Australian
Competition &
Consumer
Commission

IMPUTATION AND NON-PRICE TERMS AND CONDITIONS REPORT RELATING TO ACCOUNTING SEPARATION OF TELSTRA FOR THE JUNE QUARTER 2004

October 2004

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Executive Summary

This document contains the June quarter 2004 imputation testing and non-price terms and conditions key performance indicator reports prepared pursuant to the enhanced accounting separation regime for Telstra.

This is the fourth round of reports produced in accordance with a Direction issued by the Minister for Communications, Information Technology and the Arts on 19 June 2003.

The reports are intended to provide greater transparency of Telstra's operations to ensure that it does not unfairly discriminate between access seekers using its network services and its own retail operations.

Imputation testing

The imputation report is designed to reveal whether there is a sufficient margin between Telstra's retail prices and the prices it charges access seekers to use its network (plus related costs) to enable access seekers to compete in retail telecommunications markets.

Imputation testing has been undertaken for the following retail services for, firstly, residential customers, and secondly, business customers:

- local calls and line rental
- domestic long-distance calls
- international long-distance calls
- fixed-to-mobile calls.

Tests are conducted based on both historical and current costs. The results, for both historical and current costs, indicate that Telstra passes the imputation tests for domestic and international long-distance calls and fixed-to-mobile calls, but fails for local call services (line rental and local calls combined). Failing the imputation tests in this report does not necessarily mean that the ACCC has competition concerns, and the fail for local call services may not be of concern due to the common bundling of local call services with other telephony services.

There were no significant changes for the current quarter compared to results from the imputation report for the March quarter 2004.

KPIs for non-price terms and conditions

The key performance indicators on non-price terms and conditions measure the difference between the percentage of Telstra Wholesale's customers and Telstra Retail's customers (for business and residential customer groups separately) for which performance standards are met (defined according to the Customer Service Guarantee measures). Key performance indicators currently cover the supply of the basic access service, including:

- ordering and provisioning
- faults and maintenance

- appointments.

Across these particular indicators, Telstra’s report indicates, consistent with the previous quarters, that there does not appear to be any systematic discrimination against Telstra Wholesale’s customers. However, as the results are highly aggregated this is not intended to provide a means of identifying or addressing individual cases of discrimination. The ACCC will continue to respond to complaints of discrimination on their merits.

Accuracy

As the reports have not been audited yet, the ACCC cannot vouch for the accuracy of the reports at this stage.

1 Introduction

On 19 June 2003, the Minister for Communications, Information Technology and the Arts (the Minister) directed the ACCC to use its record keeping rule (RKR) making powers under the *Trade Practices Act 1974* (the Act) in order to introduce enhanced accounting separation of Telstra.

In accordance with this Direction, the ACCC has issued RKRs requiring Telstra to provide the ACCC with reports on:

- regulatory accounting statements that have been prepared on a current cost basis, in addition to reports prepared on a historical cost basis, under the Telecommunications Industry Regulatory Accounting Framework for core services (CCA reports)
- imputation analysis comparing Telstra's retail prices and the costs faced by access seekers in purchasing core services from Telstra in order to supply competing retail services (imputation reports)
- key performance indicators on non-price terms and conditions that compare Telstra's customer service performance between specified retail and wholesale supplied services (NPTC reports).

The Direction also requires that the ACCC publish the reports and a commentary which discusses:

- the accuracy of the reports
- the extent to which the reports comply with:
  - the Regulatory Accounting Framework (for the imputation report only)
  - any other relevant record-keeping rules made by the ACCC
  - any Direction given by the ACCC for Telstra to make public information contained in the reports.

The comments are to include any qualifications that the ACCC considers necessary.

For the imputation report, the ACCC must also summarise the results of the imputation analysis.

Telstra's CCA reports are submitted separately from this report. The Direction also requires the ACCC to provide a six-monthly report on competition in the corporate customer segment of the telecommunications market. This report is also produced separately.

Purpose of the reports

The Government's purpose in establishing the enhanced accounting separation framework for Telstra is to provide the ACCC, access seekers and the public with greater transparency about Telstra's wholesale and retail costs[1].

For example, it is intended to assist the ACCC in investigating conduct that may breach Part IV and Part XIB of the Act. This would include conduct such as predatory pricing, retail margin squeezing, cross-subsidisation and vertical cost shifting[2]. In such investigations it is usually important to be able to carefully distinguish between wholesale and retail costs.

Given that the ACCC remains concerned about Telstra's market power and its degree of horizontal and vertical integration, it supports measures, such as the enhanced accounting separation regime, that are aimed at increasing the level of transparency available to regulators, competitors and the general public.

Having said that, the ACCC considers that the enhanced accounting separation regime should be kept under review to ensure that it is appropriately targeted and that the anticipated benefits are realised. Current ACCC initiatives concerning the reports it receives from Telstra are discussed below.

Recent amendments to the RKRs

Revised RKRs were recently issued to Telstra. The revised RKRs require, either immediately or after a phasing in period:

- the preparation of CCA reports based on full current cost valuations of all major asset classes and the use of the financial capital maintenance concept
- the reporting of non price terms and conditions key performance indicators for ADSL services, and the reporting of a recurring fault metric for basic access services
- the reporting of imputation test results for the unconditioned local loop service.

