

TELSTRA CORPORATION LIMITED

Final Access Determinations Inquiry – response to information request under the BBM RKR

COMPARISON STATEMENT

7 February 2014

Public Version

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1. OVERVIEW

1.1 Introduction

The Australian Competition and Consumer Commission (“**ACCC**”) commenced its public inquiry into the making of final access determinations (“**FADs**”) for fixed line services in July 2013. As part of its FAD inquiry, the ACCC is undertaking a pricing review and, for this purpose, has requested that Telstra provide it with information under the Building Block Model Record Keeping and Reporting Rule (“**BBM RKR**”). In its letter dated 17 September 2013, the ACCC requested that Telstra provide it with a report under BBM RKR rules 10(c), 11(b) and 12(c), which:

- (a) compares forecasts for capital expenditure from the regulatory period from June 2011 to June 2014 (“**Previous Regulatory Period**”) with actual capital expenditure for that same period;
- (b) compares forecasts for operating expenditure from the Previous Regulatory Period with actual operating expenditure for that same period; and
- (c) explains any differences, trends and drivers,

(the “**Comparison Statement**”).

The BBM RKR rules as varied took effect from 28 June 2013. This is the first time that Telstra has responded to the BBM RKR rules as varied at June 2013. Telstra was not requested, and did not provide, forecast capital expenditure, operating expenditure and demand under the BBM RKR rules for the Previous Regulatory Period. Telstra notes that it is also not possible at this time to compare forecasts for the Previous Regulatory Period to actual operating expenditure, capital expenditure for that same period, because we are only part way through FY2014 (the final year of the Previous Regulatory Period). Accordingly, Telstra cannot provide a Comparison Statement under the BBM RKR rules.

Accordingly, and in order to satisfy the ACCC’s request as best as possible, Telstra has prepared, in this document, a comparison of the Fixed Line Service Model (“**FLSM**”) forecasts for capital expenditure, operating expenditure and demand for the 2011, 2012 and 2013 financial years (the “**Comparison Period**”) with Telstra’s actual capital expenditure, operating expenditure and demand. Telstra is providing information for FY2011 (although this did not form part of the Previous Regulatory Period) in order to provide the ACCC with information and comparisons across three (rather than two) years.

The 2011 FLSM forecasts for capital expenditure, operating expenditure and demand which were used to set prices in the 2011 fixed services final access determination (“**FAD**”) and the FLSM forecasts for capital expenditure, operating expenditure and demand which were used to set prices in the 2012 WDSL FAD are referred to throughout this document as “**Previous Regulatory Forecasts**”.

This document should be considered to be provided in lieu of the Comparison Statement for the purposes of satisfying rules 10(c), 11(b) and 12(c) of the BBM RKR.

1.2 Confidentiality

The information provided by Telstra in this document is highly commercially sensitive.

The disclosure of information in relation to operating expenditure and capital expenditure forecasts in this document would cause competitive harm to Telstra as rivals would be able to gain a greater insight into Telstra’s expenditure patterns and areas of investment focus. In effect, releasing the forecast data would telegraph Telstra’s commercial intentions to competitors and hinder Telstra’s ability to compete in the market.

The disclosure of such information may also prejudice Telstra's position in commercial negotiations with suppliers and wholesale customers. This could affect Telstra's performance in financial markets and its dealings with analysts, investors and shareholders.

Telstra understands the importance of a transparent process. However, Telstra considers that a balance should be struck between transparency and the protection of Telstra's highly commercially sensitive information. Accordingly, Telstra considers that the public disclosure of the information in this document should be strictly limited to that which is necessary for the purposes of the ACCC's review of the FLSM.

In that regard, Telstra considers that any disclosure of such highly commercially sensitive information should be subject to terms and conditions (pursuant to section 151BUA(2)(d) of the *Competition and Consumer Act 2010* ("CCA"). For example, disclosure should be limited to individuals who have been approved by Telstra and subject to those individuals having executed a confidentiality undertaking in a form satisfactory to Telstra.

Telstra will prepare a more detailed response once it has had an opportunity to review the ACCC's proposed notice setting out the terms and conditions on which the ACCC proposes to provide that information in the consultation process for that notice in section 152BUA(5) of the CCA.

2. CAPITAL EXPENDITURE

The ACCC's FLSM applies a building block approach to allocate capital charges and operating costs and overheads to services in order to determine prices for the fixed line services (ULLS, WLR, PSTN OTA, LCS, LSS and, since 2013, WDSL¹). Capital expenditure forecasts are an input into calculating fixed line service prices in the FLSM. The FLSM rolls forward the RAB at the end of each year to determine the opening value of the RAB for the next year. The forecast capital expenditure is added to the RAB through the roll forward process on an annual basis. It therefore forms a component of the revenue requirement through the return on capital and the return of capital.

In this section, Telstra has compared the Previous Regulatory Forecast capital expenditure values (set out in the 2011 FLSM) to actual capital expenditure values for the Comparison Period. Actual expenditure was determined by applying the same method used in the preparation of the Previous Regulatory Forecasts – that is, in calculating actual spend, Telstra used the same conversions and uplifts (as applicable), allocators and asset classes as the ACCC used for the purposes of the FLSM.

In addition, Telstra has compared its new methodology to forecast capital expenditure in the next regulatory period (from 1 July 2014) to the Previous Regulatory Forecast approach for the Comparison Period.

2.1 Forecast methodology used to prepare FLSM capex estimates for FY2011 to FY2014

2.1.1 Direct capital expenditure forecasts

The Previous Regulatory Forecasts are based on Telstra's revised forecasts provided to the ACCC in March 2011 which are set out in Table 1 below. Telstra used its actual expenditure information for the first two quarters of FY11 to develop its capital expenditure forecasts for the purpose of FY11. For FY12, Telstra applied a nominal annual increase of 1% to its 2010-11 expenditure forecast and, for FY13, it applied a nominal annual increase of 1% to its 2011-12 expenditure forecast. For FY14, it applied a nominal annual increase of [C-I-C starts] [C-I-C ends] to its 2012-13 expenditure forecast.

¹ ULLS (Unconditioned Local Loop Service); WLR (Wholesale Line Rental); PSTN (Public Switched Telephone Network Originating and Terminating Access); LCS (Local Carriage Service); LSS (Line Sharing Service); and WDSL (wholesale DSL).

Table 1: Telstra's forecast capital expenditure in nominal dollars (millions)

[C-I-C starts]

Asset Class	FY2011	FY2012	FY2013
CAN ASSETS			
Ducts and pipes	88.33	89.22	█
Copper cables	52.23	52.75	█
Other cables	39.40	39.79	█
Pair gain systems	17.35	17.52	█
CAN Radio Bearer Equipment	0.49	0.49	█
Other CAN assets	0.09	0.09	█
Other Communications Plant and Equipment	3.24	3.28	█
Network Land	-	-	█
Network Buildings/Support	29.61	29.91	█
CORE ASSETS			
Switching Equipment - Local	17.06	17.23	█
Switching Equipment - Trunk	0.01	0.01	█
Switching Equipment - Other	0.93	0.94	█
Inter-exchange Cables	80.63	81.43	█
Transmission Equipment	131.79	133.11	█
Core Radio Bearer Equipment	7.04	7.11	█
Other Communications Plant and Equipment	8.01	8.09	█
Network Land	-	-	█
Network Buildings/Support	169.93	171.63	█

[C-I-C ends]

For each of the relevant years, the nominal figures were converted to FY2009 dollars (being the FLSM base year dollars). In order to adjust for an incorrect deflation of the capital expenditure estimate in FY2011, the ACCC uploaded the nominal dollar figures for FY2011 by a factor of 0.31% in converting to FY2009 dollars.

