
5.1.2. Rule 8(b): Forecast total annual Capital Expenditure specified for each FLSM Asset Class, expressed in nominal terms.

(a) Telstra's annual inflation assumptions used in its forecasts of Operating Expenditure and Capital Expenditure
[Explanatory statement request 9(a)]

Details of Telstra's inflation assumptions are set out in section 5.1.1 above.

(b) The method used to determine the forecasts in Rule 8(b)
[Explanatory statement request 9(b)]

Introduction – General approach

Telstra adopted a "bottom up" or "project-level" approach to prepare the forecasts in the response to the current BBM RKR request, mapping forecast estimates to the FLSM Asset Classes. In summary:

- (a) Telstra first identified the asset categories within its internal management accounts that correspond to a FLSM Asset Classes. Telstra then identified all IMC Codes (or projects) that involved expenditure on one or more of those asset categories. Projects that were excluded from the analysis were those that did not include expenditure on any of the FLSM Asset Classes or the underlying asset categories, as well as those projects that:
 - (i) are expected to be completed prior to, or in, FY2014, and are not anticipated to recommence within the forecast period;
 - (ii) were identified as involving only a trivial expenditure on the relevant FLSM Asset Classes (or a small and highly irregular expenditure over recent years); or
 - (iii) were identified as being for NBN-related projects.
- (b) Once these projects were excluded, analysis was undertaken of the remaining set of relevant projects for the purposes of preparing the capital expenditure forecasts. Estimates of the forecast capital expenditure for these projects were determined by assessing (among other things):
 - (i) recent historic trends in capital expenditure for that project;
 - (ii) Telstra's broad capital planning and strategic direction – including the resolution to maintain fixed line service standards during the transition to the NBN;
 - (iii) trends in demand – including significant increases in demand for fixed line broadband services – and their likely impact on capital expenditure over the forecast period; and
 - (iv) the impact of the NBN rollout (based on Telstra's understanding of the planned roll-out as at June 2013).

Data sources used

The ACCC developed a mapping of the asset categories used in Telstra's Asset Register to the FLSM Asset Classes. This mapping was used in preparing all of the financial data supplied under this BBM RKR response in accordance with the process set out below.

As set out above, Telstra plans its capital expenditure at the project level. Actual and forecast capital expenditure is recorded in Telstra's Investment Management Business Planning Database ("JANES"), grouping like projects into programs using program-specific codes ("IMC Codes").

Within each IMC Code, capital expenditure is further broken down into individual asset categories and codes. Telstra has grouped these asset categories and codes into the ACCC's FLSM Asset Classes using the mapping.

In some instances it was also necessary for Telstra to analyse capital expenditure within a particular asset code at a more detailed, asset-by-asset level in order to ensure that the forecasts did not include any capital expenditure which was not properly attributable to a FLSM Asset Class. To do this, Telstra extracted more granular asset level data from its Project Assets and Investment Reporting ("PAIR") database to determine actual historical expenditure. The PAIR database differs from the JANES in that it derives information from Systems, Applications and Products ("SAP") data elements and so allows a more granular analysis of historical capital expenditure. This process is described in more detail below.

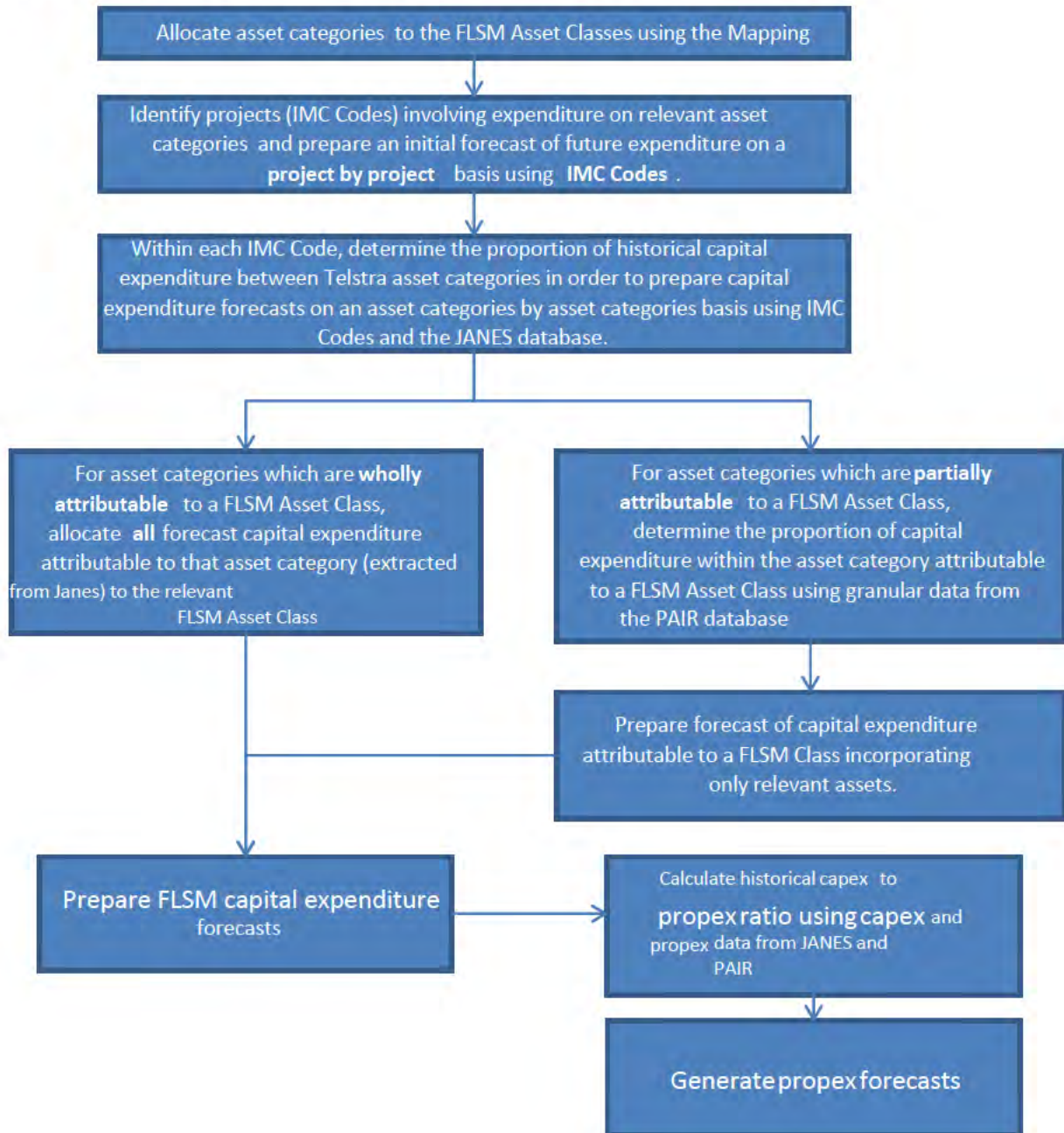
The Investment Management group provided capital forecasts against the FLSM Asset Classes for each year of the forecast regulatory period in FY2014 dollars so each subsequent year was uplifted by the cumulative forecast inflation factor (see section 5.1.1 above).