Continuing consultation about the RKRs

On 14 May 2004, the ACCC started a formal consultation process about the RKRs. As a result, a consultative group, the Accounting Separation Consultative Committee (ASCC), will meet bi-annually. The ASCC comprises the ACCC, Telstra and other industry and user representatives.

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1 DCITA, *Draft Direction on Telstra's accounting separation issued for public comment*, media release, 19 March 2003.

2 See ACCC*, Current cost methodology for Telstra's subsequent reports under the accounting separation regime*, *framework document*, January 2004, p.8-9.

2 Imputation report

2.1 Introduction to the imputation RKR

This section presents the imputation analysis of core telecommunications services supplied to access seekers. Results from previous quarters have been included to enable comparison.

On 26 June 2003 the ACCC issued a RKR to Telstra in relation to imputation testing. On 1 September 2003, the ACCC issued a revised RKR to Telstra entitled the *Imputation Testing (Initial Reports) Record Keeping and Reporting Rules* (the imputation RKR), taking effect from 28 August 2003.[3]

The primary objective of the imputation RKR is to provide an indication of whether Telstra is engaging in systemic price squeeze behaviour in relation to core telecommunications services.[4]

Whether Telstra fails or passes the imputation tests does not determine whether or not Telstra has contravened the Act. Further evidence of the purpose or effect of the specific conduct is required, in addition to the other requirements of the Act. For example, a contravention of the Act would require consideration of the appropriate market definition, which may not be the same as the service descriptions used in the imputation RKR.[5]

The Direction requires that the imputation tests be made public to improve transparency about potential price squeezes for core telecommunications services.

2.2 Background

2.2.1 Vertical price squeezing

Telstra is a vertically integrated carrier that owns the delivery platform over which its services are supplied. It supplies both retail telecommunications services, such as local calls, to end users and wholesale access services to competing retail suppliers. For many telephony services, Telstra's retail competitors rely on wholesale supply from Telstra, such as access to the 'local loop' (specifically, PSTN origination and termination). The competitors then add network services (e.g. long-distance transmission for long-distance calls) and retail services (e.g. billing or call centre support).

A 'price squeeze' could occur if Telstra reduces the margin between its retail price and the wholesale access price it charges for an essential input to that retail service. Telstra could reduce

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3 The imputation RKR was primarily revised as a result of Telstra advising the ACCC that it could not comply with certain aspects of the rule due to data constraints. In particular, the imputation RKR initially required that retail supply using the unconditioned local loop service be tested. However, the cost data reported in the RAF did not provide sufficient disaggregation to allow this test.

4 Senator Alston, *Government boost to telecommunications competition*, media release, 24 September 2002.

5 For further discussion on imputation testing, refer: ACCC, *Bundling in telecommunications market—an ACCC information paper*, August 2003.

the margin by lowering the retail price for the service and/or raising the wholesale access price for the essential input.

If the difference between wholesale access and retail prices is not sufficient to cover Telstra's network and retail costs of supply, retail suppliers equally or more efficient than Telstra in the supply of the retail service might not be able to remain in the market, as they would be achieving negative margins.

Imputation testing can be used to detect possible price squeezes in a retail market.

2.2.2 What are the elements of an imputation test?

An imputation test compares:

- the retail price charged by Telstra for a particular service
- the wholesale access price charged by Telstra for access to its network plus the additional costs incurred in transforming the essential input to the retail service.

Where the retail price is less than the sum of the wholesale access price and additional costs, a price squeeze is said to exist.

2.3 The imputation tests in this RKR

In this report, imputation testing is conducted on the following retail services that use Telstra's core telecommunications services as inputs:

- local calls and line rental, which use the local carriage service (LCS)
- domestic long-distance calls, which use the PSTN originating and terminating access service (PSTN O/T)
- international long-distance calls, which use the PSTN originating access service (PSTN O)
- fixed-to-mobile calls, which use the PSTN originating access service (PSTN O).

Reports for the September 2004 quarter onwards will also include retail services that use the unconditioned local loop (ULLS) core service.

There are three main variables in an imputation test: the retail price of the retail service; the access price for the core service and the additional costs of transforming the core service into the retail service. The imputation RKR details how each variable is calculated. The results are presented in tables 2.1 and 2.2 below.

- The 'retail price' is the average retail price of each retail service. This is calculated by using the total revenue and volume data provided by Telstra.
- The 'access price' is the volume weighted average of the prices that Telstra charges its access seekers for the service.

- The ‘unit cost’ is the average total cost of transforming the core input into the relevant retail service. The costs of transforming the essential input are reported in two categories: ‘retail costs’ and ‘other costs’.
  - Costs are derived from the Telecommunications Industry Regulatory Accounting Framework (RAF), which allocates direct and common costs. The costs attributed to ‘retail services’ in the RAF provide the ‘retail costs’ for the imputation tests. However, there are further costs incurred in transforming a core service to a retail service, such as transmission. These are listed as ‘other costs’ in the imputation results.
  - The sum of the ‘retail costs’ and ‘other costs’, per unit of retail service, is the ‘unit cost’.
  - The imputation RKR requires Telstra to provide costs calculated on both a historical cost basis and current cost accounting basis.
  - The ACCC and Telstra have agreed to certain procedures for addressing methodological issues about costs, as outlined in section 2.7.