The ACCC had initially used the simple average of the RBA's CPI forecast for the year ending June 2011 (2.75%) and the FY2010 value for the Australian Bureau of Statistics ("ABS") producer price index for communications equipment manufacturing (-2.51%) as the proxy for capital equipment

inflation that year. The ACCC revised this approach by using the 10 year geometric average of CPI (2.546%) as the proxy for FY2011 capital equipment inflation – which required the conversion factor to be applied.

The ACCC applied the same methodology for subsequent years and deflated the nominal dollar figures for each of FY20112 and FY2013 by a factor of -2.18% (which is $(1+0.31\%)/(1+2.546\%)-1$) and -4.61% (which is $(1+0.31\%)/(1+2.546\%)^2-1$), respectively in converting to FY2009 dollars.

The conversion factors adopted by the ACCC are set out in Table 2 below.

Table 2: ACCC Conversion Factor

Asset Class	FY2011	FY2012	FY2013
CAN ASSETS			
Ducts and pipes	100.31%	97.82%	95.39%
Copper cables	100.31%	97.82%	95.39%
Other cables	100.31%	97.82%	95.39%
Pair gain systems	100.31%	97.82%	95.39%
CAN Radio Bearer Equipment	100.31%	97.82%	95.39%
Other CAN assets	100.31%	97.82%	95.39%
Other Communications Plant and Equipment	100.31%	97.82%	95.39%
Network Land	-	-	-
Network Buildings/Support	100.31%	97.82%	95.39%
CORE ASSETS			
Switching Equipment - Local	100.31%	97.82%	95.39%
Switching Equipment - Trunk	100.31%	97.82%	95.39%
Switching Equipment - Other	100.31%	97.82%	95.39%
Inter-exchange Cables	100.31%	97.82%	95.39%
Transmission Equipment	100.31%	97.82%	95.39%
Core Radio Bearer Equipment	100.31%	97.82%	95.39%
Other Communications Plant and Equipment	100.31%	97.82%	95.39%
Network Land	-	-	-
Network Buildings/Support	100.31%	97.82%	95.39%

The ACCC adopted a straight line depreciation method. Capital expenditure was assumed to be

incurred evenly across the year (this equates to all capital expenditure being undertaken half way of the year). For this, the ACCC applied a half-WACC to the capital expenditure before including it in the opening RAB of the following year.

The Previous Regulatory Forecasts for direct asset capital expenditure, following the relevant conversions outlined above, are as set out in Table 3 below.

Table 3: Previous Regulatory Forecasts for direct capital expenditure in FY2009 dollars (millions)

[C-I-C starts]

FLSM Asset Class	FY2011	FY2012	FY2013
CAN ASSETS			
Ducts and pipes	88.61	87.27	■
Copper cables	52.39	51.60	■
Other cables	39.52	38.92	■
Pair gain systems	17.40	17.14	■
CAN Radio Bearer Equipment	0.49	0.48	■
Other CAN assets	0.09	0.09	■
Other Communications Plant and Equipment	3.25	3.20	■
Network Land			
Network Buildings/Support	29.70	29.26	■
CORE ASSETS			
Switching Equipment - Local	17.11	16.85	■
Switching Equipment - Trunk	0.01	0.01	■
Switching Equipment - Other	0.93	0.92	■
Inter-exchange Cables	80.88	79.66	■
Transmission Equipment	132.20	130.21	■
Core Radio Bearer Equipment	7.06	6.95	■
Other Communications Plant and Equipment	8.04	7.91	■
Network Land			
Network Buildings/Support	170.46	167.89	■

Note: The ACCC split "Other Communications Plant" and "Equipment and Network Buildings/Support" between CAN and CORE using the split ratio 28.8%: 71.2% and 14.8%:85.2%, respectively.

[C-I-C ends]

Wholesale DSL direct assets

WDSL was first declared in February 2012 and the WDSL FAD was published in May 2013. The BBM RKR was varied to ensure that the data required for estimating WDSL prices (including capital expenditure and operating expenditure forecasts) could be collected under the BBM RKR.

Telstra did not provide the ACCC with any forecasts for data equipment, but did provide actual expenditure relating to the supply of WDSL for FY2012. In the absence of specific Telstra forecasts, the ACCC used this historic data to estimate forecasts for the period of the WDSL FAD.

The ACCC applied an annual nominal 1% growth rate for each of the relevant years, and converted the nominal figures to FY2009 dollars (being the FLSM base year dollars). In the conversion, the ACCC used the inflation index with respect to FY2009 for FY2012 and FY2013 of 1.059 and 1.085, respectively. The ACCC used a simple average of the ABS's labour price index for private information media and telecommunications and the ABS's producer price index for communication equipment manufacturing for each relevant year. The results of these conversions are set out in Table 4 below.

Table 4: Data Equipment - Previous Regulatory Forecasts for direct capital expenditure

[C-I-C starts]

	FY2012	FY2013
In nominal million dollars	371.75	██████
In 2008/2009 million dollars	351.07	██████

[C-I-C ends]

Mapping to asset classes

For the fixed line services (except WDSL), Telstra supplied its actual capital expenditure to the ACCC in March 2011 for the 2011 FLSM. It also provided a cut down version of the June 2012 asset register to the ACCC on 19 October 2012. Both the capital expenditure and the asset register were provided by asset categories which were more disaggregated than the asset classes used in the FLSM. In the FLSM, the ACCC reconciled Telstra's asset categories against the asset classes in the FLSM, as set out in Tables 5 and 6 below.

For WDSL, Telstra's asset categories related to the supply of WDSL were included in the FLSM under a new asset class called "data equipment" in 2013. The categories from Telstra's asset register that were included were DSLAMs (and associated housing, racks and ADSL line cards), BRASs, IGRs, switches, servers, routers and associated software. These assets were included as a Core asset class as shown in Table 6 below.

Table 5: FLSM CAN asset classes

Telstra asset categories		ACCC FLSM asset class
Abbreviation	Description	
XC, XN	Duct & Pipe; Pit & Pipe	Ducts and pipes
XD, XU	Dist. Cable; Main Cable	Copper cables
UZ; XF	Software – Fibre to the Premise; Fibre to the Premise	Other cables
UP, XP*, XZ	Software – xDSL/ Pair Gain electronics; xDSL/ Pair Gain electronics; Customer AV equipment	Pair gain systems
XR	Radio Systems – Customer Concentrator	Radio bearer equipment
XW	Pair Gain System electronics	Other CAN assets
ZI; ZS	Support Infrastructure Racks; Support Structures	Other communications plant and equipment
1112; 1113	Network Leasehold Land; Network Owned Land	Network land
1122; 1123; 1125; 1126; 1155**; 1157**; DP; NM; MV*	Building Leasehold Improvements Network; Building Freehold - Network; Building Fitouts Leased - Network; Building Fitouts Freehold - Network; Stores Handling Equipment; Aids – Sundry P&E; Network Power Systems; Network Management; Motor Vehicles (owned)	Network buildings/support

* XP pair gain systems are mapped onto Pair Gain Systems; XP xDSL equipment is mapped onto Data Equipment.

