions in the SAU.

The reasons for the ACCC's draft decision are set out below.

#### *ACCC consideration*

The Expenditure Compliance Report did not identify any exceptions during the 2016-17 financial year. However, the report is subject to some qualifying language and expresses negative assurance conclusion. The ACCC has therefore considered NBN Co's other supporting materials to determine the extent that we can rely on the certification.

We have 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
- these processes and controls are operating effectively.

#### *Adequate procurement rules*

The ACCC has checked that NBN Co's Procurement Guidelines comply with the relevant provisions of the SAU, as well as considering NBN Co's Procurement Rules Compliance Report to determine whether NBN Co has developed appropriate procurement rules.

Section 4.3.2 below sets out the ACCC's draft decision on NBN Co's procurement rules in further detail.

#### *Processes and controls in place*

The ACCC has considered PwC's limited assurance report on the design of controls for expenditure compliance to determine whether there are processes and controls in place to support compliance with the prudency conditions in the SAU. PwC's testing included whether NBN Co has adequate controls in place to ensure that it incurs capital and operating expenditure in accordance with the Prudent Design and Prudent Cost conditions. The PwC report expresses an unqualified limited assurance conclusion.

#### *Processes and controls operating effectively*

The ACCC has considered NBN Co's supporting submission, which outlines its internal audit work, in order to assess whether NBN Co has complied with these processes and controls.

NBN Co first identified the relevant control objectives and procedures.<sup>32</sup> NBN Co revised these from the previous year to take into account:

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<sup>31</sup> *ibid*



- general updates to operating procedures and changes in roles and responsibilities,
- the introduction of additional technology types (e.g. HFC) as part of the transition to the multi technology mix, and
- increased understanding of the controls that warrant detailed effectiveness testing.

NBN Co's internal audit staff selected samples for control testing using a methodology based on generally accepted internal audit sampling criteria.<sup>33</sup> 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 260 samples for the 2016-17 financial year. This number and the sampling methodology used is consistent with NBN Co's approach in 2015-16.

NBN Co's internal audit staff undertook testing for each of the sample items to confirm that 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 documents.

NBN Co's internal audit staff did not find any exceptions regarding expenditure compliance. However, NBN Co submitted that, as in previous years, its investigations and tests are necessarily subject to inherent 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.

### ***Further information regarding NBN Co's procurement processes***

The ACCC sought further information from NBN Co as part of the 2015-16 LTRCM process, regarding NBN Co's procurement processes to improve the ACCC's understanding of how NBN Co complies with the prudency requirements in the SAU. We requested:

- general information of NBN Co's procurement activities, including statistical information on the nature, size and scope of NBN Co's procurements,
- case studies and examples of NBN Co's procurement activities, particularly to demonstrate how NBN Co considers the prudent cost condition in procurement decisions and the procurement guidelines, and
- information relating to specific matters in NBN Co's procurement guidelines.

NBN Co provided information to the ACCC in response to these requests, including through a procurement briefing given by NBN Co's procurement team to the ACCC.

The ACCC considered the material provided by NBN Co satisfied its requirement that appropriate procedures and processes exist to ensure its expenditures are in accordance with the prudency conditions set out in the SAU and that these processes are operating effectively.

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<sup>32</sup> Control objectives are included in Appendix A of NBN Co's supporting submission. NBN 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.

<sup>33</sup> 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).



The understanding gained during this process has assisted us in considering NBN Co's submission and making our draft decision for the 2016-17 LTRCM process. We consider that it is appropriate to use this information to inform our draft decision this year as NBN Co's procurement involves a combination of short and long-term contracts, so a considerable amount of this information will still be applicable this year. As such, we will not be requesting a procurement briefing this year but we may seek additional briefings in future years to further assist our understanding.

#### **4.3.2. Procurement compliance**

The ACCC considers that NBN Co has provided a Procurement Rules Compliance Report that meets the requirements of the SAU.

The Procurement Rules Compliance Report did not identify any exceptions for the 2016-17 financial year. As noted previously in this document, the Procurement Rules Compliance Report includes some qualifying language and expresses negative assurance conclusions.

