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The basis of accounting for disposals of assets in Telstra’s regulatory asset base for fixed line services

April 2015

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1 Introduction

1.1 Purpose

The Australian Competition and Consumer Commission (**ACCC**) published in March 2015 its draft decision (**Draft Decision**) for its current "Public inquiry into final access determinations for fixed line services – primary price terms"

The Draft Decision treats three classes of transactions and events as asset disposals for the purposes of rolling forward the Regulatory Asset Base (**RAB**) for fixed line services:

- assets sold to NBN Co;
- decommissioned assets; and
- assets utilised to a lesser extent.

The Draft Decision proposes to retire from the forecast cost base for Fixed Line Services *"Assets that are decommissioned and an appropriate share of assets that are utilised to a lesser extent, as a result of NBN migration."*[1]

For decommissioned copper cables in non-fibre-to-the-node areas, the Draft Decision treats a proportion of the regulatory value of the copper cables asset class as an asset disposal in each year of the forthcoming regulatory period[2].

To account for an expected under-utilisation of local switching equipment over the next regulatory period, the Draft Decision treats a proportion of the regulatory value of local switching equipment as an asset disposal in each year[3].

This report addresses the requirements of the Letter of Instruction set out at Appendix A of this report.

The sole purpose of this report is to assist Gilbert & Tobin to provide legal advice to Telstra concerning the ACCC's Draft Decision, by addressing the matters set out at Section 1.2 below.

1.2 The matters the Expert has addressed

The Letter of Instruction from Gilbert & Tobin requires the Expert to prepare a report setting out an expert opinion on the following matter:

1. Is the ACCC's approach to asset disposals in the context of a Building Block Model approach to determining required revenue consistent with Accounting Standards?

The methods and approaches that the Expert utilised to prepare his report are described at Section 2**.**

The Expert's opinion is set out at Section 3 of this report.

The factual findings and reasons on which the Expert has based his opinion are set out in Sections 4 to 6 of this report.

[1] Australian Competition and Consumer Commission, Public inquiry into final access determinations for fixed line services – primary price terms Draft Decision, March 2015, p xi.
[2] Ibid.
[3] Ibid.

A glossary of terms used in this report is set out at Appendix B.

The sources of information to which Expert has referred are set out at Appendix C.

1.3 The Expert

The author of the expert opinion set out in this report is:

Keith Lockey
KPMG
147 Collins Street
Melbourne VIC 3000

Keith Lockey's qualifications and experience by which he has gained his specialised knowledge are set out in his CV at Appendix D of this report.

The Expert has read, understood and complied with Practice Note CM7: "Expert witnesses in proceedings in the Federal Court of Australia".

1.4 Warranties and disclaimer

I have made all the enquiries that I believe are desirable and appropriate and no matters of significance that I regard as relevant have, to my knowledge, been withheld from the Court.

The purpose of this report is set out in Section 1.1 and it is not to be used for any other purpose without KPMG's prior written consent.

Accordingly, neither I nor KPMG accept responsibility in any way whatsoever for the use of this report for any purpose other than that for which it has been prepared.

Nothing in this report should be taken to imply that I have verified any information supplied to me, or have in any way carried out an audit of any information supplied to me other than as expressly stated in this report.

The analysis in this report is based on the information set out in this report. I reserve the right to amend any conclusions, if necessary, should any further information become available.

I have been provided with a copy of Federal Court of Australia Practice Note CM7 *Expert Witnesses in Proceedings in the Federal Court of Australia*, which I have read and I agree to be bound by that code of conduct.

Keith Lockey

2 Method and approach

The Expert has addressed the question asked of him by considering the ACCC's accounting treatments for each of three classes of transactions and events:

- assets sold to NBN Co;
- decommissioned assets; and
- assets utilised to a lesser extent

that are described in Sections 4.1 and 4.3**.** of this report and sourced from Section 9.5.2 of the Draft Decision.