** In 2013, these categories were discovered to be duplicated in the indirect asset category and hence these have been removed from this direct asset class in 2013.

Table 6: FLSM Core asset classes

Telstra asset categories		ACCC FLSM asset class
Abbreviation	Description	
SL, SP, UL	Switching circuit-switched (PSTN); Signalling; Software – circuit-switched (PSTN)	Switching equipment (local)
EC, ST, UT	Echo Cancellors; Switching Transit, Software - Transit	Switching equipment (trunk)
ZX	Other Switching Equipment	Switching equipment (other)
BO	Optical Fibre Cable	Inter-exchange cables
CS, PD, SD, TS, US, ZT	Synchronisation; Transmission PDH; Transmission SDH; Rotable Spares - Transmission And Radio; Software – SDH; Network Huts	Transmission equipment
BD	Radio Systems Digital Point to Point	Radio bearer equipment
ZI, ZS	Support Infrastructure Racks; Support Structures	Other communications plant and equipment
1112; 1113	Leasehold Land – Network; Owned Land - Network	Network land
1122; 1123; 1125; 1126; 1155**; 1157**; DP; NM; MA*, MT*, MV*	Building Leasehold Improvements Network; Building Freehold - Network; Building Fitouts Leased - Network; Building Fitouts Freehold - Network; Stores Handling Equipment*; Aids – Sundry P&E; Network Power Systems; Network Management; Mechanical Aids; Trailers, Caravans and Huts; Motor Vehicles (owned)	Network buildings/support
	Nil	LSS equipment
DX, UV, UX, XA, XP*	Switching Data Network; Software – Info and Data transfer; Software - IP; xDSL; xDSL and Pair Gain Systems	Data equipment***

* XP pair gain systems are mapped onto Pair Gain Systems; XP xDSL equipment is mapped onto Data Equipment.

** In 2013, these categories were discovered to be duplicated in the indirect asset category and hence these have been removed from this direct asset class in 2013.

*** Data equipment was only added as an asset class in 2013, following the WDSL FAD.

Telstra’s capital expenditure on “other communications plant and equipment”, “network land”, “network buildings/support assets” and “indirect capital assets” were not separately identified for the CAN and Core network by Telstra. The ACCC allocated the forecast capital expenditure for these asset classes to the corresponding CAN and core asset classes in the FLSM based on the share of each asset’s total depreciated value in the CAN and Core respectively. This is shown in Table 7 below.

Table 7: FLSM asset split – CAN and Core asset classes

	CAN ration	Core ration
Other Communications Plant and Equipment – ZI*	14.8%	85.2%
Other Communications Plant and Equipment – ZS*	100%	0%
Network buildings and support	14.8%	85.2%
Indirect Capital Assets	59.3%	40.7%

*In the 2011 FLSM model, the ACCC used the above ratios for ZI and ZS in determining the initial RAB. When allocating capital expenditure, the ACCC used the CAN:Core split ratio of 28.8%:71.2% for both ZI and ZS.

2.1.2 Indirect capital expenditure forecasts

The Previous Regulatory Forecast capital expenditure for indirect capital assets was obtained by using an asset life of five years and by setting capital investment equal to estimated annual depreciation on those assets, based on the written down value of those assets as at June 2009. Accordingly, the written down value is kept constant throughout the Previous Regulatory Period, and capital expenditure for indirect assets remains constant.

The FLSM used the value of the following three items in the Regulatory Accounting Framework (“RAF”) Fixed Asset Statements:

- Non-Communications Plant & Equipment - Information Technology
- Non-Communications Plant & Equipment - Other
- Other Non-Current Assets – Other

From the RAF, the written down value of the assets allocated to applicable to internal wholesale products and external wholesale products as at the end of June 2009 was [C-I-C starts] [C-I-C ends]. The forecasts which Telstra provided did not include any capital expenditure for indirect capital assets. To account for inflation, the ACCC indexed the indirect asset capital expenditure by applying a multiplication factor of 107% in FY2011, of 109% in FY2012 and 113% in FY2013.

The resulting forecast indirect asset capital expenditure is set out in Table 8 below.

Table 8: Previous Regulatory Forecasts for indirect asset capital expenditure (million dollars)

[C-I-C starts]

	FY2011		FY2012		FY2013	
	CAN	CORE	CAN	CORE	CAN	CORE
FY2009 dollars	186.92	128.50	186.92	128.50		
	315.4		315.4			
Nominal Dollars	336.6		345.0			

[C-I-C ends]

2.2 Actual capital expenditure

Applying the Previous Regulatory Forecast methodology described in Section 2.1, this section 2.2 sets out actual capital expenditure for the Comparison Period.

2.2.1 Direct capital expenditure

The actual capital expenditure for direct assets (excluding data equipment) for the Comparison Period is set out in Table 9 below.

Table 9: Actual capital expenditure for direct assets (in nominal million dollars)

[C-I-C starts]

	FY2011	FY2012	FY2013
CAN ASSETS			
Ducts and pipes	█	█	█
Copper cables	█	█	█
Other cables	█	█	█
Pair gain systems	█	█	█
CAN Radio Bearer Equipment	█	█	█
Other CAN assets	█	█	█
Other Communications Plant and Equipment	█	█	█
Network Land	█	█	█
Network Buildings/Support	█	█	█
CORE ASSETS			
Switching Equipment - Local	█	█	█
Switching Equipment - Trunk	█	█	█
Switching Equipment - Other	█	█	█
Inter-exchange Cables	█	█	█
Transmission Equipment	█	█	█
Core Radio Bearer Equipment	█	█	█
Other Communications Plant and Equipment	█	█	█
Network Land	█	█	█

	FY2011	FY2012	FY2013
Network Buildings/Support	█	█	█
LSS equipment	█	█	█

[C-I-C ends]

Wholesale DSL direct assets

The actual capital expenditure for data equipment for FY2012 and FY2013 is set out in Table 10 below.

Table 10: Data equipment – actual capital expenditure for direct assets (in nominal million dollars)

[C-I-C starts]

	FY2012	FY2013
Data equipment	█	█

█

█

█

█

[C-I-C ends]

Table 11: New asset classes (nominal million dollars)

[C-I-C starts]

Telstra Asset Category	FLSM Asset class	Asset Description	FY2012	FY2013
DX (Switching Data Network)	Data Equipment	Ethernet Optical Switch	█	█
UV (Software – Info and Data transfer)	Data Equipment	Network software – data vault	█	█
UV (Software – Info and Data transfer)	Data Equipment	Capitalised interest information and data transfer switching	█	█
UX (Software – IP)	Data Equipment	Ethernet Element Manager	█	█

Telstra Asset Category	FLSM Asset class	Asset Description	FY2012	FY2013
XA (xDSL)	Data Equipment	ISAM Top Hat Cabinet	■	■
			■	■

[C-I-C ends]

2.2.2 Indirect capital expenditure

Table 12 below shows the actual indirect capital expenditure for the Comparison Period. The actual expenditure is calculated as the difference in historic costs between two adjacent year-ends. For example, the capital addition in 2012-2013 is the difference between the historic cost at the end of June 2013 and the historic cost at the end of June 2012.