The imputed margin for each retail service can then be calculated:

- The ‘imputed margin’ is calculated by subtracting the ‘access price’ and ‘unit cost’ from the ‘retail price’ for each retail service. This represents the margin that could be available to competitors, who are equally efficient as Telstra, if supplying the retail service using Telstra’s core service.[6]

- The imputation margin as a percentage of retail price is also included in the imputation tables.

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[6] As noted above, this margin is calculated after a contribution is made to ‘common costs’—that is, costs that are shared between multiple services.

2.4 Results submitted by Telstra

Pursuant to the imputation RKR, Telstra submitted tables 2.1 and 2.2 to the ACCC on 31 August 2004.

Table 2.1 Imputation report for June quarter 2004 on historical cost basis

	Local carriage service		Domestic PSTN originating and terminating access services		Domestic PSTN originating access service				Total Bundle of Fixed Voice Products		
	Local calls and Line rental		Domestic long-distance		International long-distance		Fixed to mobile		Bundle		
	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Total
Revenues											
retail	329,413,788	597,759,616	71,112,569	193,028,314	11,665,725	50,682,860	181,077,312	202,545,204	593,269,394	1,044,015,994	1,637,285,387
other	0	0	0	0	0	0	0	0	0	0	0
total	329,413,788	597,759,616	71,112,569	193,028,314	11,665,725	50,682,860	181,077,312	202,545,204	593,269,394	1,044,015,994	1,637,285,387
Retail Costs											
organisation	32,924,633	73,886,651	4,418,620	14,659,870	920,871	4,896,310	9,778,379	8,460,000	48,042,503	101,902,831	149,945,334
product and consumer	28,527,666	62,609,477	5,677,147	18,835,344	4,312,219	22,928,245	132,498,329	114,634,118	171,015,361	219,007,184	390,022,546
total	61,452,299	136,496,128	10,095,767	33,495,213	5,233,090	27,824,555	142,276,708	123,094,118	219,057,864	320,910,015	539,967,880
Other Costs											
organisation	0	0	333,495	1,106,453	51,822	275,542	946,314	818,726	1,331,631	2,200,721	3,532,352
product and consumer	0	0	16,884	56,015	4,017	21,358	47,033	40,691	67,933	118,065	185,998
network expenses	0	0	2,779,568	9,221,907	445,500	2,368,740	4,993,515	4,320,260	8,218,583	15,910,907	24,129,490
total	0	0	3,129,947	10,384,375	501,339	2,665,640	5,986,861	5,179,677	9,618,147	18,229,693	27,847,840
Retail price	127.2811	99.5258	0.1508	0.1233	0.4923	0.4023	0.3279	0.4239	229.2314	173.8265	190.5114
Access price	124.5883	89.5898	0.0238	0.0201	0.0112	0.0100	0.0133	0.0127	131.8779	96.0578	106.8448
Unit cost	23.7443	22.7263	0.0280	0.0280	0.2420	0.2420	0.2685	0.2685	88.3574	56.4661	66.0699
Imputed margin	-21.0515	-12.7903	0.0989	0.0752	0.2391	0.1502	0.0461	0.1427	8.9962	21.3027	17.5966
Imputed margin %	-16.5394%	-12.8513%	65.6110%	60.9480%	48.5729%	37.3471%	14.0502%	33.6665%	3.9245%	12.2551%	9.2365%

Table 2.2 Imputation report for June quarter 2004 on current cost basis

	Local carriage service		Domestic PSTN originating and terminating access services		Domestic PSTN originating access service				Total Bundle of Fixed Voice Products		
	Local calls and Line rental		Domestic long-distance		International long-distance		Fixed to mobile		Bundle		
	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Business	Residential	Total
Revenues											
retail	329,413,788	597,759,616	71,112,569	193,028,314	11,665,725	50,682,860	181,077,312	202,545,204	593,269,394	1,044,015,994	1,637,285,387
other	0	0	0	0	0	0	0	0	0	0	0
total	329,413,788	597,759,616	71,112,569	193,028,314	11,665,725	50,682,860	181,077,312	202,545,204	593,269,394	1,044,015,994	1,637,285,387
Retail Costs											
organisation	32,226,895	72,314,921	4,333,339	14,376,927	903,919	4,806,173	9,576,101	8,284,994	47,040,253	99,783,015	146,823,269
product and consumer	28,264,316	62,016,254	5,644,959	18,728,552	4,305,820	22,894,224	132,421,983	114,568,065	170,637,079	218,207,095	388,844,174
total	60,491,211	134,331,175	9,978,298	33,105,479	5,209,739	27,700,398	141,998,084	122,853,060	217,677,332	317,990,111	535,667,443
Other Costs											
organisation	0	0	108,995	361,617	23,056	122,592	715,182	618,757	847,233	1,102,967	1,950,200
product and consumer	0	0	1,229	4,077	1,810	9,623	26,545	22,966	29,583	36,666	66,249
network expenses	0	0	1,754,338	5,820,453	329,462	1,751,763	4,539,572	3,927,520	6,623,373	11,499,736	18,123,109
total	0	0	1,864,562	6,186,147	354,328	1,883,979	5,281,299	4,569,243	7,500,189	12,639,368	20,139,558
Retail price	127.2811	99.5258	0.1508	0.1233	0.4923	0.4023	0.3279	0.4239	229.2314	173.8265	190.5114
Access price	124.5883	89.5898	0.0238	0.0201	0.0112	0.0100	0.0133	0.0127	131.8779	96.0578	106.8448
Unit cost	23.3730	22.3659	0.0251	0.0251	0.2348	0.2348	0.2667	0.2667	87.0056	55.0491	64.6726
Imputed margin	-20.6802	-12.4299	0.1019	0.0781	0.2463	0.1574	0.0479	0.1445	10.3479	22.7196	18.9940
Imputed margin %	-16.2477%	-12.4891%	67.5556%	63.3248%	50.0333%	39.1343%	14.5938%	34.0869%	4.5142%	13.0703%	9.9700%