The Expert's assumptions concerning these transactions and events are based solely on these sources of information. Consequently:

- if the ACCC has made further assumptions about future events that are not included in the extracts from the Draft Decision referred to at Sections 4.1 and 4.3**.**, then the Expert's opinions could change if any further undisclosed assumptions were to have a bearing on the reasons set out in this report; and
- the Expert has not examined the historic transactions or proposed or actual contractual arrangements for future events. Accordingly, he does not pass an opinion on whether any specific transactions meet the conditions for whether a disposal has taken place. Rather, the opinion in this report is based on the application of principles to assumptions referred to above, concerning the nature of the four classes of transactions and events.

To develop the information necessary to answer the question, the Expert:

- documented in Section 4, his understanding of the ACCC's approach to asset disposals, gained from his reading of the Draft Decision;
- established the relevance of Accounting Standards as an appropriate basis for determining the accounting treatment for asset disposals in the Building Block Model (**BBM**). This reasoning is set out in Section 5; and
- documented in Section 6, the relevant requirements of Accounting Standards, compared the ACCC's approach to guidance provided by Accounting Standards and used that comparison as a basis for answering in Section 3, the question asked of the Expert.

3 The Expert's Opinion

The Expert's opinion on the question posed to the Expert in the Letter of Instruction is set out below, together with reasons for his opinion. Sections 4 to 6 of this report set out the factual findings on which the Expert's opinion is based and further explain the reasons for the Expert's opinion.

The Expert's opinion is based wholly or substantially on the Expert's specialised knowledge.

Question

Is the ACCC's approach to asset disposals in the context of a Building Block Model approach to determining required revenue consistent with Accounting Standards?

Opinion

The Expert's opinion is that:

- the ACCC's treatment of asset sales as disposals is consistent with an expectation that such transactions would normally meet the conditions of paragraph 14 of AASB118. For assets sold to NBN Co the Expert has assumed that but has not confirmed whether, the specific sale transactions meet the conditions of paragraph 14 of Australian Accounting Standard AASB118 (Revenue); and
- the ACCC's classifications of decommissioned assets and assets utilised to a lesser extent, as asset disposals as a consequence of the assets being decommissioned or utilised to a lesser extent, are inconsistent with Accounting Standards. This is because the ACCC's classifications and descriptions provided in the Draft Decision[4] do not provide assumptions that meet the conditions of paragraph 14 of AASB118 that are necessary to account for an asset disposal. Because of this, the Expert's opinion is that it is incorrect to account for the decommissioned assets and assets utilised to a lesser extent, as disposals in a BBM.

Reasons

The Expert has assumed that the assets which are the subject of the three classes of transaction or event meet the definition of "Property, Plant and Equipment" provided by Australian Accounting Standard AASB116 (Property, Plant and Equipment), namely:

> *"Property, plant and equipment are tangible items that:*
>
> *a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and*
> *b) are expected to be used during more than one period."*[5]

AASB116 provides that property, plant and equipment can be de-recognised in the financial statements of an entity through either:

- disposal; or

[4] Australian Competition and Consumer Commission, Public inquiry into final access determinations for fixed line services – primary price terms Draft Decision, March 2015, p xi.
[5] AASB 116, Definitions, p 13.

- when no further economic benefits are expected from it use or disposal.[6]

The Expert has only considered the conditions under which de-recognition by a disposal may occur. These conditions are provided by paragraph 14 of Australian Accounting Standard AASB118 (Revenue), namely that for a disposal to be recognised all of the following conditions must be satisfied.

> a) *the entity has transferred to the buyer the significant risks and rewards of ownership of the item;*
>
> b) *the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the item sold;*
>
> c) *the amount of revenue can be measured reliably;*
>
> d) *it is probable that the economic benefits associated with the transaction will flow to the entity; and*
>
> e) *the costs incurred or to be incurred in respect of the transaction can be measured reliably."*

Paragraph 15 of AASB118 goes on to provide guidance on the transfer of risk and rewards of ownership:

> *"The assessment of when an entity has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales. In other cases, the transfer of risks and rewards of ownership occurs at a different time from the transfer of legal title or the passing of possession."*

Australian Accounting Standard AASB117 (Leases) also provides guidance on the risks and records of asset ownership for the purposes of identifying the party with whom they lie.