The ACCC considered the material in NBN Co's supporting submission outlining what has informed the EGM Procurement's certification in order to be satisfied with NBN Co's Procurement Rules Compliance Report.

NBN Co advised, from 1 July 2016 to 27 November 2016, the Procurement Rules consisted of its Procurement Guidelines v1.0, which came into effect on 1 May 2016 and replaced the two documents that previously formed the Procurement Rules (the Procurement Manual v2.0 and the Buying Guide v4.0). From 28 November 2016 to 30 June 2017, the Procurement Rules consisted of the Procurement Guidelines v1.1, which contained a small number of relatively minor changes to align some processes and terminology more closely with NBN Co's then current business practices. The ACCC received the updated Procurement Guidelines from NBN Co on 22 December 2016 in accordance with the SAU. The ACCC has considered the amendments to the Procurement Guidelines and considers they are consistent with the SAU's relevant provisions.

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

## 5. Assessment of LTRCM financial information

### 5.1. SAU requirements

#### 5.1.1. Forecast financial information

For each financial year during the initial regulatory period, the SAU requires NBN Co to submit forecasts or estimates of its capital expenditure (by asset type), operating expenditure, disposals (by asset type), and the opening and closing value of construction in progress. NBN Co must submit this forecast financial information to the ACCC by 30 June prior to the commencement of the relevant financial year.<sup>34</sup>

On 30 June 2016, NBN Co submitted its forecast financial information for the 2016–17 financial year. This submission consisted of the following two schedules:

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

NBN Co's forecast financial information is confidential.

#### 5.1.2. Actual financial information

NBN Co's regulatory information must include its actual financial information for the relevant financial year. This includes values for June quarter CPI, capital expenditure (by asset type), revenue, operating expenditure, disposals (by asset type), interest expense, account and tax asset lifetimes, the risk free rate, and the nominal rate of return.

NBN Co must also submit information setting out any material variances between the forecast and actual financial information, and give reasons for the variances.<sup>35</sup> NBN Co has classified this information as 'confidential of particular sensitivity'.

#### 5.1.3. Proposed financial information

NBN Co must also submit its proposed values for the LTRCM components in its regulatory information. This includes values for:

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

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<sup>34</sup> Clause 1F.1.2 of the SAU

<sup>35</sup> Clause 1F.1.3 of the SAU

## 5.2. NBN Co's LTRCM submission

### 5.2.1. 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.

In June 2017, NBN Co informed the ACCC that it was undertaking an update of the RAAM. In August 2017, NBN Co provided the ACCC with a copy of its updated RAAM for 2016-17. NBN Co's 2016-17 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 included 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 4 August 2017 and have been reconciled with the audited general purpose financial statements, and
- Schedule 10 has been prepared in accordance with the reporting requirements of the SAU.

### 5.2.2. Actual and proposed financial information

In its regulatory information, NBN Co submitted its actual and proposed financial information for the 2016-17 financial year. This submission consisted of the following 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.

NBN Co also submitted an LTRCM spreadsheet, which sets out the underlying calculations of NBN Co's proposed ABBRR, RAB and ICRA values. A public version of NBN Co's LTRCM proposal is available on the ACCC website.

### 5.2.3. Independent assurance reports

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

- a reasonable assurance audit report for Schedules 6 to 9: PwC's opinion in this report was unqualified and complements the audit of NBN Co's general purpose financial statements, and

- factual findings of agreed upon procedures report for Schedule 10: PwC checked that the relevant values for previous years were in accordance with the 2015-16 LTRCM determination, that the relevant input values for 2016-17 were correctly extracted from Schedules 6 to 9 into the LTRCM spreadsheet, and that the relevant LTRCM calculations were undertaken in accordance with the SAU.

### 5.3. ACCC draft decision

The ACCC has considered NBN Co's regulatory information and considers that NBN Co has calculated its proposed values for the RAB, ABBRR and ICRA in accordance with the formulas in Schedules 1D and 1E of the SAU. Therefore, the ACCC's draft decision is to accept NBN Co's proposed values for the RAB, ABBRR and ICRA without amendment.