Table 12: Actual capital expenditure for indirect assets (in nominal million dollars)

[C-I-C starts]

	FY2011	FY2012	FY2013
Actual capital expenditure	■	■	■

[C-I-C ends]

2.3 Comparison of Previous Regulatory Forecasts to actual capital expenditure

This section sets out the comparison of the Previous Regulatory Forecasts for capital expenditure for the Comparison Period (reproduced in section 2.1 above) with actual capital expenditure for the same period (set out in section 2.2 above).

2.3.1 Direct capital expenditure

Table 13 sets out the Previous Regulatory Forecasts for capital expenditure on direct assets, the actual capital expenditure on direct assets and the difference between Previous Regulatory Forecasts and actual expenditure in each of the financial years of the Comparison Period. Data equipment is dealt with separately, as this was not forecast until the WDSL FAD was made in 2013.

Table 13: Difference in actual direct capital expenditure and Previous Regulatory Forecast direct capital expenditure (nominal million dollars)

[C-I-C starts]

	FY2011			FY2012			FY2013			Over three years		
	For.	Act.	Delta	For.	Act.	Delta	For.	Act.	Delta	For.	Act.	Delta
CAN ASSETS												
Ducts and pipes	■	■	■	■	■	■	■	■	■	■	■	■
Copper cables	■	■	■	■	■	■	■	■	■	■	■	■
Other cables	■	■	■	■	■	■	■	■	■	■	■	■
Pair gain systems	■	■	■	■	■	■	■	■	■	■	■	■
CAN Radio Bearer Equipment	■	■	■	■	■	■	■	■	■	■	■	■
Other CAN assets	■	■	■	■	■	■	■	■	■	■	■	■
Other Comms Plant and Equipment	■	■	■	■	■	■	■	■	■	■	■	■
Network Land	■	■	■	■	■	■	■	■	■	■	■	■
Network Buildings/Support	■	■	■	■	■	■	■	■	■	■	■	■
CORE ASSETS												
Switching Equipment - Local	■	■	■	■	■	■	■	■	■	■	■	■
Switching Equipment - Trunk	■	■	■	■	■	■	■	■	■	■	■	■
Switching Equipment - Other	■	■	■	■	■	■	■	■	■	■	■	■
Inter-exchange Cables	■	■	■	■	■	■	■	■	■	■	■	■
Transmission Equipment	■	■	■	■	■	■	■	■	■	■	■	■
Core Radio Bearer Equipment	■	■	■	■	■	■	■	■	■	■	■	■
Other Communications Plant and Equipment	■	■	■	■	■	■	■	■	■	■	■	■
Network Land	■	■	■	■	■	■	■	■	■	■	■	■
Network Buildings/Support	■	■	■	■	■	■	■	■	■	■	■	■
TOTAL	■	■	■	■	■	■	■	■	■	■	■	■

[REDACTED]

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

[C-I-C ends]

Data equipment

Table 14 below sets out the Previous Regulatory Forecasts for capital expenditure on data equipment (related to the supply of WDSL), the actual capital expenditure on data equipment and the difference between Previous Regulatory Forecasts and actual expenditure in each of the financial years of 2011-12 and 2012-13 (noting that the WDSL FAD was made in May 2013).

Table 14: Difference in actual and Previous Regulatory Forecast data equipment direct asset capital expenditure (nominal million dollars)

[C-I-C starts]

	FY2012		FY2013	
	Forecast	Actual	Forecast	Actual
Nominal figures (millions)	■	■	■	■
Delta	■		■	

[REDACTED]

[C-I-C ends]

2.3.2 Indirect capital expenditure

As set out in section 2.1, the Previous Regulatory Forecast capital expenditure for indirect capital assets was obtained by using an asset life of five years and by setting capital investment equal to estimated annual depreciation on those assets, based on the written down value of those assets as at June 2009 in FY2009 dollars [C-I-C starts]

[REDACTED] [C-I-C ends]

Table 15 below sets out the forecast written down value for FY2010 to FY2013 and compares it to the actual written down values throughout that period.

Table 15: Forecast and actual written down values and actual depreciation (million dollars)

[C-I-C starts]

	FY2010	FY2011	FY2012	FY2013
Forecast written down value in 2008/2009 dollars				
Forecast written down value in nominal dollars				
Historic cost from the RAF drill down in nominal dollars				
Accumulated depreciation from the RAF drill down in nominal dollars				
Actual Written Down Value from RAF in nominal dollars				

[C-I-C ends]

*The asset values shown in Telstra's RAF Fixed Assets Statements for Internal Wholesale and External Wholesale products can be drilled down to historic cost and accumulated depreciation General Ledger accounts. The difference in historic cost between the two year-ends provides an approximation of the capital expenditure during the year. This approximation is an under-estimate of the capital expenditure because assets which expire during the year are not included in the historic cost in subsequent years. Further, asset re-evaluations or changes in the residue value of assets which affect the accuracy of the estimation can occur; however for 2011-2013, there were no re-evaluation of indirect assets. In addition, there may be changes in the residue value of assets which affects the owned motor vehicles (MV), major mechanical aids (MA) and trailers, caravans and huts (MT) asset categories.

[C-I-C starts]

[C-I-C ends]

Table 16 below sets out the Previous Regulatory Forecasts for capital expenditure on indirect assets in the Comparison Period, the actual capital expenditure on indirect assets in that period and the difference between these values. [C-I-C starts]

[C-I-C ends]

Table 16: Difference in actual to Previous Regulatory Forecasts for indirect asset capital expenditure

[C-I-C starts]

	FY2011		FY2012		FY2013	
	Forecast	Actual	Forecast	Actual	Forecast	Actual
Nominal dollars (millions)						
Delta						

[C-I-C ends]

2.4 Reasons for differences in forecasts to actual capital expenditure [C-I-C starts]

2.4.1 Direct assets

[REDACTED]

- | [REDACTED]
- | [REDACTED]
- | [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]



[REDACTED]

[REDACTED]

[REDACTED]

Data equipment

[REDACTED]

[REDACTED]

[REDACTED]

2.4.2 Indirect assets

[REDACTED]

[REDACTED]

[C-I-C ends]

2.5 Telstra's new methodology for forecasts in next regulatory period

Telstra's new methodology to forecast capital expenditure in the next regulatory period (from 1 July 2014) is set out in Telstra's Final Access Determinations Inquiry – confidential response to information request under the BBM RKR ("**RKR Response**") at section 5.1.

The FLSM approach to forecasting capital expenditure for the Previous Regulatory Period was to look at capital expenditure at the asset class level in the base year FY2011 and project a percentage growth of 1% on this historic capital expenditure. This did not account for a number of project specific factors including where capital expenditure on a particular project is highly variable from year to year and projects in Telstra's WIP account in the base year for the Previous Regulatory Forecasts.

To more directly address the requirements specified within the RKR, and to provide a more robust, forward-looking view of relevant expenditure (whilst seeking to minimise the inclusion of non-relevant expenditure), Telstra has relied on detailed, bottom-up estimates, drawing on specialists within Telstra's Operations, Finance and Wholesale Business Units. This approach will provide a better view of FLSM project related expenditure and reduce the risk of under and over recovery.

Telstra plans capital expenditure at the project level rather than at the FLSM asset class level used in the FLSM and, as part of its planning process, Telstra normally only prepares detailed capital expenditure forecasts one year in advance. This bottom up or "project level" bottom up approach has been adopted in preparing capital expenditure forecasts for the next regulatory period. Telstra's new method is to identify the projects related to the FLSM asset classes and then, based on the project program, to identify spend in future years for these projects.