> *"Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return because of changing economic conditions. Rewards may be represented by the expectation of profitable operation over the asset's economic life and of gain from appreciation in value or realisation of a residual value."*[7]

Assets sold to NBN Co

A sale transaction is normally associated with all of the conditions of paragraph 14 of AASB118 for a disposal. For example, if Telstra:

- has transferred to NBN Co significant risks and rewards of ownership of the assets;
- no longer has ownership of or effective control over, the assets; and

[6] AASB 116, para 67.
[7] AASB 117, pp 14-16.

- has received a known amount of revenue and can account for corresponding costs of the transaction or transactions

then it would be reasonable for the ACCC to account for sales of assets to NBN Co by Telstra as disposals from Telstra's RAB.

Decommissioned assets and assets utilised to a lesser extent

The Expert is unaware of any assumption or suggestion by the ACCC that a sale transaction will take place and absent that, neither the decommissioning of an asset nor the utilisation of an asset at a lesser capacity require or imply that:

a) Telstra will transfer to a buyer the significant risks and rewards of ownership of the assets; or

b) Telstra will retain neither continuing managerial involvement to the degree usually associated with ownership nor effective control over assets sold.

Paragraph 14 of AASB118 requires that both of these conditions must be fulfilled for a disposal to be recognised.

A decommissioned item of property, plant and equipment may no longer be recognised in an entity's financial statements if it is no longer expected to generate future economic benefits from its use or disposal. However, Section 6.1 explains that a disposal is not necessary for an asset to be de-recognised. Decommissioning and disposal are separate events. Where the conditions of Paragraph 14 of AASB118 are not fulfilled, it would be contrary to Accounting Standards to de-recognise an asset by way of a disposal.

The ACCC indicates that the migration payments received from NBN Co under the Definitive Agreements provide replacement revenues to Telstra and compensate for the underutilisation of local switching equipment[8]. However, the ACCC does not suggest that any sale of local switching equipment will take place or that Telstra will relinquish ownership or the risks or rewards of that equipment. Absent these conditions, there is no basis on which to account for an asset disposal.

The Expert is of the view that Accounting Standards provide the appropriate framework for determining whether a transaction or event constitutes an asset disposal for the purposes of the FLSM. Section 5 of this report details the reasons for this view. Because decommissioned assets and assets utilised to a lesser extent do not fufill the conditions required necessary to account for these events as asset disposals, the Expert's opinion is that it is incorrect to account for these events as disposals in the FLSM BBM.

[8] Ibid, p 140.

4 The accounting treatments adopted by the ACCC

The Expert summarises below his understanding of how the ACCC has treated in Section 9.5.2 of the Draft Decision, certain actual and assumed transactions and events.

4.1 Assets sold to NBN Co

The ACCC's Draft Decision is that assets sold to NBN Co will be treated as asset disposals and removed from the RAB, and that the amount to be removed from the RAB will be based on the regulatory value of those assets[9].

4.2 Decommissioned assets

The ACCC's Draft Decision is that assets that are decommissioned as a result of NBN migration should be removed from the fixed line cost base, and that the amount to be removed should be based on the regulatory value of those assets.

The ACCC considers that copper cables — specifically those in FTTP and HFC areas where they will not form part of the NBN — will be progressively decommissioned as customers are migrated to the NBN. This is because, as the NBN is rolled out in these areas, customers will be disconnected from the copper network and then connected to the NBN via either fibre optic or coaxial cable. The disconnected copper cables would no longer be used to provide declared services.