2.5 Summary of results

There was little difference between the imputation results based on historical cost and those based on current cost. Current cost accounting adjusts historical cost data to allow for cost variations in respect of depreciation and cost of capital to Telstra's fixed assets.[7] However, as imputation tests use the access price instead of Telstra's actual cost of supplying the core service using its fixed assets, the current cost imputed margins are unlikely to significantly differ from historical cost margins.

While the ACCC has provided the imputation results for both historical and current cost, the ensuing results and discussion focuses on the historical cost results.

The imputation RKR uses average total cost in calculating the cost of transforming Telstra's core service into a retail service. The ACCC believes that this measure provides an important indicator of the long-run impacts of particular pricing.[8]

Table 2.3 provides an overview of the imputation test results. The results show that Telstra passes the imputation tests for domestic and international long-distance calls and fixed-to-mobile calls, but fails for line rental and local calls. The table also shows that the current results are broadly consistent with the results for the September 2003,[9] December 2003 and March 2004 quarters.

The results do not show any major changes in imputed margins between March 2004 and June 2004. As the March and June 2004 costs are both based on the July-December 2003 RAF, no large changes in cost base would be expected.

The largest change is an approximately 4% increase in the result for residential local calls and line rental from -17% to -13%. This appears to have occurred because of an increase in the retail price for residential local calls and line rental and a drop in the access price for the local carriage service. There was also a 2% increase in the margin for residential fixed-to-mobile calls and an increase of 2% on the overall bundle of residential services. The margins on residential domestic long-distance and international long-distance calls each increased by 1%.

Margins on business local calls and line rental, fixed to mobile calls and the overall bundle fell slightly between the March and June quarters, but increased on business domestic long-distance calls. The margin for business international long-distance calls remained stable.

None of the changes in margin altered the overall pass/fail results of the tests from the results in the previous quarter.

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7 From the September 2004 quarter onwards, a new current cost approach, which employs the financial capital maintenance concept and involves full revaluation of all major asset classes, will be applied to Telstra. However this does not affect the current cost results in this report.

8 The ACCC has discussed this issue in its *Bundling in telecommunications markets* report, fn 5.

9 As in the last report, this report contains amended results for the September quarter 2003. The original results for that quarter were incorrect due to the way Telstra obtained certain data.

Table 2.3 Imputation testing undertaking on a historical cost basis

Retail service	Core service(s)		Imputed margin (Sep 03)*	Imputed margin (Dec 03)	Imputed margin (Mar 04)	Imputed margin (Jun 04)	Result
Local calls and line rental	LCS	Business	-9%	-10%	-16%	-17%	Fail
		Residential	-8%	-8%	-17%	-13%	Fail
Domestic long-distance	PSTN O/T	Business	64%	64%	65%	66%	Pass
		Residential	58%	59%	60%	61%	Pass
International long-distance	PSTN O	Business	40%	24%	49%	49%	Pass
		Residential	24%	22%	36%	37%	Pass
Fixed-to-mobile	PSTN O	Business	21%	19%	15%	14%	Pass
		Residential	36%	36%	32%	34%	Pass
A bundle comprising all of the above services	LCS and PSTN O/T	Business	11%	8%	5%	4%	Pass
		Residential	15%	15%	10%	12%	Pass
		Total	13%	13%	8%	9%	Pass

* Telstra provided revised margins for the September 2003 quarter in May 2004.

Line rental and local calls

The results indicate that Telstra would receive a negative margin if it supplied the grouped local call and line rental retail services by purchasing the local carriage service input at arms' length from itself. Telstra has achieved 'fails' for the local call and line rental services in all four imputation reports.

These results could be seen as raising price squeeze concerns. However, failure of an imputation test does not necessarily show a contravention of the Act.

The ACCC does not regard the failures for the local call and line rental retail product as being a concern at this stage.

The first reason for this view is that the ACCC uses 'unbundled' local call retail prices in a "retail minus" methodology to determine the access price for the LCS. Local call retail prices can be for local calls as part of a bundle of retail service offerings, or for stand alone local calls (ie. unbundled prices). These unbundled prices might be expected to be higher than the average retail prices used in the imputation test. This may make an imputation test failure for the local call and line rental retail service more likely.

Secondly, the positive margins on long-distance calls may mean that competing retail providers could recover the loss on line rental and local calls from their long-distance and fixed-to-mobile business. The positive margins on the bundles of line rental, local calls, long-distance and fixed-to-mobile calls tend to support this proposition. The ACCC has previously noted in its *Final determination for model price terms and conditions for the PSTN, ULLS and LCS* that:

> The Commission's imputation analysis indicated that there is cross-subsidisation of Telstra's local call services [consisting of line rental, local and neighbourhood calls] from its long distance services. However, the existence of positive margins on the long distance services which more than offset the negative margins on local call services means that Telstra's retail local call prices are not considered predatory because access seekers should be able to emulate this cross-subsidisation. [10]

Thirdly, the ACCC notes that Telstra has argued that it is common practice for telecommunication providers to discount line rental and local call services to obtain long-distance business. The ACCC understands that access seekers would aim to supply long-distance and fixed-to-mobile calls to customers in addition to providing local calls.