Telstra's capital expenditure forecasts on "Other Communications Plant and Equipment", "Network Buildings/Support Assets" and "Indirect Capital Assets" are not separately identified for the CAN and Core network by Telstra. For these FLSM Asset Classes, Telstra followed the methodology which was used by the ACCC for the previous regulatory period. 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 (See Table 7 of the Comparison Statement for more detail). The capital expenditure forecasts were allocated between the CAN and Core using the same ratios.

Overview of Telstra's capital expenditure and project-specific opex forecasting process

A simplified diagram explaining the process used by Telstra to generate the FLSM capital expenditure and project-specific operating expenditure ("**propex**") forecasts is set out in Figure 8 below:

Figure 8: Simplified outline – capital expenditure and propex forecasting process



Identifying relevant projects

To prepare the forecasts, Telstra first identified the asset categories within its internal management accounts that correspond to a FLSM Asset Class. Telstra then identified all IMC Codes (or projects) that involved expenditure on one or more of those asset categories.

Once all potentially relevant projects were identified, Telstra excluded from the data set those projects that:

- (a) relate to the NBN;

-
- (b) are scheduled for completion in FY2014;
 - (c) do not involve material capital expenditure on an asset category falling within a FLSM Asset Class;
 - (d) involve significantly variable expenditure from year to year (such that future capital, and not material, expenditure cannot be accurately forecast); or
 - (e) will not have any significant impact on network build.

As a result of this process, Telstra has excluded from its forecasts total capital expenditure of **[C-I-C starts]** [REDACTED] **[C-I-C ends]** in FY2014 and **[C-I-C starts]** [REDACTED] **[C-I-C ends]** in FY2015, including approximately **[C-I-C starts]** [REDACTED] **[C-I-C ends]** in FY2014 of NBN-related capital expenditure (and **[C-I-C starts]** [REDACTED] **[C-I-C ends]** in FY2015) from its forecasts. This comprises investments in Telstra's systems, processes and network infrastructure to support NBN-based retail and wholesale services (i.e. investments Telstra is making to facilitate its utilisation of the NBN as a service provider), as well as specific capital projects that Telstra is undertaking as a supplier of services and infrastructure to NBN Co. This is illustrated in Table 7 below.

Table 7: Capital expenditure forecasts – excluded projects (\$m) [C-I-C starts]

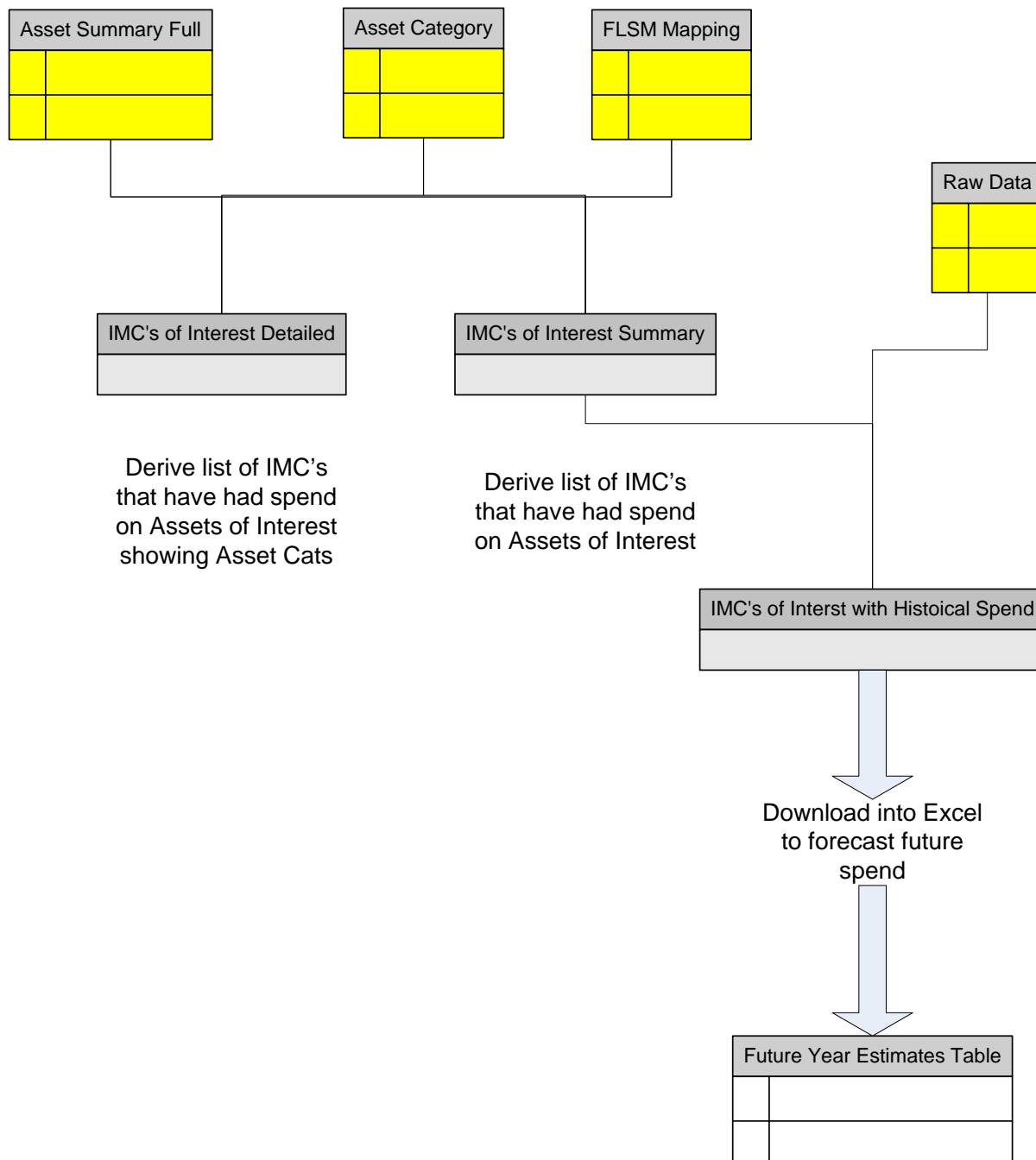
Reason for exclusion	FY2014 (\$m)	FY2015 (\$m)
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]

[C-I-C ends] Once the relevant projects were identified, Telstra then prepared an initial forecast of future capital expenditure for each of these IMC Codes on a project-by-project basis, using the following method:

- (a) Telstra analysed its historical data over the past three years to identify capital expenditure trends on an IMC Code level (e.g. whether capital expenditure on particular projects was increasing, decreasing or remaining stable); and
- (b) Telstra then prepared capital expenditure forecasts for each IMC Code having regard to these trends and the specific circumstances of each project.

This process is illustrated in Figure 9 below.