The reasons for the ACCC's draft decision are set out below.

#### 5.3.1. Financial information reporting

The ACCC has considered NBN Co's actual and proposed financial information in assessing whether NBN Co has calculated its proposed LTRCM values in accordance with Schedules 1D and 1E of the SAU. The ACCC has also had regard to NBN Co's LTRCM spreadsheet, which sets out the inputs and calculations used by NBN Co to determine its proposed values for the RAB, ABBRR and ICRA.

Further, the ACCC has considered the independent assurance reports from PwC and the statement of material variances, which support NBN Co's financial reporting.

#### **Assurance**

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

PwC's reasonable assurance audit of NBN Co's actual financial information provides the ACCC with assurance that NBN Co has prepared the information in Schedules 6-9 in accordance with the RAAM. PwC's audit opinion is unqualified and complements the existing auditing of NBN Co's general purpose financial statements. The ACCC considers that the PwC reasonable assurance audit report provides independent verification that NBN Co has accurately adjusted its financial statements 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 items provide the ACCC with additional comfort that NBN Co's statement of LTRCM and RAB items in Schedule 10 includes information that has been extracted and calculated correctly.

#### **Statement of material variances**

NBN Co's regulatory information included a statement of material variances (Schedule 11), in accordance with clause 1F.1.3(b) of the SAU. Schedule 11 sets out the variances between the forecast and actual financial information for capital expenditure, operating expenditure and construction in progress for 2016-17, as well as the reasons for these variances.<sup>36</sup>

The ACCC considers that NBN Co has met the requirement to provide a statement of material variances as required by clause 1F.1.3(b) of the SAU. The statement assists the

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<sup>36</sup> The statement of material variances has been classified as 'confidential of particular sensitivity'.

ACCC in understanding the reasons for any significant differences between forecast and actual expenditure. The ACCC has reviewed Schedule 11 and is satisfied that it does not raise any significant concerns regarding the magnitude of capital and operating expenditure.

### 5.3.2. Regulatory asset base components

The RAB is the value of NBN Co's capital investment. The RAB equation is set out in Schedule 1D of the SAU and determines how that value will change over time. We calculate the RAB by rolling forward the balance of the RAB from the previous financial year, then adding capital expenditure less disposals and regulatory depreciation from the financial year.

The ACCC has checked NBN Co's RAB calculations and is satisfied they comply with the relevant SAU provisions. The RAB components are set out in Table 5.1 below.

**Table 5.1: RAB calculation, 2016-17**

	<b>2016-17 (\$'000)</b>
RAB opening (real)	8 722 380
Add real capital expenditure	5 765 586
Less real disposal	-
Less real straight line depreciation	(741 397)
<b>RAB closing (real)</b>	<b>13 746 569</b>
Cumulative inflation factor	1.045
<b>RAB closing (nominal)</b>	<b>14 369 643</b>

#### *Capital expenditure*

Consistent with the ACCC's assessment of capital expenditure compliance in section 4 above, the ACCC is satisfied that NBN Co's proposed capital expenditure in its RAB calculations meets the prudence conditions set out in the SAU.

#### *Disposals*

The ACCC understands that there were no disposals during 2016-17.

#### *Depreciation*

Under clause 1E.9.1 of the SAU, depreciation in the RAB equation is straight-line depreciation of the 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.

#### *Cumulative inflation factor*

The cumulative inflation factor (CIF) is an index for converting between real and nominal values. The CIF is the cumulative product of the percentage change in June quarter CPI published for each financial year from the commencement of the SAU, relative to the first financial year.<sup>37</sup>

<sup>37</sup> See clause 1E.9.4(b) of the SAU

The ACCC has checked the June quarter CPI for 2017 and NBN Co's calculation of the CIF. The ACCC is satisfied that NBN Co has calculated and applied the CIF correctly.

### 5.3.3. Annual building block revenue requirement components

The ABBRR is 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. The ABBRR equation is set out in Schedule 1E of the SAU and 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 NBN Co's ABBRR calculations and is satisfied that they comply with the relevant SAU provisions. The ABBRR components are set out in Table 5.2 below.