Projects that are not within the scope of FLSM are excluded in the forecast. Projects that have already concluded by 30 June 2013 will not be included in the forecast. Projects relating to the NBN are also not included. The need to allocate costs away from the FLSM for projects not within scope and for NBN specific projects is therefore removed in the new methodology. In addition, where Telstra has not been able to predict future capital expenditure with a reasonable degree of certainty (e.g. where capital expenditure on a particular project is highly variable from year to year) Telstra has excluded the project from its forecasts even if it is likely that the project will involve some (unquantifiable) capital expenditure over the regulatory period. Further, with the limited exception of disaster rectification, Telstra has not made any allowance for unplanned capital expenditure.

In general, forecast capital expenditure produced by the new method is likely to be lower than forecasts that would be generated by the ACCC's previous method because the new method looks only at projects that continue into the future. This is illustrated by comparing forecasts for capital

expenditure for FY2014 using the Previous Regulated Forecast methodology (as described in section 2.1) and Telstra's new methodology.

Table 18: Forecast capital expenditure for FY2014 (in nominal million dollars)

[C-I-C starts]

FLSM asset classes	Previous Regulatory Forecast	Telstra's new methodology	Delta
CAN assets			
Ducts and pipes	■	■	■
Copper cables	■	■	■
Other cables	■	■	■
Pair gain systems	■	■	■
CAN Radio Bearer Equipment	■	■	■
Other CAN assets	■	■	■
Other Communications Plant and Equipment	■	■	■
Network Land	■	■	■
Network Buildings/Support	■	■	■
Indirect asset	■	■	■
Core assets			
Switching Equipment - Local	■	■	■
Switching Equipment - Trunk	■	■	■
Switching Equipment - Other	■	■	■
Inter-exchange Cables	■	■	■
Transmission Equipment	■	■	■
Core Radio Bearer Equipment	■	■	■
Other Communications Plant and Equipment	■	■	■
Network Land	■	■	■
Network Buildings/Support	■	■	■
Indirect asset	■	■	■
LSS			

FLSM asset classes	Previous Regulatory Forecast	Telstra's new methodology	Delta
Data equipment	██████████	██████████	██████████
Total	██████████	██████████	██████████

[C-I-C ends]

3. OPERATING EXPENDITURE

Operating expenditure is one of the cost blocks in the FLSM. Forecast operating expenditure contributes directly to the estimated revenue requirement over the Previous Regulatory Period.

In this section, Telstra has compared the Previous Regulatory Forecast operating expenditure values (set out in the 2011 FLSM) to actual operating expenditure values for the Comparison Period. Actual spend is determined based on an application of the same method used in the preparation of the FLSM figures – that is, in calculating actual spend, Telstra used the same conversions and uplifts (as applicable), allocators and asset classes as the ACCC used for the purposes of the FLSM. Comparisons have only been done for the financial years 2011-2013 because, although Previous Regulatory Forecasts include figures for FY2014, it is not possible at this time to compare these to actual expenditure (as we are only part way through FY2014).

In addition, Telstra has compared its new methodology to forecast operating expenditure in the next regulatory period (from 1 July 2014) to the Previous Regulatory Forecast approach for the Previous Regulatory Period.

3.1 Forecast methodology used to prepare FLSM opex estimates for FY2011 to FY2014

3.1.1 Direct operating expenditure forecasts

The FY2010 data for actual direct operating expenditure provided by Telstra (the RAF data from the 'A-CAP-External' and 'A-CAP-Internal' worksheets) was used to forecast operating expenditure for direct assets for the 2011 FLSM. Direct operating expenditure was calculated as the sum of 'Maintenance' and 'Other Expenses' (for internal wholesale and external wholesale products) for each RAF asset category. Actual operating expenditure in RAF asset categories was allocated to the FLSM asset classes set out in Tables 19 and 20 below.

Table 19: FLSM asset classes for operating expenditure

CAN assets	Core assets
Ducts and pipes	Switching Equipment - Local
Copper cables	Switching Equipment - Trunk
Other cables	Switching Equipment - Other
Pair gain systems	Inter-exchange Cables
Radio Bearer Equipment	Transmission Equipment
Other CAN	Radio Bearer Equipment
-	LSS equipment
-	Data equipment
Other communications plant and equipment*	
Network Land**	
Network Building/Support**	

*Common to CAN and Core. Operating expenditure in this FLSM asset class is taken as 0.36% of the operating expenditure of Telstra's RAF category 4.3.90 Other Communications Plant and Equipment. This ratio is the percentage of the written down value in the 2009 FLSM RAB to the written down value in Telstra's RAF. The FLSM asset class is then split between CAN and Core using a split CAN:Core ratio of 28.82% : 71.18%.

**Common to CAN and Core. Network Land and Network Building/Support operating expenditure are not visible in the RAF but included under Other Communications Plant and Equipment. The FLSM used allocators to assign operating expenditure to these categories.

Table 20: Actual operating expenditure (nominal million dollars) from the RAF

[C-I-C starts]

FLSM Asset Class	FY2006	FY2007	FY2008	FY2009	FY2010
CAN ASSETS					
Ducts & Pipes	█	█	█	█	█
Copper Cables	█	█	█	█	█
Other Cables	█	█	█	█	█
Pair Gain Systems	█	█	█	█	█
Radio Bearer Equipment	█	█	█	█	█
Other CAN	█	█	█	█	█
CORE ASSETS					
Switching Equipment - Local	█	█	█	█	█
Switching Equipment - Trunk	█	█	█	█	█
Switching Equipment - Other	█	█	█	█	█
Inter-exchange Cables	█	█	█	█	█
Transmission Equipment	█	█	█	█	█
Radio Bearer Equipment	█	█	█	█	█
Common to CAN and CORE					
Other communications plants and equipment	█	█	█	█	█
FLSM Other communications plants and equipment (0.36% of RAF)	█	█	█	█	█
Allocated to CAN (28.8% of total)	█	█	█	█	█
Allocated to CORE (71.8% of total)	█	█	█	█	█
TOTAL ALLOCATED TO CAN	█	█	█	█	█
TOTAL ALLOCATED TO CORE	█	█	█	█	█

█

[C-I-C ends]

To forecast CAN direct asset operating expenditure for the Previous Regulatory Period, the FLSM started with actual expenditure in FY2010 and assumed that operating expenditure would remain constant at this level in real terms over the Previous Regulatory Period.²

To forecast Core direct asset operating expenditure for the Previous Regulatory Period, the FLSM assumed real operating expenditure to remain stable at its average level over five to FY2010.

Operating expenditure for FY2009 was not indexed because it was assumed to have been incurred on 30 June 2009 and was therefore effectively in FY2009 dollars. For the later years, to convert nominal operating expenditure to real dollars (i.e. to the FLSM's base year dollars as at 1 July 2009), operating expenditure was indexed using a simple average of the ABS producer index for communication equipment manufacturing and the ABS labour price index for information media and telecommunications. The FLSM assumed that operating expenditure is incurred at the end of the financial year.

Table 21: Inflation indexation

	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012
Yearly inflation	2.45%	2.16%	2.72%	4.30%	-0.31%	1.39%	4.76%
Conversion factor to year 2009 dollars	1.0945	1.0714	1.0430	1.0000	1.003	0.989	0.944

The resulting forecast operating expenditure across CAN and Core assets is set out in Table 22.