Figure 9: Identifying relevant IMC Codes



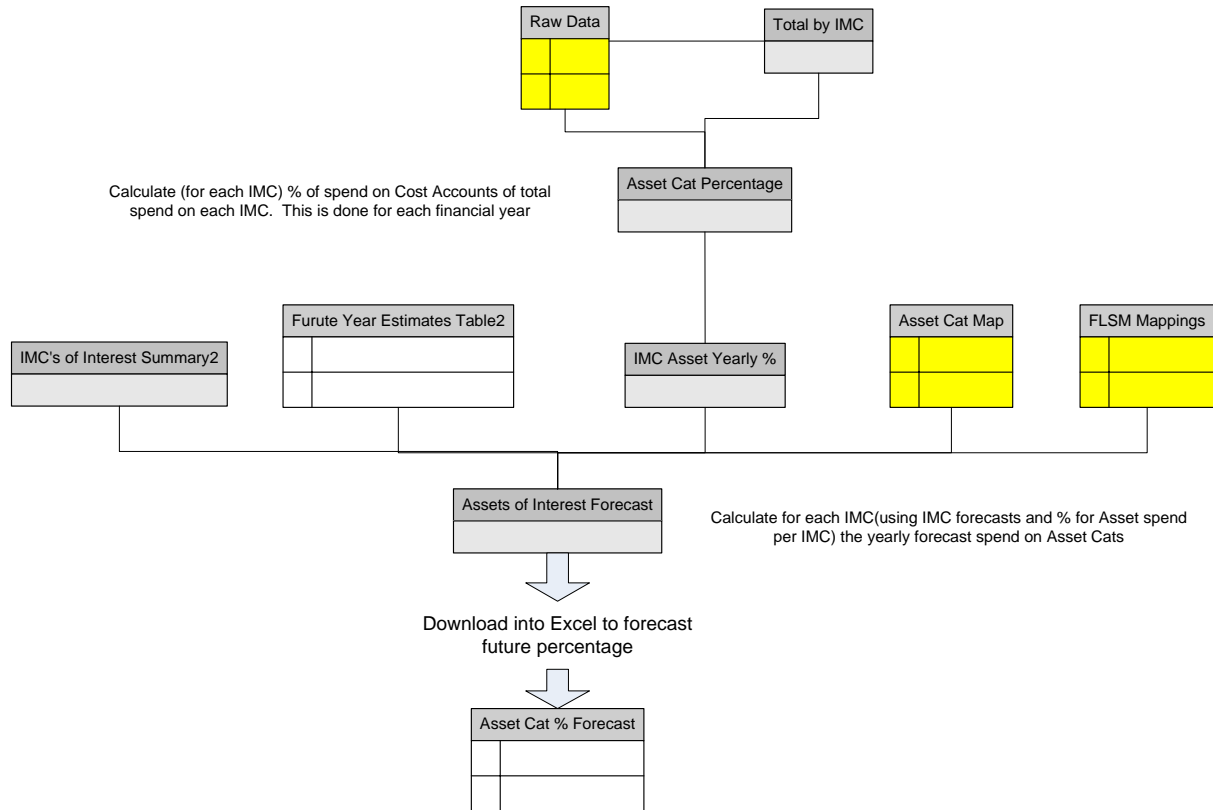
Preparing capital expenditure forecasts at an “asset class” level

As set out above, in order to prepare the FLSM forecasts requested by the ACCC, it was also necessary for Telstra to break down each of its “project level” capital expenditure forecasts into a series of more granular “asset category” level forecasts.

To do this, Telstra calculated, for each IMC Code, the proportion of total capital expenditure attributable to each asset class over each of the previous three years as a percentage of total expenditure. These proportions were then forecast into future years having regard to the trends and the specific circumstances of each project. Telstra then applied these percentages to the capital expenditure

forecasts for each IMC Code to generate forecasts on an asset category by asset category basis. This process is illustrated in Figure 10 below:

Figure 10: Calculating expenditure by Asset Class



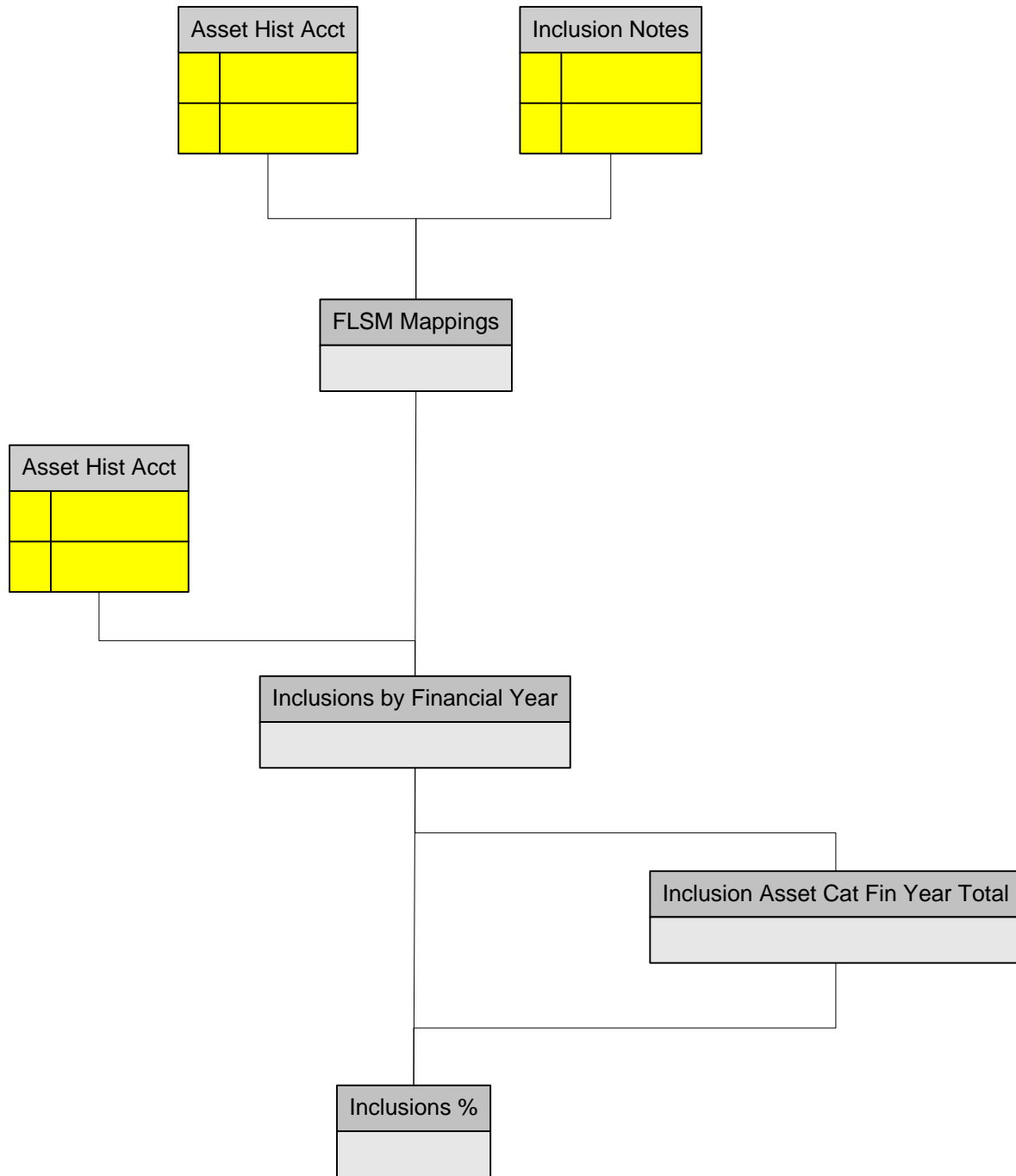
Allocating capital forecasts to the FLSM Asset Classes

In the majority of cases, all assets within a particular asset category (e.g. CAN Copper Cables) are wholly attributable to the fixed line network and a single FLSM Asset Class. In these cases, Telstra allocated the “asset category” level forecasts directly to the relevant FLSM Asset Class (“**Wholly-Allocated Asset Class Forecasts**”).