The ACCC will therefore treat a proportion of the RAB value of the copper cables asset class as an asset disposal in each year, with that proportion being based on the expected rate of FTTP and HFC rollout[10].

4.3 Assets utilised to a lesser extent

In the case of local switching equipment, the ACCC considers that these assets will be utilised progressively less during the upcoming regulatory period. The ACCC's Draft Decision is that adjustments are required to reflect the resulting under-utilisation in the FLSM.

The ACCC considers that local switching equipment will be progressively under-utilised over the upcoming regulatory period, and that this will occur to a large extent as a direct consequence of NBN migration.

The ACCC notes that the migration payments received from NBN Co under the Definitive Agreements provide replacement revenues to Telstra. The progressive disconnection of customers from the fixed line network, for which Telstra will receive migration payments, will contribute to the under-utilisation of local switching equipment and will subsequently lead to higher unit costs for WLR, FOAS/FTAS and LCS than would otherwise be the case.

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[9] ACCC, Public inquiry into final access determinations for fixed line services- primary price terms, Draft decision, March 2015, p 138.
[10] Ibid, p 139.

The ACCC has treated a proportion of the RAB value of the local switching equipment asset class as an asset disposal in each year, with that proportion being based on the expected rate of the overall fixed line NBN rollout[11].

[11] Ibid, pp 139-140.

5 An appropriate accounting framework

5.1 The general requirement for a framework

The Draft Decision has used a BBM, the Fixed Line Services Model (FLSM) to assess the required revenue for Telstra's FLS[12].

The FLSM operates to determine a revenue requirement that comprises the total of the following components of forward looking annual cost assumed to be incurred by Telstra in order to deliver FLS[13]:

- operating expenditure;
- depreciation on a RAB;
- a post tax rate of return on the depreciated value of the RAB; and
- cost of tax.

The value of the RAB is therefore critical to the determination of FLS revenue requirements. The FLSM operates to calculate the value of the RAB for each year within a determination period as follows:

Closing value	=	Opening value
		plus
		Additions at cost
		less
		Disposals[14]
		less
		Depreciation charges

Like any BBM, the FLSM requires accounting rules or a framework to enable the accounting bases of the key inputs to the FLSM to be defined and recognised on a consistent and predictable basis. For the RAB, these inputs include asset disposals.

Without a framework, it would be open to Telstra or the ACCC to develop definitions and recognition policies on ad hoc bases, that may not permit independent attestation of those definitions and recognition policies.

By "accounting framework", the Expert means a set of principles and policies that can be used to determine the accounting treatments and definition of inputs to the FLSM:

- on a mutually consistent basis;
- with reasonable prospective certainty; and
- which an independent party could use to attest to whether the inputs to the FLSM are prepared and presented in accordance that framework.

[12] http://www.accc.gov.au/regulated-infrastructure/communications/fixed-line-services/fixed-line-services-fad-inquiry-2013/draft-decision.
[13] ACCC, Draft Decision, p 6.
[14] The ACCC has stated that the FLSM works by adding the net of additions less disposals. Refer to page 9 of the ACCC's FLSM Operations Manual.

By "mutually consistent", the Expert means that it is necessary for the accounting framework to apply consistent principles and policies to all inputs to the FLSM. For example, it is reasonable to assume that the accounting principles on which the operating expenditure is recognised should be consistent with the accounting principles under which the inputs to the RAB are recognised.

5.2 The ACCC has not specified a relevant accounting framework

The Expert has considered the ACCC's Telecommunications Industry Regulatory Accounting Framework (**RAF** or **RKR**). The objectives of the RKR are to provide[15]:

- a comprehensive regulatory reporting architecture specifying the services which reporting carriers and carriage service providers are required to report against;
- details of the information and financial reports to be provided for each service, particularly the revenues, costs and capital associated with each service;
- principles to be applied by reporting carriers and carriage service providers in developing detailed allocation methodologies in compliance with the Rules;
- details of specific reports on service usage;
- rules that reporting carriers and carriage service providers must follow in developing their manuals;
- specific reporting cycles; and
- the audit and compliance framework for ensuring the integrity of the information provided to the ACCC.