Having said that, the ACCC will review the LCS declaration and associated pricing principles and would intend to consider this matter further in light of information made available in the course of that inquiry.

Domestic and international long-distance and fixed-to-mobile calls

In the retail supply of domestic and international long-distance and fixed-to-mobile call, Telstra would make a positive margin if it purchased the essential input, the domestic PSTN originating and terminating access, at arms' length from itself.

Telstra's margins vary significantly between the three retail services, with the highest margins being achieved on domestic long-distance calls, then international long-distance and then fixed-to-mobile calls.

The margins also vary between business and residential retail services. Margins are higher on business long-distance calls than residential long-distance calls, but lower on business fixed-to-mobile calls. It should be noted that as the RAF does not disaggregate costs between customer groups, there are no differences between the unit costs for residential and business customers. The differences in margin are therefore largely due to differences in retail price.

Bundle of services

Telstra has also undertaken an imputation test on bundles of local calls, line rental, domestic and international long-distance calls and fixed-to-mobile calls. Telstra passed the test for the bundles with a margin of 12% for residential customers and 4% for business customers.

Results over the last twelve months

Table 2.3 shows that, in all four reports to date, Telstra has failed the imputation tests for local calls and line rental but passed the imputation test for all other products.

Between the September and December 2003 quarters the only large change was the decrease in margin for business international long-distance calls. In submitting its

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10 ACCC, *Final determination for model price terms and conditions for the PSTN, ULLS and LCS services,* October 2003, p. 101.

figures for the December 2003 quarter, Telstra advised that this was caused by a large decrease in revenues due to adjustments of the retail price for the service.

Between the December quarter 2003 and March quarter 2004 the significant changes were an decrease in margin for local calls and line rental margins and an increase in margin for the international long-distance services. Telstra advised that these changes were caused respectively by an increase in information technology retail costs for local calls and line rentals, and by a decrease in international settlement costs driven largely by the appreciation of the Australian dollar.

Aside from these large quarter to quarter changes, the ACCC has also observed:

- a consistent decrease in the margins for business fixed-to-mobile calls from 21% to 14%, which seems to have been caused by decreases in the retail price Telstra charges for the service

- a consistent decrease in margins for the overall bundle of services as charged to businesses from 11% to 4%, which appears to result from decreases in retail prices and increases in unit costs for the services in the bundle offsetting decreases in the access prices

- consistent increases in the margins on domestic long-distance calls, although the total change is not large.

2.6 Reconciling imputation RKR data with the RAF

Telstra is required to provide a reconciliation report to the ACCC. In essence, the reconciliation report aggregates the data derived for total revenues and costs for the two quarterly periods to which the RAF relates, and compares it to the actual RAF for the period. The reconciliation report seeks to determine whether the use of lagged cost information is a reasonable proxy for actual cost information where that cost information is not available in time.

The reconciliation report is required to be provided to the ACCC at the same time as the RAF report to which the reconciliation report relates. Telstra's RAF report for the March and June quarters 2004 is not due to be submitted to the ACCC until 30 October 2004, which is after the date for publishing this imputation testing report.[11] As such, the ACCC expects to publish Telstra's reconciliation report for the March and June quarters 2004 in the next imputation test report.

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[11] Telstra must submit its RAF report for the second half of the financial year within 4 weeks of the date on which it must lodge its end of year reports with the Australian Securities and Investments Commission (ASIC) under section 319 of the *Corporations Act* — which is within 75 days after the end of the financial year.

2.7 Extent to which the reports comply with the RAF and other RKRs

In addition to summarising the imputation test results, the Ministerial Direction requires the ACCC to comment on the extent to which the reports comply with:

- the RAF
- any other relevant record-keeping rules made by the ACCC (whether for the purposes of the Minister's Direction or otherwise)
- any Direction given by the ACCC for Telstra to make public information contained in the reports.

This section discusses the extent to which the reports comply with the RAF.

2.7.1 Relationship between the RAF and the imputation RKR

Telstra provides financial information to the ACCC in the RAF. Under the RAF, Telstra must provide capital adjusted profit and loss statements for its retail services, internal wholesale services and external wholesale services. Telstra must also provide capital employed and fixed asset statements for those three services.

The Ministerial Direction requires that Telstra provide the imputation RKR information to the ACCC on a quarterly basis. Telstra currently provides RAF information to the ACCC every six months. To address the time disparity, the ACCC requires Telstra to:

- obtain revenue information for core and retail services for the relevant quarter from Telstra's general ledger accounts
- obtain volume information for core and retail services for the relevant quarter from Telstra's management information systems
- obtain cost information for retail services each quarter by multiplying the volume data for the relevant quarter with the unit costs of the service derived from the RAF accounts for the six-month reporting period preceding that quarter.