However, in some cases, Telstra’s internal asset categories include assets which are both attributable to the FLSM Asset Classes and assets which do not fall within an FLSM Asset Class. Telstra has used the methodology set out below to account for these asset categories in its FLSM forecasts:

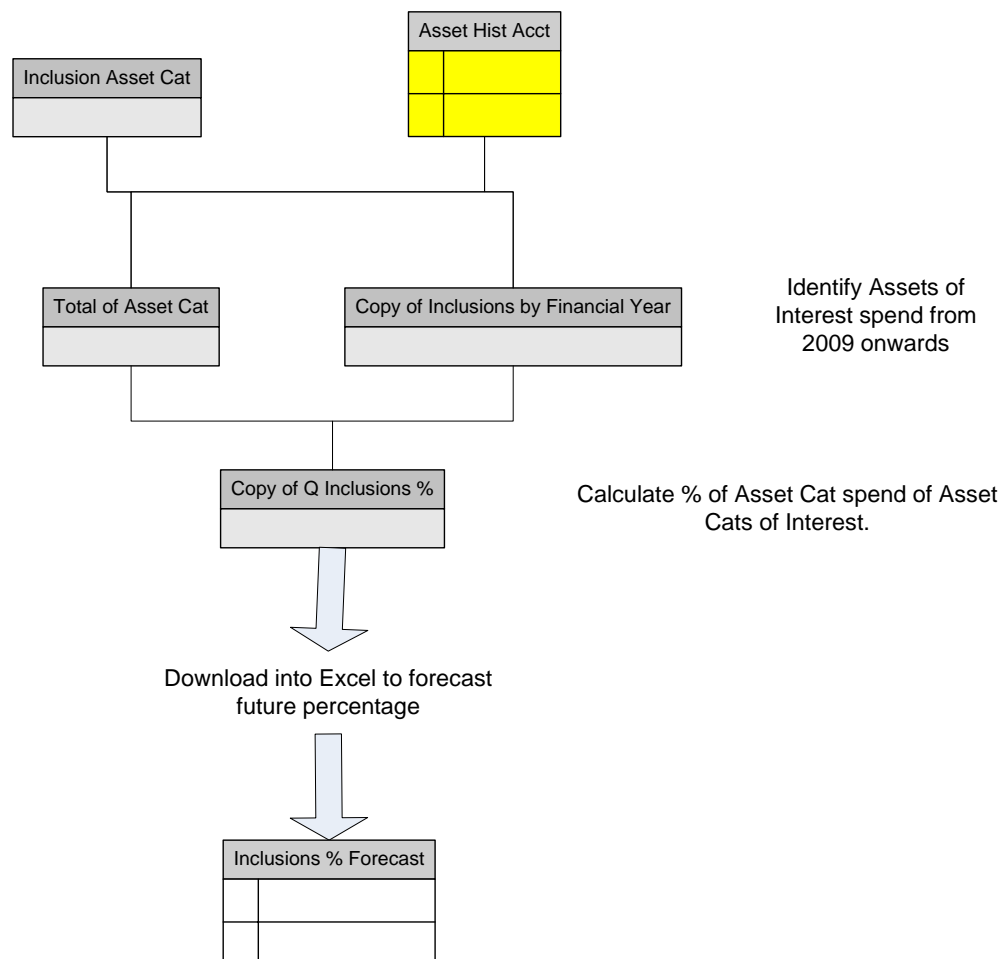
- **Step 1** - Telstra analysed the granular historical capital expenditure data in its PAIR database on an asset-by-asset basis to identify those assets which should be assigned to an FLSM Asset Class and which should be excluded from the forecasts. Telstra used this data to calculate the proportion of historical capital expenditure within each asset category that was attributable to assets within an FLSM Asset Class. This is illustrated in Figure 11 below:

Figure 11: Calculating historical expenditure on relevant assets



- Step 2** - After calculating the proportion of capital expenditure within each asset category that should be allocated to a particular FLSM Asset Class, Telstra multiplied each asset category-level forecast by this percentage to generate a forecast of relevant capital expenditure within the asset category ("**Pro-Rata Asset Class Forecasts**"). This process is illustrated in Figure 12 below:

Figure 12: Preparing Pro-Rata FLSM Asset Class Forecasts



Step 3 - Telstra generated overall capital expenditure forecasts for each FLSM Asset Class by adding together the Wholly-Allocated FLSM Asset Class Forecasts and the Pro-Rata FLSM Asset Class Forecasts.

(c) The assumptions used to determine the forecasts in Rule 8(b) [Explanatory statement request 9(c)]

Details of the assumptions used to determine the forecasts in Rule 8(b) are set out below and in section 5.1.2(b) above.

Capital expenditure which cannot be foreseen or quantified in advance

From time to time, Telstra is required to undertake capital expenditure which either:

- (a) cannot be foreseen or forecast; or
- (b) can be predicted with a degree of certainty, but cannot accurately be quantified in advance.

An example of the first category of capital expenditure is the South Brisbane Exchange Project, which involved unforeseen capital expenditure of approximately [C-I-C starts] [redacted] [C-I-C ends] between FY2011 and FY2013 as a result of the construction of a Children's Hospital on a site occupied by the

former South Brisbane exchange. Telstra has not made any allowance or “contingency” in its capital expenditure forecasts for this category of expenditure.

An example of the second category is disaster recovery expenditure (e.g. capital expenditure arising out of the Queensland floods or such as the Warrnambool exchange fire). Telstra has made an allowance in its forecasts of [C-I-C starts] [redacted] [C-I-C ends] per annum for disaster rectification as it can predict with a reasonable degree of certainty that it will incur disaster recovery related capital expenditure over the forecast period.

NBN rollout

Telstra's capital expenditure forecasts are based on Telstra's view of the NBN rollout (and its consequent impact on fixed line network capital expenditure) as at June 2013.

Telstra has prepared its capital expenditure forecasts based on currently approved projects. These projects have been, and continue to be funded by Telstra on the basis of the best information available in relation to the scope and timing of the NBN rollout as at June 2013.

As described in more detail below, these investments are primarily intended to manage the migration from the legacy copper network to the NBN by maintaining existing service levels (in terms of network performance, reliability and fault levels) as far as practical while minimising investments in assets that will be stranded following the rollout of the NBN.

Further, as noted in section 5.1.2(b) above, Telstra has excluded NBN-related capital expenditure from its forecasts.

(d) The basis for the assumptions [Explanatory statement request 9(d)]

See sections 5.1.2(b) and 5.1.2(c) above.

(e) Any internal guidelines used by Telstra for either of the following purposes: (i) to assess the prudence of forecast Capital Expenditure [Explanatory statement request 9(e)]

The response below sets out details of the capital expenditure planning processes that Telstra implements in relation to all proposed projects and services. These processes do not apply, and have not been implemented, exclusively for the purpose of preparing forecasts for the projects and asset types that are relevant to the FLSM.

As set out above, Telstra has only deviated from these standard processes where necessary to meet the express requirements of the BBM RKR (for example, forecasts for periods beyond Telstra's standard 12 to 36 month business planning horizon).

Overview of Telstra's capital expenditure planning framework and processes

Telstra plans capital expenditure at a project level rather than at the FLSM Asset Class level used by the ACCC. As part of its planning process, each business unit prepares detailed capital expenditure forecasts three years in advance. Expenditure forecasts are revised each year taking into account actual expenditure in the previous year and anticipated expenditure trends.