Therefore, it appears reasonable to expect that the recognition of inputs to the FLSM should be consistent with the RKR. However, the Expert did not identify any guidance within the RAF:

- specifically concerning the accounting treatment of asset disposals; or
- on matters of accounting principles or policy more generally that could be applied to determine the accounting treatment of asset disposals.

The Expert:

- is not aware of the ACCC having published any special purpose accounting framework for application to the FLSM;
- notes that the ACCC has documented the operations of the FLSM[16] albeit for a Version 1.2 of the FLSM (the current version used by the ACCC in Draft Decision is v.2.0). This documentation does not extend to providing guidance on the accounting treatments and policies that are to underlie the inputs to the FLSM;
- notes that the "Cover" worksheet within Version 2.0 of the FLSM specifically states that this version of the FLSM was adjusted for:

  "A revised method to account for asset disposals has been included. This is to reflect the ACCC's draft decision on the impacts of the NBN."

  However, the FLSM does not disclose how the adjustment was made and whether there was logic in the FLSM that has been changed to support that comment. The operation of the FLSM deducts a user defined input value for disposals from the

[15] ACCC, Telecommunications Industry Regulatory Accounting Framework (Record-keeping rules), October 2003, p. 7.
[16] ACCC, Final – Fixed Line Services Model version 1.2 – User Manual, 2013.

user defined input value from additions in the "9. RAB Roll-forward" worksheet (rows 159 to 206) to determine a value for net additions; and

- the most recently published ACCC guidance on the FLSM "Final - Fixed Line Services Model version 1.2 – User Manual" (dated 2013) makes references to disposals. The references state that the model deducts the input value for disposals from the input value for additions to determine net additions. There is no guidance provided on whether proceeds of disposal, or the value of the written down assets or the cost of the assets disposed of, should be used in the input values for the model. It states on page 13 for example that "the user must give values for capital additions to and disposals from each asset class in each year" but does not provide a definition or explanation of the accounting basis for a "disposal".

5.3 In the absence of relevant guidance from the ACCC, it is reasonable to refer to Accounting Standards

The Expert considers that in the absence of any special guidance or framework published by the ACCC that governs matters of accounting treatment, it is necessary to refer to Australian Accounting Standards (**Accounting Standards**) to provide an appropriate basis for the recognition of asset disposals for the purposes of the FLSM. The reasons for this view are set out below.

Australian Accounting Standards provide the regulatory framework that governs accounting policies and disclosures in Australian financial reports or statements that are intended to provide a true and fair view of a reporting entity's (e.g. Telstra's) financial performance and position, to general users of those reports or statements.

Australian Accounting Standards are developed and published by the Australian Government's Australian Accounting Standards Board (**AASB**).

Section 296 of the *Corporations Act 2001* requires financial reports to comply with Australian Accounting Standards[17].

Section 297 of the *Corporations Act 2001* requires financial statements and notes to give a true and fair view of a reporting entity's financial performance and financial position.

AASB has published a Framework for the preparation and presentation of financial statements (**AASB Framework**) that explains that it is (and hence Accounting Standards are) concerned with general purpose financial reports. This is reiterated in the "Application" section at the front of individual Accounting Standards.

The AASB Framework emphasises the importance of neutrality in financial reports. For example, it states:

> *"To be reliable, the information contained in financial reports must be neutral, that is, free from bias. Financial reports are not neutral if, by the selection or*

[17] Section 296 allows certain exemptions for small proprietary companies and small companies limited by guarantee. These exemptions do not appear likely to apply to Telstra Corporation.