The RAF records volume information for retail and core services. The imputation RKR requires Telstra to use volume data for retail services from the RAF for the previous six-months to unitise cost information. It also requires volume data for the relevant quarter be used, and this can later be compared to the volume data that appears in the RAF.[12]

The ACCC notes that the RAF does not disaggregate data between business and residential customer groups.

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[12] The ACCC has released some volume information pursuant to section 151BUA of the Act. See, for example, ACCC, *Telecommunications market indicator report 2002-03* (June 2004).

2.7.2 Revenue differences between the imputation RKR and the RAF

The RAF allocates revenues across various retail services. The imputation RKR requires Telstra to allocate its retail revenues in a manner consistent with the RAF. This allows for the reports provided by Telstra to be reconciled with the RAF data in future periods.

The ACCC has noted one relevant difference between the revenues that Telstra extracts from its general ledger for the imputation RKR and those included in the RAF. The definition for the domestic long-distance service in the imputation RKR excludes revenues from operator assisted calls, which are included in the corresponding RAF category. Therefore, the domestic long-distance revenues in the RKR will be lower than the RAF revenue for the national long-distance retail service.

The revenues for line rental[13], local calls, international long-distance and fixed-to-mobile calls in the imputation RKR are consistent with the revenues items for these services in the RAF.

2.7.3 Cost differences between the imputation RKR and the RAF

The RAF allocates common costs as well as direct costs to wholesale and retail services. The costs attributed to retail services in the RAF are appropriate for calculating 'retail costs' for the imputation test, but do not include all costs in the transformation of a core service to a retail service (such as transmission). Therefore, the additional costs are listed separately as 'other costs' in Telstra's imputation testing results.

Telstra uses unitised cost information from the RAF reports from the preceding six-monthly reporting period, which is multiplied by the volume for the relevant quarter. This cost information is later reconciled with the RAF. In constructing the imputation test under the current RKR, Telstra raised four implementation issues relating to the calculation of appropriate retail and other costs using the RAF data. Telstra sought the ACCC's agreement on the way to resolve these issues. The ACCC agreed that the implementation issues existed and needed rectification, and that the proposed methods appeared reasonable.

The issues identified by Telstra, and the agreed solutions, have resulted in some adjustments to the RAF figures in the imputation test. The adjustments relate to:

- the removal of installation costs from the cost of line rental—as required by the imputation RKR
- the use of a mobile termination methodology for costing fixed-to-mobile services
- the avoidance of double-counting PSTN originating and terminating access service costs.

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13 A previously existing difference was that line rental revenues in the RKR include revenue from the "Faxstream Access" product while line rental revenues in the 2002-03 RAF did not. However Faxstream revenue was to be included in the RAF for 2003-04, which the present report uses.

The latter two dot points are described in more detail below.

The ACCC also notes that Telstra has included the retail and wholesale costs of capital in the imputation tests. The WACC used in calculating the cost of capital is that set out in Telstra's RAF. In its RAF for the six months to December 2003, Telstra used an annual WACC figure of 14.51%. Should Telstra have used the ACCC's WACC, then Telstra's calculated costs would have been lower and, as such, the imputed margins would have been higher.

Mobile termination methodology for fixed-to-mobile services

As the imputation tests are designed to show whether an efficient access seeker is able to compete with Telstra, the imputation test needed adjustment to account for Telstra's on-net fixed-to-mobile calls. The ACCC and Telstra agreed, for at least the first reports, that Telstra impute the weighted average mobile termination charge that would apply to an access seeker which terminates fixed-to-mobile traffic on Telstra's mobile network.

Double-counting PSTN originating and terminating costs

To calculate the costs of transforming the PSTN core service into the retail services specified in the imputation RKR, Telstra uses its Retail and Internal Wholesale accounts in the RAF. However, the Internal Wholesale accounts include costs of network elements and functions that are already captured in the access price for the PSTN originating and terminating access service. For example, the Internal Wholesale costs recorded in the RAF allocate local switching and transmission costs to the domestic long-distance service, which are already factored into the access price.

To overcome this issue, Telstra deducted the common elements located in the External Wholesale PSTN accounts in the RAF (which are used to calculate the access price) from the costs located in the Internal Wholesale PSTN account in the RAF.

2.7.4 Conclusion on the extent to which the reports comply with the RAF

Subject to the exceptions noted in sections 2.7.2 and 2.7.3, the revenue data for retail services and the cost data for retail services is likely to comply with the RAF. Other data involved in the imputation testing is not required to comply with the RAF.

2.8 Accuracy of the imputation RKR reports

The Ministerial Direction requires the ACCC to comment on the accuracy of the reports lodged by Telstra.

2.8.1 Audit process

Clause 13 of the imputation RKR addresses the audit requirements for the reports. In particular, this clause requires a single audit to be undertaken each year. The audit report is required to relate to the report prepared for the quarter ending 30 September and the three immediately proceeding quarters. The next audit report will therefore cover the December 2003 and the March, June and September quarters 2004. The report must be provided to the ACCC by 30 November 2004.

2.8.2 Accuracy of report

As noted previously, the results of the imputation testing conducted on a historical basis are not unexpected as they are consistent with previous results the ACCC has obtained when it has conducted imputation testing for its own purposes.

The ACCC also notes that:

- Costs in this imputation tests use unitised costs from the RAF for the previous six-month reporting period, with certain adjustments. This means that there is a slight lag with the cost information, and that the time periods for the revenues and costs do not correspond.