Each year, Telstra's board approves an overall capital expenditure “envelope” (currently approximately [C-I-C starts] [redacted] [C-I-C ends] of sales). All capital expenditure (both on the fixed network and other networks and services) needs to be funded out of this envelope. Telstra has detailed capital management processes in place to allocate its capital expenditure budget between competing priorities.

In particular, Telstra will generally only invest in a specific network, project, product or service if:

-
- (a) the return on investment from the project is greater than that which would be available by investing in alternative projects;
 - (b) the investment is necessary for Telstra to meet customer service level expectations (e.g. investing in increased transmission capacity in response to increased data traffic);
 - (c) the investment is necessary to avoid service failures; or
 - (d) the investment is necessary to meet the Universal Service Obligation (“USO”) and other regulatory requirements.

Compared to other regulated services providers (e.g. in the energy and gas sectors), Telstra’s regulated services represent a relatively small proportion of its business (approximately [C-I-C starts] [C-I-C ends]) and *all* fixed line voice and fixed broadband revenue accounts for only approximately 25% of Telstra’s total revenue. In addition, overall revenue from fixed services is declining, while revenue growth in other areas is increasing. In FY2013, revenue from fixed line services decreased by 2.7% while revenue from mobiles increased by 6%, NAS revenue increased by 17.7% and revenue from international businesses increased by 16.2%. Telstra also faces a significant risk that any new investments in the fixed network will be stranded once the NBN rollout is complete.

In many cases therefore, returns from investments outside the fixed network are significantly more attractive than the returns available on investments in the fixed network. Telstra’s fixed line investments are primarily intended to maintain existing services levels and to meet USO requirements while the NBN is rolled out. This internal “competition for capital expenditure” within Telstra, together with the factors set out above, ensure that Telstra’s investment in fixed services is prudent.

As outlined above, Telstra has prepared its capital expenditure forecasts using a bottom up or “project level” approach. This is a conservative approach which includes only projects that are currently underway and are expected to continue over the regulatory period. It does not account for unplanned or unforeseen capital expenditure.

Matters to be taken into account in assessing the prudence of Telstra’s capital expenditure forecasts

The ACCC has stated (in clause 6.10 of the Fixed Principles Provisions (clause 6 of the Final Access Determination for the Declared Fixed Line Services)) that it will take the following matters into account in assessing the reasonableness of Telstra’s capital expenditure forecasts:

- the access provider’s level of capital expenditure in the previous regulatory period;
- reasons for proposed changes to capital expenditure from one regulatory period to the next regulatory period;
- whether the access provider’s asset management and planning framework reflects best practice;
- any relevant regulatory obligations, or changes to such obligations, applicable to providing the relevant declared fixed line services; and
- any other matters relevant to whether forecast capital expenditures reflect prudent and efficient costs.

These matters are addressed below.

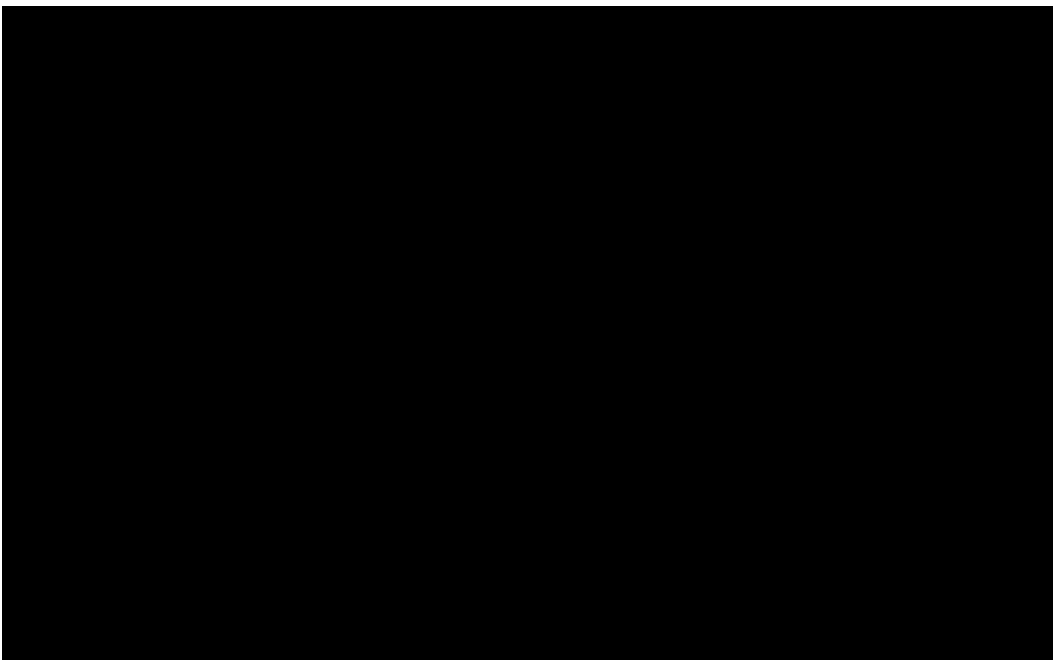
Criteria 1 - Capital expenditure in the Previous Regulatory Period and Criteria 2 - Reasons for proposed changes to capital expenditure from one regulatory period to the next


In order to comply with the requirements of the RKR, Telstra has developed a “project level” bottom up approach in preparing capital expenditure forecasts for the regulatory period the subject of the ACCC’s BBM RKR request. The benefit of this approach is that it removes the need to allocate costs away from the FLSM for projects not within scope and for NBN specific projects. However, direct comparison to past period actuals is more complex.

Telstra’s forecasts do not simply adopt all capital expenditure at a project level that can be mapped to the relevant FLSM Asset Classes at the current point in time. Projects that are not within the scope of the FLSM or relevant to the RKR period have been excluded from the forecast. That is, projects that have already concluded by 30 June 2013 will not be included in the forecast. Projects specifically relating to the NBN are also excluded. As a result, comparing the forecast values to past period figures is difficult as the relevant capital expenditure to which these forecasts should be compared will not necessarily be drawn from the same set of projects included in the forecast estimates. These issues are set out in greater detail in the annexed Comparison Statement.

Nevertheless, the following chart illustrates that based on those projects that have been included in the forecasts for the BBM RKR response, the actual value of capital expenditure within those same projects in the previous regulatory period was generally higher.