> *presentation of information, they influence the making of a decision or judgment in order to achieve a predetermined result or outcome."*[18]

The AASB Framework states that:

> *"The objective of financial reports is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions."*[19]

The AASB Framework also explains with specific reference to general purpose financial reports, that:

> *"Such financial reports are prepared and presented at least annually and are directed toward the common information needs of a wide range of users. . . . . Many users, however, have to rely on the financial report as their major source of financial information and such financial reports should, therefore, be prepared and presented with their needs in view."*[20]

The AASB's Glossary of defined terms further supports this explanation. It defines general purpose financial statements as:

> *"Financial statements that are intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs."*[21]

This means that Accounting Standards are required to enable financial statements to meet the needs of a wide variety of users who require financial statements to provide a true and fair view.

The AASB has recognised the range of users whose needs the general purpose financial statements are required to meet, including:[22]

- investors;
- employees;
- lenders;
- suppliers and other trade creditors;
- customers;
- governments and their agencies; and
- the public.

[18] AASB, Framework for the preparation and presentation of financial statements, July 2004, p. 19.
[19] AASB, Framework for the preparation and presentation of financial statements, July 2004, p. 13.
[20] Ibid, p. 11.
[21] AASB, Glossary of defined terms, September 2012, p. 26.
[22] AASB, Framework for the preparation and presentation of financial statements, July 2004, p. 12-13.

In particular, the AASB recognises that general purpose financial statements may need to meet the needs of regulators:

> *"Governments and their agencies are interested in the allocation of resources and, therefore, the activities of entities.* ***They also require information to regulate the activities of entities****. . . ."*[23] (Author's emphasis)

5.4 Regulatory precedents

The Expert has assisted Australian access regulators to develop guidelines that implement reports to regulators of regulated businesses' financial performance, assets and liabilities, since 1995 (for the Office of the Regulator-General Victoria[24]) and most recently, for the Office of the Tasmanian Economic Regulator, 2013[25].

In the Expert's experience, these requirements normally require a regulated business to base its reports on its audited general purpose financial reports, which accord with Corporations Law and Accounting Standards. The regulator typically requires the business to follow accounting policies under Accounting Standards except where the regulator may specify a substitute policy to meet a special purpose of the regulator. This was the case for the two examples that mark the period 1995 to 2013, cited above.

Other examples include the ACCC. The ACCC's Airport prices monitoring and financial reporting guideline states within a broader suite of requirements to report under Accounting Standards, that:

> *"The accounting principles and policies adopted by Airport Operators must comply with Australian Accounting Standards where applicable"*[26]

The Expert's experience includes assisting the ACCC to develop *"Regulatory reporting guidelines for gas pipeline service providers"* (May 2004). The ACCC (and subsequently the AER) chose not to implement this guideline, although it was published for consultation[27]. That Guideline also followed the general approach of requiring the financial reports to the regulator to be based on general purpose financial statements prepared under Accounting Standards.[28]

5.5 Findings

The information set out above in this Section 5 shows that the Accounting Standards have objectives of implementing accounting policies and disclosures that are relevant to providing an impartial, true and fair view of a reporting entity's general purpose reports of its financial performance and position.

While the inputs to FLSM do not comprise a general purpose financial report:

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[23] Ibid.
[24] Office of the Regulator-General, Victoria, Electricity Industry Guideline No 3, Regulatory Accounting Information Requirements.
[25] Office of the Tasmanian Economic Regulator, Water and Sewerage Accounting Ring Fencing Guideline, Version 1.0, 2013.
[26] ACCC, Airport prices monitoring and financial reporting guideline, June 2009, p8
[27] http://www.aer.gov.au/content/index.phtml/itemId/683187
[28] ACCC, Regulatory reporting guidelines for gas pipeline service providers, May 2004, p12.