- The current RAF does not allocate costs on the basis of customer groups. The imputation RKR requires Telstra to allocate costs to the customer groups to which it is attributable. Where this is not possible, the costs are to be allocated on the basis of usage, which has occurred. Therefore, care must be taken in interpreting the results of imputation tests for each customer group.

- The imputed margin for local calls and line rental for residential customers may be understated because of the inclusion of Telstra's 'InContact' product. This product can be used to receive calls and to make calls to a limited range of services including emergency numbers, service difficulties and faults. InContact is only available to non-business customers, holding an eligible concession card, at private dwellings where no other access service is provided to the dwelling or customer. The ACCC understands that InContact represents only a small proportion of Telstra's customers. Nonetheless, its inclusion may slightly reduce the margin in the imputation test for local calls and line rental services.

Given that the June quarter results have not yet been audited, and given the considerations listed above, the ACCC is not in a position to conclusively state whether the reports provided by Telstra for the June quarter 2004 are accurate.

3 Non-price terms and conditions report

The key performance indicators (KPIs) on non-price terms and conditions currently relate to Telstra's Basic Access service. They measure the difference between the percentage of Telstra Wholesale customers and Telstra Retail customers (for residential and business customers separately) for which the performance standards are met (defined according to Customer Service Guarantee measures). The KPIs relate to:

- ordering and provisioning
- faults and maintenance
- appointments.

The KPI measures were determined by the ACCC after undertaking a thorough investigation of the systems used by Telstra for the supply of services to its wholesale and retail customers. In particular, the ACCC examined in some detail Telstra's ordering and provisioning systems and its fault rectification systems for wholesale and retail services.

The principal objective of the KPIs is to compare Telstra's performance in providing services to its retail customers to the supply of services to its wholesale customers that on-supply to their retail customers. They are designed to reveal to the public, industry and the Government details of the differences in the treatment by Telstra of its wholesale and retail customers.

The Ministerial Direction requires the ACCC to publish the KPI information provided by Telstra.

Table 3.1 is Telstra's KPI report for the quarter ended 30 June 2004. In this table a positive difference means that Telstra performed better in meeting the performance standard for its wholesale customers than for its retail customers. A negative difference means that it did not perform as well in meeting the performance standard for its wholesale customers as its retail customers.

Table 3.1 Telstra's KPI report for non-price terms and conditions

Ordering and Provisioning – Basic Access

Metric	Measure	The difference between percentage of Wholesale Business customers and Retail Business customers in target (that is, that have met the performance standard)	The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (that is, that have met the performance standard)
1	The percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard – previous service available for automatic connection	1.54	-1.39
2	The percentage of basic access customer installation orders provisioned in the quarter, on or by the performance standard – new service with available cabling and capacity	1.96	-4.82
3	The percentage of Basic Access orders provisioned in the quarter, on or by the performance standard - new service which requires additional cable or network capacity	8.21	4.64
4	The percentage of basic access order appointments that are met in the quarter	-1.05	-0.30

Faults and Maintenance – Basic Access

Metric	Measure	The difference between percentage of Wholesale Business customers and Retail Business customers in target (that is, that have met the performance standard)	The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (that is, that have met the performance standard)
5	The percentage of basic access faults that are rectified in the quarter, on or by the performance standard	-1.34	-1.37
6	The percentage of basic access fault appointments that are met in the quarter	1.80	-0.40

Notes:

- The performance standard used for all metrics is the same as that used for the Customer Service Guarantee, unless otherwise stated.
- A positive difference means that Wholesale met the performance standard in a greater percentage of cases than Retail.
- For metrics 1-3, the performance standard = target provisioning time (TPT)
- For metric 5, the performance standard = target date/time.

Business customers

Telstra's June quarter figures indicate that its performance was generally better for its Wholesale Business customers than for its Retail Business customers. The only exceptions were Metric 4 (the percentage of basic access order appointments that are met in the quarter) and Metric 5 (the percentage of basic access faults that are rectified in the quarter, on or by the performance standard).

With the exception of Metric 3 (the percentage of basic access customer installation orders provisioned in the quarter, on or by the performance standard—new services which requires additional cable or network capacity), the variances shown in Table 3.1 above indicate that Telstra's performance declined during the June quarter for its Wholesale Business customers compared to the previous quarter.

The greatest variance reported for business customers during the June quarter related to Metric 3 (the percentage of basic access customer installation orders provisioned in the quarter, on or by the performance standard—new services which requires additional cable or network capacity). Telstra advised that during late February and March 2004, mass service disruptions were declared across the East Coast of Australia, which affects Telstra's ability in meeting held orders due to an increased focus on faults during this time. Telstra also advised that due to the small Wholesale volumes in this measure, there can be wide variations in performances.

Residential customers

Telstra's June quarter figures indicate that performance was better for its Wholesale Residential customers with regard to Metric 3 (the percentage of basic access customer installation orders provisioned in the quarter, on or by the performance standard – new services which requires additional cable or network capacity). However, Telstra's figures show that its performance was better for its Retail Residential customers for Metric 1 (the percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard—previous service available for automatic connection), Metric 2 (the percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard—new service with available cabling and capacity), Metric 4 (the percentage of basic access order appointments that are met in the quarter), Metric 5 (the percentage of basic access faults that are rectified in the quarter, on or by the performance standard) and Metric 6 (the percentage of basic access fault appointments that are met in the quarter). Telstra advised that due to system outage it experienced a number of late order entry delays that affected the variance figures for Metrics 1 and 2.