Figure 13: Value of capital expenditure in projects included in forecast for BBM RKR response (Actual and Forecast) [C-I-C starts]

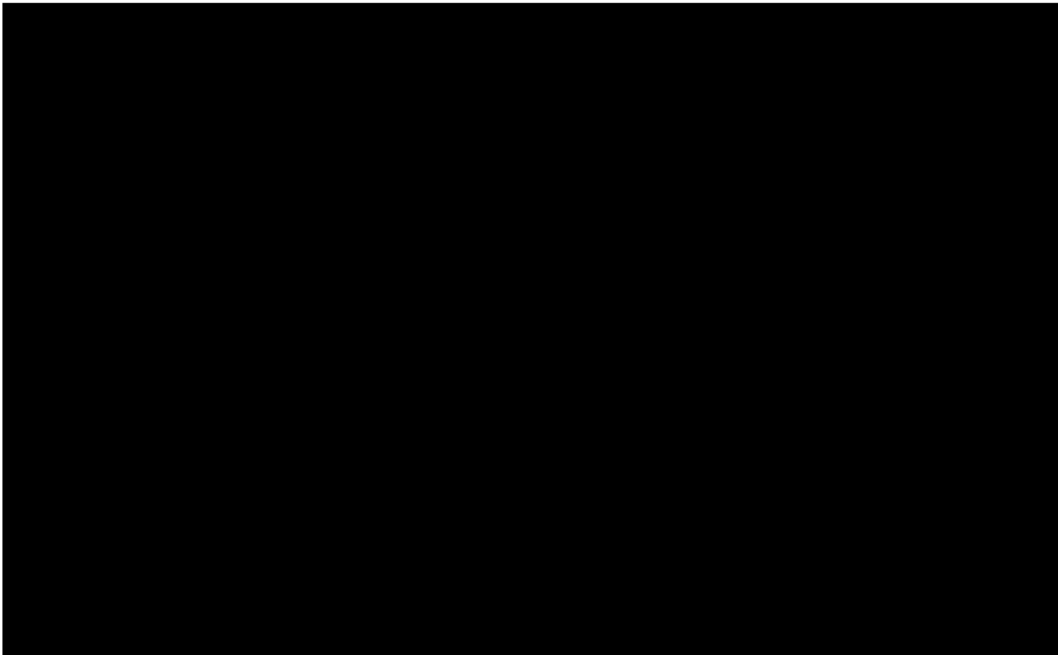


[C-I-C ends] The above chart shows the forecast capital expenditure produced by the new method, and the capital expenditure for the preceding four years calculated using the same method. **[C-I-C starts]**  **[C-I-C ends]**.

However, this approach to comparing forecasts from the Previous Regulatory Period with forecasts using the new method only serves as a partial comparison, as it excludes projects (and associated capital expenditure) that would have occurred in prior regulatory periods but were excluded from the forecasts because, for example, they were unanticipated at the time that the forecasts were made (e.g. capital expenditure associated with the South Brisbane exchange and the Top Hat project). This is discussed in more detail in the Comparison Statement.

An alternative approach is to compare actual additions to Telstra's Asset Register over the prior period to the forecast capital expenditure. As set out in the following Figure, the level of capital booked to the asset register (and adopting the FLSM estimation approach) in the prior regulatory period is much higher than the forecast capital expenditure based on the new method. This is mainly due to the asset register including a much larger amount for Indirect Assets than the new method – approximately [C-I-C starts] [C-I-C ends] in FY2013 as compared to [C-I-C starts] [C-I-C ends], but can also be traced to the cost of those projects which had completed prior to June 2013 being booked to the asset register but not included in the forecast method.

Figure 14: Summary of alternative approach [C-I-C starts]



[C-I-C ends] This second method is still limited as it reflects in part methodology differences as much as actual spending changes. [C-I-C starts]

[C-I-C ends].

Criteria 3 - Whether Telstra's asset management and planning framework reflects best practice

Telstra has robust internal processes that are designed to ensure that capital expenditure is prudent. These include:

- (a) approval of an overall capital expenditure envelope by the board and the Investment Management Committee ("IMC"). Telstra currently targets a medium-term capital expenditure/sales ratio of approximately [C-I-C starts] [C-I-C ends];
- (b) allocation of capital expenditure budget between business units in order to maximise overall profitability (see below);
- (c) requirements for capital expenditure projects to be supported by a robust business case;

-
- (d) a capital management governance structure involving review and oversight of business cases by specialist committees; and
 - (e) processes for the ongoing review and monitoring of approved capital expenditure projects.

Capital expenditure framework

All capital expenditure by Telstra is required to be within the authorised capital expenditure envelope and in accordance with the relevant business unit's Strategic Investment Portfolio Roadmap ("**Delivery Roadmap**"). Delivery Roadmaps are approved by each business unit's Group Managing Director ("**GMD**"), the Portfolio Management Committee ("**PMC**") and the Investment Management Committee ("**IMBC**"). Once approved, Delivery Roadmaps can only be varied with the approval of these decision-making bodies.

All approved capital expenditure within a business unit's Delivery Roadmap must fall into one of the following five categories:

- (a) Strategic Initiatives;
- (b) Tactical Discretionary (a prioritised list of relatively small investment projects managed at a local business unit level);
- (c) Customer Demand Driven;
- (d) Shared Infrastructure investment driven by customer demand; or
- (e) Stay in Business.

Allocation of the capital expenditure budget between business units

Each year Telstra prepares a "top down" capital expenditure plan (allocating the overall capital expenditure envelope between competing business units) for the coming year, as part of its annual strategy discussions.

Following this, each business unit prepares a "bottom up" estimate of capital expenditure broken down into the specific initiatives the business unit considers necessary to support that business unit's revenue targets.

Once these initial estimates have been completed, each business unit ranks the individual initiatives it has identified in order of priority. The "bottom up" forecasts are then submitted to Telstra Corporate, where they are adjusted to fit within the plan, and funding is provisionally allocated to business units.

Each business unit is then required to nominate:

- one additional project which it would undertake, if additional funding was available; and
- of the projects that have provisionally been allocated funding, the lowest priority project (i.e. the project which the business unit would abandon first if funding was decreased).

The IMC reviews these projects and, where appropriate, adjusts the funding made available to business units by allocating funding previously allocated to "low priority" capital projects to capital projects within different business units which would otherwise be unfunded.

Capital Management Governance

Telstra has three tiers of capital management governance committees. With the exception of small expenditures of less than [C-I-C starts] [C-I-C ends], all new business cases must be approved by one or more of these committees before any expenditure can be incurred:

- (a) the IMC, which is the executive body responsible for providing strategic direction to the Capital Investment Programme and the review and approval of high impact project business cases. The IMC is chaired by Telstra's CEO. All capital expenditure projects with an expected expenditure exceeding [C-I-C starts] [C-I-C ends] require IMC approval;
- (b) the PMC, which is responsible to the IMC for the management of the Capital Investment project portfolio. Its primary role is to ensure that projects are being executed at the right time and are delivering to agreed quality, time and cost expectations. Its focus is on strategic alignment, cross-functional alignment and achievability. The PMC has oversight over all portfolios' progress and status. All capital expenditure projects with expected expenditure of between [C-I-C starts] [C-I-C ends] require PMC approval. Projects with capital expenditure exceeding [C-I-C starts] [C-I-C ends] must be reviewed and endorsed by the PMC before being submitted to the IMC; and
- (c) the Portfolio Steering Committee ("PSC") for each business unit, which is responsible for reviewing and approving all other business cases up to [C-I-C starts] [C-I-C ends].

Approval delegations

These capital management governance arrangements are supported by the capital expenditure approval delegations described below:

- (a) Board approval – All capital expenditure projects which exceed [C-I-C starts] [C-I-C ends] must be approved by the CEO, CFO and the board. IMC approval is required before a project can be submitted for CEO and CFO approval; and
- (b) GMD approval – All capital expenditure projects with expected expenditure of between [C-I-C starts] [C-I-C ends] require GMD approval. Projects with capital expenditure exceeding [C-I-C starts] [C-I-C ends] must be reviewed and endorsed by the relevant GMD before being submitted to the CEO and CFO for approval.