Table 22: Previous Regulatory Forecast operating expenditure (2009 million dollars)

[C-I-C starts]

	FY2011	FY2012	FY2013
CAN (equal to 2010 year)	553.2	553.2	■
CORE (average over 5 years to 2010)	577.3	577.3	■

[C-I-C ends]

LSS forecast operating expenditure

The November 2010 LSS data for operating expenditure provided by Telstra to the ACCC **[C-I-C starts]** ■ **[C-I-C ends]** was used to estimate operating expenditure. Operating expenditure for LSS excludes network related costs and international settlement costs. For the July 2011 FAD final decision, the ACCC made revisions to the modelling in response to revised LSS demand forecasts. As explained in the final decision, the ACCC considered that reductions in LSS demand should not lead to increases in the estimated unit costs of providing the service since the costs incurred mainly related to the labour costs associated with provisioning and billing. As also noted in the decision, the equipment costs used to provide the LSS specific services are fully depreciated so all costs are transaction-related. The ACCC also used an alternative source of unit cost information described in the final decision to test the reasonableness of the unit cost information used for the LSS and found that the draft price fell

² Page 79.

between reasonable upper and lower bounds. For these reasons the ACCC decided to hold the LSS price at the \$1.80 consulted on in the April 2011 discussion paper and revised the operating expenditure figure for LSS in accordance with that decision.³

In the final decision, the ACCC did not make any explicit adjustment to – or remove certain types of operating expenditure from – the \$17.23m draft FAD operating expenditure figure to get to the \$14.34m of operating expenditure for FY2010. Instead, the LSS operating expenditure values were adjusted down to a level that would result in a real unit cost for LSS of around \$1.63 for each year, given the LSS demand forecasts for that year.

Table 23: Previous Regulatory Forecast operating expenditure for LSS Equipment (in 2009 million dollars) (including indirect operating expenditure)

[C-I-C starts]

FY2011	FY2012	FY2013
14.12	13.91	

[C-I-C ends]

Data equipment forecast operating expenditure

For the FLSM asset class “data equipment” (deployed for WDSL), the corresponding RAF categories for asset mapping were: CAN Pair Gain Systems; Switching Equipment – Local; and Data Equipment. To forecast data equipment operating expenditure for 2013 and 2014, the ACCC:

- First, took the average actual expenditure for the five years up to and including FY2012 for each of the RAF asset categories.
- Second, for each of the RAF categories, only a proportion of the operating expenditure was allocated to the FLSM data equipment asset class. The proportion was the ratio of the sum of the historic cost for these categories from the asset register provided by Telstra for WDSL to the sum of the historic cost of the assets from the FY2012 RAF Fixed Asset Statement (Internal + External).
- Third, operating expenditure was held constant in the FLSM for FY2013 and FY2014.

[C-I-C starts] [REDACTED] [C-I-C ends]

This is reproduced in Table 24 below.

³ July 2011 Final Decision, pp. 86-87.

Table 24: Previous Regulatory Forecast direct operating expenditure for data equipment (2009 million dollars)

[C-I-C starts]

	FY2008 Actual	FY2009 Actual	FY2010 Actual	FY2011 Actual	FY2012 Actual	AVE. across 2008-2012	Proportion of costs allocated to FLSM	
CAN Pair Gain Systems	117.13	134.63	85.35	76.58	63.03	95.34	25.2%	
Switching Equipment - Local	157.56	140.56	136.37	130.81	123.14	137.69	0.0011%	
Data Equipment	285.64	321.78	268.09	258.64	233.18	273.47	61.1%	
TOTAL FLSM CLASS - DATA EQUIPMENT								

[C-I-C ends]

3.1.2 Indirect operating expenditure forecasts

Previous Regulatory Forecasts of indirect operating expenditure for the CAN and the Core networks including data equipment (but excluding LSS), were determined as being [C-I-C starts] [C-I-C ends] of direct operating expenditure. For the CAN and the Core network asset classes (excluding data equipment), total LSS costs were then deducted from total indirect operating expenditure in the FLSM before the remaining indirect operating expenditure is allocated to other fixed line services.

In respect of LSS, operating expenses are inclusive of indirect expenditure (i.e. overheads). The ACCC estimated LSS operating costs as the indirect costs allocated to LSS and the LSS specific direct cost estimates provided by Telstra. The ACCC then inflated this estimate by CPI to obtain a unit cost estimate for 2009-10 (the base year of the FLSM). Network costs were excluded as these are assumed to be recovered through the WLR price and retail line service prices. LSS operating expenditure is fully allocated to the "LSS equipment" asset class.

Table 25: Previous Regulatory Forecast indirect operating expenditure (in FY2009 million dollars)

[C-I-C starts]

	FY2011	FY2012	FY2013
CAN indirect opex = [redacted] of direct operating expenditure forecast*	435.66	435.77	[redacted]
CORE indirect opex = [redacted] of direct operating expenditure forecast*	454.64	454.74	[redacted]
Data equipment = [redacted] of direct operating expenditure forecast	-	-	[redacted]

[C-I-C ends]

3.1.3 Total forecast operating expenditure (direct + indirect)

Table 26 below sets out the total forecast operating expenditure in FY2009 dollars.

Table 26: Previous Regulatory Forecast operating expenditure (in 2009 million dollars) – direct + indirect

[C-I-C starts]

	FY2011	FY2012	FY2013
CAN direct opex and indirect opex	988.9	989.0	█
CORE direct opex and indirect opex	1,031.9	1,032.1	█
Data equipment	-	-	█

[C-I-C ends]

In the FLSM, the inflation index was forecasted to be 2.546%. The operating expenditure forecast in FY2009 dollars was converted to nominal dollars using the following conversion factors: 1.0516 for 2011; 1.0783 for 2012 and 1.1058 for 2013.

Table 27: Previous Regulatory Forecast direct + indirect operating expenditure (nominal million dollars)

[C-I-C starts]

	FY2011	FY2012	FY2013
CAN direct opex and indirect opex	1,039.9	1,066.5	█
CORE direct opex and indirect opex	1,085.2	1,112.9	█
LSS opex (indirect opex inclusive)	14.85	15.00	█
Data equipment	-	-	█

[C-I-C ends]

After total operating expenditure (direct plus indirect) for CAN and Core assets was forecasted in the FLSM this total was then allocated these to individual FLSM asset classes based on the relative proportions of their undepreciated values in the FY2009 RAB.

3.2 Actual operating expenditure

3.2.1 Direct operating expenditure

Adopting the Previous Regulatory Forecast methodology set out in section 3.1, actual operating expenditure for direct and indirect assets is derived from the direct operating expenditure in the RAF. Table 28 below shows the RAF direct operating expenditure for financial years 2011, 2012 and 2013, excluding data equipment which is dealt with separately below. The total CAN and total CORE operating expenditure is then allocated to FLSM asset classes. The allocation into FLSM asset classes is based on share of total undepreciated asset value in 2008-09. The allocators and the allocations to FLSM asset classes are provided in Table 33 of section 3.3. Note that the FLSM

allocations differ from what is observed in the RAF. Also note that the operating expenditure for LSS Equipment and Data Equipment derived from the RAF is mapped directly to LSS and Data Equipment in the FLSM.