A further qualification that needs to be made is that the reported results for all Metrics are not directly comparable to those reported by the Australian Communications Authority in the context of CSG reporting, as the CSG only applies to customers with five lines or less.

Telstra's average annual KPI performance

The ACCC recognises that Telstra's KPI metrics may vary between quarters due to a number of factors. As such, care needs to be taken when making inter-quarter comparisons. To minimise the effect of these factors and to examine Telstra's KPI performance over a longer timeframe, the ACCC has used Telstra's quarterly reports to calculate the average annual variances in KPI metrics for the 12 months ended 30 June 2004. These results are shown in Table 3.2 below.

In this table a positive difference means that Telstra performed better in meeting the performance standard for its wholesale customers than for its retail customers. A negative difference means that it did not perform as well in meeting the performance standard for its wholesale customers as its retail customers.

Table 3.2 Average variances in KPI metrics - 12 months ending 30 June 2004

Metric	The difference between percentage of Wholesale Business customers and Retail Business customers in target (that is, that have met the performance standard)					The difference between percentage of Wholesale Residential customers and Retail Residential customers in target (that is, that have met the performance standard)				
	2003		**2004**		**Av.**	**2003**		**2004**		**Av.**
	Sep	**Dec**	**Mar**	**Jun**		**Sep**	**Dec**	**Mar**	**Jun**	
1	1.05	1.23	2.57	1.54	**1.60**	-1.90	-1.93	-1.28	-1.39	**-1.63**
2	-1.36	1.54	2.72	1.96	**1.22**	-3.72	-4.21	-3.43	-4.82	**-4.05**
3	17.93	12.20	5.04	8.21	**10.85**	-1.61	3.34	4.10	4.64	**2.62**
4	0.04	1.31	1.31	-1.05	**0.40**	-0.57	0.37	1.08	-0.30	**0.15**
5	-0.89	-1.00	-1.11	-1.34	**-1.09**	-1.21	-0.75	-1.12	-1.37	**1.11**
6	2.12	3.71	6.42	1.80	**3.51**	3.63	3.01	3.02	-0.40	**2.32**

Notes:

- The performance standard used for all metrics is the same as that used for the Customer Service Guarantee, unless otherwise stated.
- A positive difference means that Wholesale met the performance standard in a greater percentage of cases than Retail.
- For metrics 1-3, the performance standard = target provisioning time (TPT)
- For metric 5, the performance standard = target date/time.

Business customers

Telstra's average annual figures also indicate that its performance was generally better for its Wholesale Business customers than for its Retail Business customers. The only exception is Metric 5 (the percentage of basic access faults that are rectified in the quarter, on or by the performance standard).

Residential customers

Telstra's average annual figures also indicate that its performance was generally better for its Wholesale Residential customers. The two exceptions are Metric 1 (the percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard—previous service available for automatic connection) and Metric 2 (the percentage of basic access customer installation orders provisioned in the quarter on or by the performance standard—new service with available cabling and capacity).

While the above information provides no evidence to suggest that there is any systematic discrimination against Telstra Wholesale customers, it may not be possible to identify given the highly aggregated information used in the reported Metrics. In addition, it does not provide a means of identifying or addressing individual cases of discrimination. The ACCC will, therefore, continue to respond to complaints of discrimination on their merits.

3.1 Extent to which the report conforms with the RKR

The ACCC is satisfied that the report conforms broadly with the requirements of the RKR.

The non-price terms and conditions RKR requires Telstra to aggregate end-user customers into the business customer group and the residential customer group on the basis of Telstra's product codes.

Telstra advised that it conducted a sample test which indicated that the use of consumer ownership codes appears to offer a reasonable proxy for customer aggregations based on product codes.

Notwithstanding the reasonableness of the use of consumer ownership codes, there is an issue regarding the time required by Telstra to implement the necessary changes to its existing information systems. As such, until such changes are made, it is considered appropriate for Telstra to aggregate its customers on the basis of the consumer codes it assigned to the customer.

3.2 Accuracy

The ACCC issued its audit terms of reference for the initial reporting period ending 30 September 2003. The audit is designed to determine whether or not the report provided by Telstra has been prepared in accordance with the methodologies outlined in the Regulatory Accounting Procedures Manual (RAPM) to meet the requirements of the non-price terms and conditions RKR. An audit for all reports submitted in the previous four quarters will occur with the provision of the September 2004 quarterly report.

The ACCC notes that the report has been prepared on similar basis to the September quarter 2003 report that was audited and believes that it is likely to be reasonably accurate on that basis. It cannot however conclusively state whether or not the report provided by Telstra is accurate.

3.3 Subsequent reporting requirements

As noted in the explanatory statement to the RKR, the ACCC intends to adopt a phased approach to the development of KPIs. The ACCC, therefore, will continue to discuss with Telstra, and industry more generally, a number of possible options to improve the KPIs in order to meet the Government's stated policy objectives.

The ACCC is currently considering whether additional KPI measures could be developed for those services that require access to Telstra's local loop (such as ADSL services). The ACCC is also considering the development of performance metrics for recurring complaints or faults (including catastrophic faults).