Business case requirements

All discretionary investment decisions are required to be supported by a business case. Business cases must be:

- clearly linked to Telstra's physical, financial and performance targets;
- provide clear statements of accountability, deliverables, and measurements of benefit realisation; and
- demonstrate a clear linkage between the benefits from the investment and Telstra's overall profitability.

In order to gain approval, proposals must also meet the following financial hurdles [C-I-C starts]:

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

For demand driven and Asset Replacement & Operational Support (“**AROS**”) projects, the approval process differs slightly depending on whether the project is a new project or is “stay in business” expenditure on an existing project. All new demand-driven projects are required to be supported by a business case.

For ongoing demand projects (e.g. projects that have already been approved by the IMC and have an approved business case in place), Telstra’s processes do not require a further formal business case to be submitted for each release of additional funds. Rather, the business unit is required to submit a “justification statement” justifying the release of further funds by reference to forecast demand physicals, costs and revenues.

Release and expenditure of funds

All proposals are required to be funded out of the relevant business unit’s budget before being submitted to a relevant committee for approval. Funds are released only after formal approval is obtained.

Once funds have been released for a specific project, they are not transferable and cannot be applied against another project. In all cases, contracts cannot be entered into until a business case has been approved by the relevant committee. Funds can only be substituted to other projects by formal approval of the relevant committee under the governance framework.

Review and monitoring

Telstra has a variety of review mechanisms in place to monitor its capital spend.

Project owners are responsible for ensuring that spend does not exceed funds released and for delivering the project on time, on scope and within budget.

Business cases are required to be re-submitted to the relevant committee for approval if:

- it becomes clear that a project will vary from the original business case by [C-I-C starts] [REDACTED] [C-I-C ends] or more;
- the scope of the approved business case is expected to change materially; or
- for multi-year projects, the cost or benefit varies adversely by more than [C-I-C starts] [REDACTED] [C-I-C ends] within a budget year.

As part of its standard approval process, the IMC may require a formal Post Implementation Review (“**PIR**”) to be scheduled as a condition of approving expenditure on a particular project.

In addition to these formal project-specific reviews, Telstra conducts the following regular reviews of the capital expenditure program as a whole:

- the Executive Director of each business unit conducts a review of the business unit’s capital expenditure each month;
- the PMC reviews company-wide capital expenditure on a monthly basis; and

-
- the IMC reviews company capital expenditure on a quarterly basis.

Having regard to these matters, Telstra considers that its asset management and capital expenditure planning framework reflect best practice and ensure the reasonableness and prudence of any investment.

Criteria 4 - Relevant regulatory obligations

The key regulatory obligations that impact on the FLSM capital expenditure forecasts are:

- the USO, which obliges Telstra to provide new copper connections at greenfield and brownfield estates (regardless of whether or not those investments will be profitable);
- the Customer Service Guarantee framework, which obliges Telstra to meet performance standards and provide customers with financial compensation when these standards are not met;
- the National Reliability Framework requirements, which ensures faults are repaired within reasonable time frames;
- the Telecommunications Consumer Protections Code (“TCP”), which requires Telstra to implement better spend management tools including improvements in billing processes and credit management, and the introduction of unit pricing and notifications about data usage and expenditure thresholds;
- the legal interception rules (under the *Telecommunications (Interception and Access) Act 1979*) which require Telstra to cooperate with Australian law enforcement and security agencies to intercept communications, access stored communications and disclose telecommunications data in certain circumstances;
- the IT system changes associated with the Structural Separation Undertaking (“SSU”) which obliges Telstra to ensure staff within its retail business units do not have access to wholesale customer protected information; and
- privacy legislation which requires Telstra to protect its customers’ personal information from misuse, loss, unauthorised access, modification or disclosure.

Telstra has considered each of these matters in preparing its capital expenditure forecasts.

Criteria 5 - Other relevant matters

For the reasons set out above, Telstra considers that:

- the nature and purpose of forecast capital expenditure on the fixed network (i.e. maintaining existing service levels during the migration to NBN);
- the need for capital expenditure projects on the fixed network to “compete” for funding with projects involving other services; and
- the approach which has been taken in preparing the forecasts,

mean that the ACCC can have a high degree of confidence that the forecasts set out in this response are reasonable and reflect only prudent and efficient investment by Telstra in assets included in the FLSM Asset Classes over the regulatory period.

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- (ii) **Any internal guidelines used for tendering or contracting out Capital Expenditure projects.**
[Explanatory statement request 9(e)]

Telstra's policies in relation to tendering or contracting out Capital Expenditure projects

[C-I-C starts] [Redacted]

[Redacted]

[Redacted]

[Redacted]

- [Redacted]
- [Redacted]
- [Redacted]

[Redacted]

[Redacted]

[Redacted]

■ [REDACTED]

■ [REDACTED]

■ [REDACTED]

[REDACTED]

■ [REDACTED]

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■ [REDACTED]

■ [REDACTED]

■ [REDACTED]

■ [REDACTED]

■ [REDACTED]



[C-I-C ends]

- (f) **An explanation of the investment program detailing:**
- (i) **How non-discretionary projects relate to the drivers of investment, such as population growth and replacement of assets nearing the end of their asset lives;**
[Explanatory statement request 11(a)(i)]
 - (ii) **For discretionary projects, a broad description of the type of investments being undertaken and the drivers of those investments.**
[Explanatory statement request 11(a)(ii)]

Background

Telstra's investment program is required to meet a number of different objectives. In particular, the investment program must:

- enable Telstra to continue to meet its regulatory obligations, in particular the USO;
- protect and maintain the core network; and
- balance the competing objectives of further investing in the fixed network to maintain customer experience while avoiding unnecessary investments which will either not achieve a commercial return or be stranded as a result of the NBN rollout.

Against this background, the major drivers of forecast capital expenditure are:

- **Demand driven investments** – Network demand growth is the main driver of the network investment program as fixed and wireless traffic volumes continue to grow over the forecast period. Approximately [C-I-C starts] [redacted] [C-I-C ends] of capital expenditure is driven by network demand;
- **Asset Replacement & Operational Support (AROS)** – the next largest category of capital expenditure is AROS expenditure. Over the forecast period, AROS capital expenditure is forecast to account for approximately [C-I-C starts] [redacted] [C-I-C ends] of forecast capital expenditure;
- **Capitalised Interest** – Capitalised interest is estimated to account for approximately [C-I-C starts] [redacted] [C-I-C ends] of forecast capital expenditure over the forecast period; and
- **Discretionary spending** – Approximately [C-I-C starts] [redacted] [C-I-C ends] of forecast capital expenditure is expected to be on discretionary projects (such as new product development).