**Table 5.2: ABBRR calculation, 2016-17 (nominal)**

	<b>2016-17 (\$'000)</b>
Return on capital	503 458
Add regulatory depreciation	602 036
Add operating expenditure	3 726 986
Add net tax allowance	-
Add annual construction in progress allowance	224 636
<b>ABBRR</b>	<b>5 057 117</b>

#### *Return on capital*

The SAU allows NBN Co to earn an appropriate commercial return on its investment in the infrastructure assets that it uses to supply services under the SAU. The specified return on capital is the opening RAB value multiplied by the cost of capital. The SAU sets the cost of capital as the risk free rate<sup>38</sup> with a 350 basis point risk premium.

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

#### *Regulatory depreciation*

Under clause 1E.9.1(c) of the SAU, nominal regulatory depreciation is nominal straight line depreciation less the change in value of the nominal RAB due to inflation (calculated as the percentage change in June quarter CPI multiplied by the opening RAB value for the current financial year).

The ACCC has reviewed NBN Co's calculation of regulatory depreciation and is satisfied that the calculations comply with the relevant SAU requirements.

#### *Operating expenditure*

In line with the ACCC's assessment of operating expenditure compliance in section 4 above, the ACCC is satisfied that NBN Co's proposed operating expenditure in its ABBRR calculations meets the prudence conditions set out in the SAU.

<sup>38</sup> The risk free rate of interest is calculated on a moving average basis from the mean annualised yield on Commonwealth Government securities with a maturity of 10 years, averaged over the final 20 business days of the preceding financial year and using the indicative mid rates published by the Reserve Bank of Australia.

### **Net tax allowance**

NBN Co is currently in a loss-making position. The ACCC therefore notes that the net tax allowance is not applicable for the 2016-17 LTRCM draft determination.

### **Annual construction in progress allowance**

The annual construction in progress allowance (ACIPA) provides for the financing costs associating with capital expenditure relating to assets that are not yet in service. The ACIPA is the value of construction in progress for the financial year multiplied by the cost of capital.<sup>39</sup>

The ACCC understands that NBN Co's value of construction in progress is determined in accordance with NBN Co's audited accounts, 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 has checked NBN Co's proposed ACIPA and is satisfied that the calculations are in accordance with clause 1E.10.1 of the SAU.

### **5.3.4. Initial cost recovery account components**

The ICRA is an account for accumulating (and rolling forward) NBN Co's initial unrecovered costs. The ICRA equation is set out in Schedule 1E of the SAU and involves calculating the difference between the ABBRR and the amount of revenue actually earned by NBN Co via access prices in that year. We then add the unrecovered cost amount to the ICRA balance from the previous year, which is capitalised and carried forward.<sup>40</sup>

The ACCC has checked NBN Co's ICRA calculations and is 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)**

	<b>2016-17 (\$'000)</b>
ABBRR	5 057 117
Less revenue	(1 001 002)
Unrecovered cost	4 056 114

### **Revenue**

NBN Co's proposed value for revenue is the same value included in NBN Co's audited general purpose financial statements, including an adjustment to remove interest income. As in previous years, the ACCC remains of the view that it is appropriate to exclude interest income from regulated revenue for the LTRCM determination.<sup>41</sup>

<sup>39</sup> See formula in clause 1E.10.1 of the SAU

<sup>40</sup> Clause 1E.5 of the SAU

<sup>41</sup> 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

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

	<b>2016-17 (\$'000)</b>
<b>Capitalised ICRA from prior period</b>	9 428 175
<b>Less unrecovered cost</b>	(4 056 114)
<b>ICRA closing</b>	<b>14 014 956</b>

***Capitalised ICRA from prior period***

Under Schedule 1E of the SAU, the closing balance of the ICRA from the previous financial year is capitalised and carried forward into the current financial year, then added to the unrecovered cost from the current financial year. The cost of capital is the same as used for the ABBRR and annual construction in progress allowance.