Table 28: Actual direct operating expenditure from the RAF (nominal million dollars)

[C-I-C starts]

	FY2011	FY2012	FY2013
Common to CAN and CORE			
Other communications plants and equipment	█	█	█
FLSM Other communications plants and equipment	█	█	█
Allocated to CAN	█	█	█
Allocated to CORE	█	█	█
CAN ASSETS			
CAN Ducts & Pipes	█	█	█
CAN Copper Cables	█	█	█
CAN Other Cables	█	█	█
CAN Pair Gain Systems	█	█	█
CAN Radio Bearer Equipment	█	█	█
Other CAN	█	█	█
Total CAN*	█	█	█
CORE ASSETS (excluding data equipment)			
Switching Equipment - Local	█	█	█
Switching Equipment - Trunk	█	█	█
Switching Equipment - Other	█	█	█
Inter-exchange Cables	█	█	█
Transmission Equipment	█	█	█
Radio Bearer Equipment	█	█	█
Total CORE **	█	█	█
LSS assets			
LSS Equipment***	█	█	█

[C-I-C ends]

Data equipment

Actual direct operating expenditure for data equipment in the RAF in FY2013 was [C-I-C starts] █ [C-I-C ends] Using the FLSM allocators, [C-I-C starts] █ [C-I-C ends] of this allocated to the FLSM data equipment asset class. This is shown in Table 29 below.

Table 29: Actual direct operating expenditure for data equipment (nominal millions)

[C-I-C starts]

Telstra asset categories	Actual opex from the RAF	Proportion of costs allocated to FLSM	Actual opex allocated to FLSM
CAN Pair Gain Systems	████	████	████
Switching Equipment - Local	████	████	████
Data Equipment	████	████	████
TOTAL for FLSM asset class "data equipment"	████	████	████

[C-I-C ends]

3.2.2 Indirect operating expenditure

Actual indirect operating expenditure for CAN and Core assets (excluding data equipment) is calculated by taking [C-I-C starts] █████ [C-I-C ends] of actual direct operating expenditure. As set out above, for CAN and the Core networks (excluding data equipment), total LSS costs are deducted from total indirect operating expenditure in the FLSM before the remaining indirect operating expenditure is allocated to other fixed line services.

The actual indirect operating expenditure, excluding LSS and data equipment, for CAN and Core assets is set out in Table 30 below.

Table 30: Actual indirect operating expenditure (nominal million dollars)

[C-I-C starts]

	FY2011	FY2012	FY2013
CAN	████	████	████
CORE	████	████	████
TOTAL CAN AND CORE	████	████	████

[C-I-C ends]

Data equipment

The actual indirect operating expenditure for data equipment is set out in Table 31 below.

Table 31: Actual indirect operating expenditure for data equipment (nominal millions)

[C-I-C starts]

Telstra asset categories	Indirect opex (of direct opex)	Proportion of costs allocated to FLSM	Actual indirect opex allocated to FLSM
CAN Pair Gain Systems			
Switching Equipment - Local			
Data Equipment			
TOTAL for FLSM asset class "data equipment"			

[C-I-C ends]

3.2.3 Total operating expenditure

The total operating expenditure for all asset classes is set out in Table 32 below.

Table 32: Actual direct + indirect operating expenditure (nominal million dollars)

[C-I-C starts]

	FY2011	FY2012	FY2013
TOTAL CAN operating expenditure			
TOTAL CORE operating expenditure			
Data equipment			
LSS			

[C-I-C ends]

3.3 Comparison of Previous Regulatory Forecasts to actual operating expenditure

Applying the ACCC methodology described in Section 3.1, Table 33 below sets out the comparison of Previous Regulatory Forecast direct operating expenditure for the Comparison Period with actual direct operating expenditure for that same period. The comparison considers direct operating expenditure only, as indirect forecasts were obtained by taking [C-I-C starts] [C-I-C ends] of direct operating expenditure forecasts.

Table 33: Comparison of Previous Regulatory Forecasts to actual direct operating expenditure (nominal million dollars)

[C-I-C starts]

	FLSM Allocator	FY2011			FY2012			FY2013			TOTAL DELTA
		For.	Act.	Delta	For.	Act.	Delta	For.	Act.	Delta	
CAN Ducts & Pipes											
CAN Copper Cables											
CAN Other Cables											
CAN Pair Gain Systems											
CAN Radio Bearer Equipment											
Other CAN											
Other comms plant & equip-CAN											
Network Land											
Network Buildings/Supp											
Total CAN											
Switching Equipment - Local											
Switching Equipment - Trunk											
Switching Equipment - Other											
Inter-exchange Cables											
Transmission Equipment											
Radio Bearer Equipment											
Other comms plant & equip-CORE											
Network Land											

	FLSM Allocator	FY2011			FY2012			FY2013			TOTAL DELTA
		For.	Act.	Delta	For.	Act.	Delta	For.	Act.	Delta	
Network Buildings/Supp	█	█	█	█	█	█	█	█	█	█	█
Total CORE		█	█	█	█	█	█	█	█	█	█
Data Equipment								█	█	█	█
LSS		█	█	█	█	█	█	█	█	█	█

[C-I-C ends]

3.4 Reason for differences in Previous Regulatory Forecasts to actual operating expenditure
[C-I-C starts]

█

- █ █

- █ █

- █ █

[C-I-C ends]

3.5 Telstra's new methodology for forecasts in next regulatory period

Telstra's new methodology for forecasting operating expenditure for the next regulatory period is set out in the RKR Response at section 5.1.

Telstra has departed from the Previous Regulatory Forecast approach for Previous Regulatory Period. This previous approach drew on aggregate expenditure estimates as set out in the RAF Reports. To more directly address the requirements specified within the RKR, and to provide a more robust, forward-looking view of relevant expenditure (whilst seeking to minimise the inclusion of non-relevant expenditure), Telstra has relied on detailed, bottom-up estimates, drawing on specialists within Telstra's Operations, Finance and Wholesale Business Units. The operating expenditure forecasts are comprised of four key elements:

- estimated operating expenditure the directly and indirectly attributable to the relevant FLSM asset classes and relevant fixed line services, as incurred by the Telstra Operations Business Unit, excluding operating expenditure relating to capital projects;
- estimated direct and indirect operating expenditure related to capital projects, based on analysis of the RKR capital expenditure forecasts attributable to the FLSM asset classes;
- estimated operating expenditure indirectly attributable to the regulated fixed line services as incurred by the Telstra Wholesale Business Unit – these estimates reflect the cost to Telstra of developing, marketing and managing the regulated fixed line access services; and
- an estimated percentage mark-up to reflect a contribution toward un-attributable costs – e.g. a contribution towards corporate overheads.

The only exception to the above approach was that used to provide forecast operating expenditure estimates for the LSS Equipment asset class. Due to the definition of the LSS Equipment class, generating a bottom-up forecast of costs (using a similar approach as for the other FLSM asset classes) is not possible. Instead Telstra has generated forecasts based on RAF estimates, a similar approach to that used in the FLSM for the Previous Regulatory Period.

Table 34 below compares forecast operating expenditure using the FLSM approach and the new methodology for FY2014. As can be seen, operating expenditure forecasts are lower using Telstra's new methodology.