The total capital expenditure attributable to each of these categories is shown in Table 8 below:

Table 8: Capital expenditure forecasts, by driver (\$m) [C-I-C starts]

Expenditure type	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019
Demand	██████	██████	██████	██████	██████	██████
AROS	██████	██████	██████	██████	██████	██████
Capitalised Interest	██████	██████	██████	██████	██████	██████
Discretionary	██████	██████	██████	██████	██████	██████
Total	██████	██████	██████	██████	██████	██████

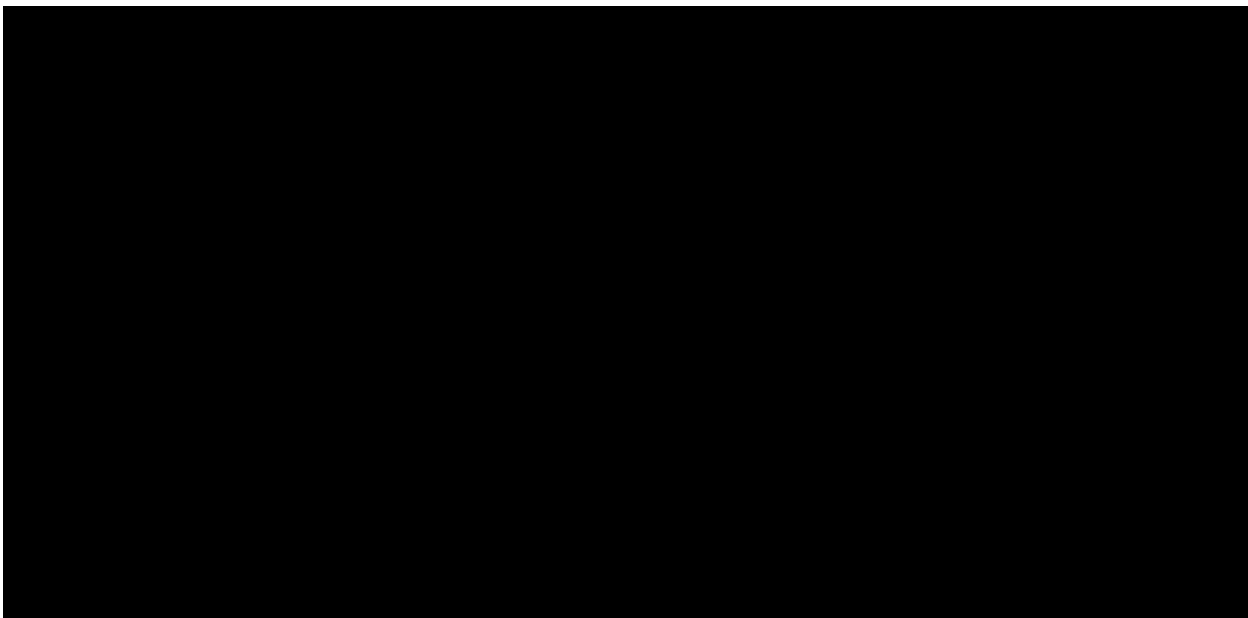
[C-I-C ends] A detailed description of the major investment drivers for each of these categories is set out below:

Demand driven investments

Fixed broadband data growth

Telstra is currently experiencing very significant growth in fixed broadband data consumption, including on the ADSL network relevant to the FLSM. The significant growth in data consumption – driven particularly by growth in ADSL network throughput - is shown in Figure 15 below:

Figure 15: Fixed broadband data growth (Gbps) [C-I-C starts]



[C-I-C ends] This growth is expected to continue over the forecast period. There are currently over 3m retail and wholesale ADSL SIO's nationally. As set out within the RKR, ADSL SIO volumes are forecast to decrease by June 2016 to approximately [C-I-C starts] ████████ [C-I-C ends] SIOs. However, at the same time demand at peak times on the ADSL network (peak usage) is expected to increase by over [C-

[C-I starts] [C-I-C ends] compared to June 2013 levels (from approximately [C-I-C starts]

[C-I-C ends]

Given the forecast growth in ADSL traffic in coming years (in spite of a commensurate forecast reduction in ADSL SIOs), Telstra will be required to continue investing in relevant ADSL access and core infrastructure. [C-I-C starts]

[C-I-C ends].

The capital expenditure forecasts involve significant investments in the fixed network to accommodate this increased demand for ADSL services and the need to maintain customer experience by relieving congestion while the NBN rolls out. In recent years, Telstra has implemented projects to provide backhaul congestion relief to approximately [C-I-C starts] [C-I-C ends] SIO's through the provision of new DSLAM and TopHat infrastructure (as well as associated upgrades to related backhaul and transmission capacity where necessary).

This significant growth in data demand has also necessitated further investment in the core network to maintain customer service at acceptable levels for both wholesale and retail customers. Core network and transmission network investments are also being driven by similar growth in data demand across Telstra's mobile and HFC networks.

Basic telephone service connections

Another significant demand driver is the need to establish new basic telephone service connections. Demand for basic telephone connections is driven by:

- (a) development of new housing projects (greenfield developments);
- (b) redevelopment of existing projects (brownfield developments);
- (c) orders from wholesale customers; and
- (d) Telstra retail orders.

Telstra is subject to obligations and requirements to provide fixed line telephony services to Australians, as well as requirements to ensure the quality of those services (for example CSGs and NRF). Accordingly, Telstra is required to invest in new Basic Telephone Service connections even where it is unlikely to receive a commercial return on that investment (e.g. where the investment will be short-lived due to the roll-out of the NBN).

Asset Replacement & Operational Support (AROS) expenditure

AROS funding is allocated using a Risk Management & Assurance risk assessment methodology to prioritise each project based on:

- (a) the likelihood of an adverse event (e.g. equipment failure) occurring; and
- (b) the consequences of failure if funding is not provided.

The process is designed to provide a fair and equitable means to allocate scarce AROS funding.

Contractual commitments and carry-in projects are the highest priority as these projects have a financial obligation to pay, or potential write-off if not completed. The remaining AROS projects are assessed and ranked on their risk profile and funded/unfunded projects identified in order of priority within a budget allocation.

This methodology has been in place since FY2009 and is supported by an auditable AROS database.

Capitalised Interest

Capitalised Interest that is related to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are included in the cost of that asset. Such borrowing costs are capitalised as part of the cost of the asset when it is probable that they will result in future economic benefits to the entity and the costs can be measured reliably.

Telstra's capitalised interest costs are driven directly by its costs of borrowing to fund the various projects included in the FLSM forecasts.

In order to forecast future capitalised interest requirements, Telstra has averaged its capitalised interest over the past three years, and held this constant over the regulatory period.

Discretionary expenditure

Only a very small proportion [C-I-C starts] ██████████ [C-I-C ends] of Telstra's forecast capital expenditure is discretionary expenditure. Telstra's discretionary capital expenditure is primarily driven by product development activities and activities directed towards generating productivity improvements.

The small percentage of forecast capital expenditure falling under the discretionary expenditure category is consistent with Telstra's broader capital expenditure objectives with respect to the fixed line network over the forecast period – namely, to maintain service levels (particularly in the presence of ongoing growth in broadband demand) and efficiently manage the transition from the PSTN and legacy fixed line services to the NBN.

- (g) A report comparing forecasts for the previous Regulatory Period with the actual Capital Expenditure for that period, and an explanation of any differences, trends and drivers; [Explanatory statement request 11(b)]**

Please refer to the Comparison Statement.

- (h) For discretionary projects, an explanation of any major differences in the types of investment undertaken compared to the forecasts; and [Explanatory statement request 11(c)]**

As the Previous Regulatory Forecasts were not prepared using a “bottom up” assessment of individual projects, it is not possible to provide a detailed explanation of any differences in actual project investment and forecast investment for particular discretionary projects.

For further information in relation to the comparison of prior capital expenditure forecast to actual investment, please see the Comparison Statement.

- (i) Evidence that a review of Capital Expenditure projects was undertaken in accordance with any investment guidelines. [Explanatory statement request 11(d)]**

See above.