The ACCC has checked NBN Co's calculation of the capitalised ICRA balance and is satisfied that NBN Co has calculated the proposed ICRA closing balance for 2016-17 in accordance with the relevant provisions in Schedule 1E of the SAU.



## 6. Assessment of price compliance

### 6.1. SAU requirements

NBN Co's regulatory information must include a Price Compliance Report signed by its CFO (or an authorised delegate) certifying that the prices for 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 is also required to provide any other information that it considers would be reasonably necessary for the ACCC to assess NBN Co's compliance with Schedule 1C of the SAU.

### 6.2. NBN Co's LTRCM submission

In its regulatory information, NBN Co submitted a Price Compliance Report and a price compliance spreadsheet for the period from 1 July 2016 to 30 June 2017.<sup>42</sup>

The Price Compliance Report sets out the certification from NBN Co's CFO that the pricing of NBN Co's product offers and other charges did not exceed the applicable maximum regulated prices and complied with the requirements of Schedule 1C of the SAU. The report does not identify any exceptions. Similar to the Expenditure Compliance Report and the Procurement Compliance Report, the report includes some qualifying language and expresses negative assurance conclusions.

NBN Co advised that the certification in the Price Compliance Report is informed by a range of investigations and testing. These include:

- identifying the price lists that applied under Wholesale Broadband Agreement (WBA) 2 (for fibre, long term satellite and fixed wireless), the Satellite WBA (for the interim satellite service) and the Cell Site Access Service (CSAS) Interim Agreement over the relevant period,
- checking these price lists, including any changes made in the relevant period, for consistency with Schedule 1C of the SAU, and
- work performed by NBN Co's internal audit of relevant processes and controls relating to price compliance.

NBN Co further advised that these investigations and testing are necessarily subject to inherent limitations and that there is an unavoidable risk that they may not detect some deficiencies.<sup>43</sup> NBN Co also submitted a price compliance spreadsheet, which sets out its analysis of its price compliance. The ACCC has published NBN Co's Price Compliance Report and price compliance spreadsheet on the ACCC website.

NBN Co made a number of changes to the price lists during 2016-17, which it sets out in its submission. The main changes relate to the following:

- the introduction of some service transfer charges for the satellite network,
- the introduction of additional enhanced fault rectification service options for the fibre to the basement (FTTB), fibre to the node (FTTN) and hybrid fibre coaxial (HFC) networks,
- the introduction of after hours installation charges for the fibre, FTTB and FTTN networks, and

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<sup>42</sup> Pursuant to clause 1F.3(a) of the SAU

<sup>43</sup> NBN Co, *nbn submission to the ACCC – 2016-17 Regulatory Information and LTRCM Determination*, p. 17

- the introduction of additional access virtual circuit (AVC) speed tiers for the HFC network.

NBN Co also noted that the Satellite WBA (including its price list) expired on 28 February 2017, on the same day that NBN Co withdrew the interim satellite service in accordance with clause 11.5 of the SAU. NBN Co introduced the CSAS Interim Agreement during the relevant financial year, on 22 September 2016.

In previous years, NBN Co has also lodged an independent assurance report by PwC on the effectiveness of its control procedures to ensure price compliance. As part of this year's LTRCM submission, NBN Co did not seek independent assurance work from PwC for price compliance. The ACCC agrees with this approach in line with the reasons presented by NBN Co in its LTRCM supporting submission: 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 consider that the independent assurance work is not necessary this year, but we note that there are provisions in the SAU that allow us to seek additional assurance in future years if required.

### 6.3. ACCC draft decision

The ACCC has considered NBN Co's Price Compliance Report and its supporting submission. The ACCC is satisfied that NBN Co's prices in 2016-17 did not exceed the maximum regulated prices set out in Schedule 1C of the SAU.

The ACCC has undertaken analysis of the price compliance spreadsheet submitted by NBN Co. We reviewed the prices listed in the spreadsheet and compared them to Schedule 1C of the SAU. We did not find any instances in which the listed prices exceeded the applicable maximum regulated prices.