Table 34: Forecast comparison for opex FY2014 (nominal million dollars)

[C-I-C starts]

	Previous Regulatory Forecast method	Telstra's new forecast method	Delta
Direct operating expenditure			
CAN direct operating expenditure	██████	██████	██████
Core direct operating expenditure	██████	██████	██████
Data Equipment direct operating expenditure	██████	██████	██████
LSS direct operating expenditure	██████	██████	██████
Indirect operating expenditure			
Total indirect operating expenditure	██████	██████	██████

* The Previous Regulatory Forecast method did not include operating expenditure for CAN and Core indirect assets. The new methodology includes operating expenditure allocated for CAN and Core indirect assets in direct operating expenditure.

[C-I-C ends]

4. DEMAND

Demand is an input into calculating fixed line service prices in the FLSM. The share of the revenue requirement allocated to each service is divided by forecast demand to determine the average price (or unit price) for that service.

In this section, Telstra has compared Previous Regulatory Forecast demand for the fixed services to actual demand for the Comparison Period. In addition, Telstra has compared its new methodology to forecast demand in the next regulatory period (from 1 July 2014) to the Previous Regulatory Forecast approach for the Previous Regulatory Period.

4.1 Forecast methodology used to prepare FLSM demand estimates for FY2011 to FY2014

The ACCC has taken an iterative approach to forecasting demand. Its first demand forecasts were set out in September 2010, in its *Review of the 1997 telecommunications access pricing principles for fixed line services, Draft report (Draft Report)*. At that time, the ACCC generated its own forecasts for FY2011 to FY2014, taking into account recent trends in demand for each service and other factors expected to influence demand over the proposed regulatory period.

In April 2011, the ACCC revised its demand forecasts, which were included in its *Public inquiry to make final access determinations for the declared fixed line services, Discussion paper (Discussion Paper)*. These revised forecasts for FY2011 to FY2014 took account of the following inputs:

- more recent actual demand figures;
- internal demand forecasts provided by Telstra in November 2010;
- updated information on factors expected to influence demand for the declared fixed line services; and
- submissions received in response to the Draft Report.

In addition, the Discussion Paper included forecast demand for FY2015 and FY2016, which the ACCC expected to be stable. The ACCC explained that this assumption reflected the uncertainty surrounding the timing of the migration of services from Telstra's copper network to the NBN.

The ACCC finalised its demand forecasts in July 2011, in its *Inquiry to make final access determinations for the declared fixed line services, Final report (Final Report)*. Only Telstra and AAPT had provided comments on the ACCC's demand forecasts in its Discussion Paper, with Telstra providing revised demand forecasts for the period FY2011 to FY2013 in May 2011.

Notwithstanding this information, the ACCC considered that Telstra had not provided sufficient new information or explanation to warrant an amendment to its April 2011 Discussion Paper demand forecasts for the ULLS, WLR, PSTN OTA and LCS. The ACCC stated that in its Discussion Paper it had broadly accepted Telstra's November 2010 demand forecasts, although it had made some adjustments, including factors to allow for:

- the impacts on demand for the fixed line services resulting from price changes (that is, between the IAD prices and the previous indicative prices);
- ongoing fixed to mobile substitution; and
- a slowing in access seekers' substitution away from Telstra's resale services to their own infrastructure in the lead up to the NBN roll out.

[C-I-C starts]



[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] [C-I-C ends]

Further details of the Previous Regulatory Forecasts for demand are set out in Table 35 below.

Table 35: Previous Regulatory Forecast demand for fixed line services

[C-I-C starts]

Services	FY2010	FY2011	FY2012	FY2013	FY2014
ULLS (SIOs)	827,333	992,800	1,092,080	[REDACTED]	[REDACTED]
LSS (SIOs)	734,155	723,143	712,296	[REDACTED]	[REDACTED]
WLR (SIOs)	1,252,784	1,233,992	1,215,482	[REDACTED]	[REDACTED]
PSTN OTA (million minutes)	16,530.0	15,703.5	14,918.3	[REDACTED]	[REDACTED]
LCS (million minutes)	3,429.0	2,743.2	2,249.4	[REDACTED]	[REDACTED]
WDSL (SIOs)	-	-	767,270	[REDACTED]	[REDACTED]
Usage per SIO (Mbps)	-	-	0.1390	[REDACTED]	[REDACTED]

[C-I-C ends]

4.2 Comparison of Previous Regulatory Forecasts to actual demand

Applying the FLSM methodology described in Section 4.1, Table 36 below sets out the comparison of Previous Regulatory Forecasts for demand for the Comparison Period with actual demand for that same period.

Table 36: Comparison of Previous Regulatory Forecast demand to actual demand

[C-I-C starts]

Service	Previous Regulatory Forecast demand			Actual demand		
	FY2011	FY2012	FY2013	FY2011	FY2012	FY2013
ULLS (SIOs)	[REDACTED]	[REDACTED]	[REDACTED]	1,001,459	1,160,257	[REDACTED]
LSS (SIOs)	[REDACTED]	[REDACTED]	[REDACTED]	725,293	695,513	[REDACTED]
WLR (SIOs)	[REDACTED]	[REDACTED]	[REDACTED]	1,212,440	1,180,080	[REDACTED]
PSTN OTA (million minutes)	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
LCS (million minutes)	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
WDSL (SIOs)		[REDACTED]	[REDACTED]		[REDACTED]	[REDACTED]
Usage per SIO (Mbps)		[REDACTED]	[REDACTED]		[REDACTED]	[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]



[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]



[REDACTED]

[REDACTED]

[REDACTED]

[C-I-C ends]

4.3 Reason for differences in Previous Regulatory Forecasts to actual costs [C-I-C starts]

[REDACTED]

[REDACTED]

[REDACTED]

⁴ ACCC, *Inquiry to make final access determinations for the declared fixed line services, Final report, July 2011*, p112.

⁵ *ibid*, p110.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[C-I-C ends]

4.4 Telstra's new methodology for forecasts in next regulatory period

Telstra's forecast demand for each of the fixed line services has been developed by the relevant Telstra Wholesale product managers. The precise methodology employed and the relevant factors taken into account for each fixed line service are set out in section 5.2 of the RKR Response. However, in general, forecast demand begins with observed demand and employs a rolling average to determine future monthly demand, taking into account new connections, disconnections and movement from one fixed line service to another, e.g. from ULLS to WLR. Depending upon the product, the forecasts may be overlaid with churn from Retail, input from relevant customer account teams and may also be adjusted by the product managers, based upon their knowledge of the product and past trends. The expected impact of the NBN is also overlaid onto the forecasts.

The approach employed by Telstra to forecasting demand for the fixed line services is not dissimilar to that employed in preparing Telstra's previous forecasts:

These forecasts are prepared by the finance team within the relevant business unit, drawing on the knowledge and experience of sales, marketing and product experts within that unit and other Telstra business units, including the strategy, operations and marketing groups. In the case of Telstra Wholesale forecasts, these also take into account forecast information provided to Telstra by wholesale customers.⁶

In its Final Report, the ACCC stated that while it broadly accepted Telstra's forecasts (made using the methodology described above) it had made a number of adjustments to those forecasts. Telstra considers that the approach that it has employed in this BBM RKR to forecasting demand is robust, although it accepts that its forecasts cannot be expected to be completely accurate. Nevertheless, Telstra urges the ACCC to carefully consider any adjustments that it may consider making to the forecast demand because as the current regulatory period shows, actual demand can be very different to forecasts, with potentially significant impacts upon the pricing for the relevant services.

⁶ Telstra Corporation, *Pricing Principles for Fixed Line Services, Response to the ACCC's Draft Report*, October 2010, p111.