We also note that the price compliance spreadsheet contains several new prices that NBN Co introduced in 2016-17.<sup>44</sup> The SAU does not specify a maximum regulated price for these products. We recognise that NBN Co has the ability to set prices for new products under the SAU. However, we also note that the ACCC has the ability to initiate a price review to ensure that new prices are set in a way that promotes competition and the efficient use of the network, if we consider that this would be appropriate.<sup>45</sup>

The ACCC is satisfied that NBN Co's Price Compliance Report and supporting submission provide assurance that NBN Co has key control procedures in place to ensure that the prices for NBN Co's products do not exceed the applicable maximum regulated prices. Our analysis of the price compliance spreadsheet supports this conclusion. Therefore, the ACCC is satisfied that NBN Co has met its price compliance obligations in the SAU.

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<sup>44</sup> These new prices relate to new ancillary services and additional features for existing products.

<sup>45</sup> Schedule 1G of the SAU

## 7. The ACCC's LTRCM draft determination

For the reasons set out in this document, the ACCC has determined the values in Table 7.1 for the purposes of the 2016-17 LTRCM Draft Determination. We have derived these values from the regulatory information provided by NBN Co.<sup>46</sup>

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.<sup>47</sup>

**Table 7.1: 2016-17 LTRCM Draft Determination<sup>48</sup>**

Year	2016-17
<b>CPI and Cumulative Inflation Factor</b>	
June Quarter CPI (annual percentage change) – as per Attachment C to the SAU	1.934%
Cumulative Inflation Factor – as per Clauses 1E.9.4(b) and (c)	1.045
<b>Rate of Return – as per Clause 1E.7.1</b>	
Risk free rate of interest – as per Clause 1E.7.1(b) and (c)	2.129%
Nominal rate of return – as per Clause 1E.7.1(a)	5.629%
<b>Regulatory Asset Base (\$'000 REAL) – as per Clause 1D.2.1</b>	
Real RAB (start period) – as per Clause 1D.2.1(a) and (b)	8 722 380
Real capital expenditure	5 765 586
Real disposals	-
Real straight line depreciation	741 397
Real RAB (end period) – as per Clause 1D.2.1(b)	13 746 569
<b>Regulatory Asset Base (\$'000 NOMINAL) – as per Clause 1D.2.2</b>	
Nominal RAB (start period) – as per Clauses 1D.2.1(a) and 1D.2.2	8 944 763
Nominal straight line depreciation (as per Clause 1E.9.1(b))	775 001
Nominal RAB (end period) – as per Clause 1D.2.2	14 369 643
<b>ABBRR (\$'000 NOMINAL) – as per Clause 1E.4.1</b>	
Return on capital	503 458
Nominal regulatory depreciation – as per clause 1E.9.1(c)	602 036
Nominal operating expenditure	3 726 986
Net tax allowance	-
Annual construction in progress allowance – as per Clause 1E.10	224 636
ABBRR	5 057 117

<sup>46</sup> In accordance with Clause 1E.1.2(c)(vi) of the SAU

<sup>47</sup> Clause 1E.1.2(a) of the SAU

<sup>48</sup> The clause references in this table refer to the formulas in the SAU.

<b>Taxation calculations (\$'000 NOMINAL) – as per Clause 1E.9.3</b>	
Nominal revenue	1 001 002
<i>Add</i> value of assets received for nil consideration	129 447
<i>Less</i> nominal operating expenditure	3 726 986
<i>Less</i> nominal tax depreciation	760 053
<i>Less</i> interest expense	5
Taxable profit – as per Clause 1E.9.3	(3 356 595)
Tax loss carried forward (Start period) – as per Clause 1E.9.3	(6 944 456)
Tax loss carried forward (End period) – as per Clause 1E.9.3	(10 301 051)
Net tax allowance – as per Clause 1E.9.3	-
<b>ICRA and CFRA (\$'000 NOMINAL) – as per Clause 1E.5</b>	
ICRA (start period) – as per Clause 1E.5.2	9 428 175
Unrecovered cost – as per Clause 1E.5.1	4 056 114
ICRA (end period) – as per Clause 1E.5.2	14 014 956
Carry forward revenue adjustment – as per Clause 1E.5.3	n/a