- the explanations provided in Section 5.3 above demonstrate that where a user of financial information does not or is unable to, require an alternative basis of preparation, it is reasonable to assume that financial inputs prepared and presented under Accounting Standards would meet the needs of a general purpose user for that information to present a true and fair view;
- the Expert assumes that the ACCC shares an objective of a general purpose financial report, of presenting asset disposals on a basis that provides a true and fair view to general purpose users;
- the ACCC has not published guidance that provides a basis alternative to Accounting Standards, for the recognition of asset disposals; and
- there is a body of regulatory precedent that indicates that regulators including the ACCC and Australian Energy Regulator[29], anticipate that financial information reported by access regulated businesses will be reported under Accounting Standards, in the absence of regulatory guidance to the contrary.

On these bases, the Expert is of the view that Accounting Standards provide an appropriate basis for preparing and presenting information on asset disposals for the purposes of the FLSM.

[29] For example see: Australian Energy Regulator, Final Category Analysis Regulatory Information Notice for transmission network service providers, March 2014, p3

6 Relevant Accounting Standards requirements

Section 5 has established that Accounting Standards provide an appropriate basis for determining the accounting treatment of asset disposals for the purposes of the FLSM.

The Expert has referred to the following Accounting Standards for specific guidance.

- *AASB116, Property, Plant and Equipment*; and
- *AASB118, Revenue.*

The Expert has assumed that the equipment subject to those parts of the ACCC 's Draft Decision referred to in Section 4, comprise property, plant and equipment as defined by AASB 116 such that:

> "*Property, plant and equipment* are tangible items that:
>
> a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
> b) are expected to be used during more than one period."[30]

6.1 Derecognition of an asset

Paragraph 67 of AASB 116 goes on to state the conditions under which an item of property, plant and equipment may no longer be recognised in the financial statements of an entity:

> "The carrying amount of an item of property, plant and equipment shall be derecognised:
>
> a) on disposal; or
> b) when no future economic benefits are expected from its use or disposal."

Accordingly, an asset that has not been disposed of but is expected to deliver reduced future economic benefits may still be recognised in an entity's financial statements, but potentially at a lower value.

Paragraph 14 of AASB118 provides the criteria that are used to recognise when the sale of goods takes place and in turn whether an item of property, plant and equipment under AASB 116 has been disposed of:

> "Revenue from the sale of goods shall be recognised when **all** (author's emphasis) the following conditions have been satisfied:
>
> a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;
>
> b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
>
> c) the amount of revenue can be measured reliably;

[30] AASB 116, Definitions, p 13.

d) it is probable that the economic benefits associated with the transaction will flow to the entity; and

e) the costs incurred or to be incurred in respect of the transaction can be measured reliably."

Paragraph 15 of AASB118 goes on to provide guidance on the transfer of risk and rewards of ownership:

> *"The assessment of when an entity has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales. In other cases, the transfer of risks and rewards of ownership occurs at a different time from the transfer of legal title or the passing of possession."*

6.2 Accounting treatment of a disposal

When a disposal is recognised, the questions of whether a gain or loss on disposal arises and if so, how it should be accounted for.

Guidance on these matters is provided by paragraph 71 of AASB 116 which states:

> "The gain or loss arising from the derecognition of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item."

7 Expert's statement

Keith Lockey has made all the inquiries that Keith Lockey believes are desirable and appropriate and that no matters of significance that Keith Lockey regards as relevant have, to Keith Lockey's knowledge, been withheld from the Court.

Appendix A: Letter of instruction from Gilbert & Tobin Lawyers

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29 April 2015

By email

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Confidential and privileged

Dear Mr Lockey

ACCC review of prices for declared fixed line services

We act for Telstra Corporation Ltd (**Telstra**) are currently advising Telstra in relation to a review of pricing for declared fixed-line services.

Background

As previously discussed with you, the Australian Competition and Consumer Commission (**ACCC**) is currently conducting a review of pricing for Telstra's declared fixed-line services (the Unconditioned Local Loop Service (**ULLS**), Line Sharing Service (**LSS**), Wholesale Line Rental (**WLR**), Local Carriage Service (**LCS**), PSTN Originating and Terminating Access (**PSTN OTA**), and Wholesale ADSL). At the conclusion of this inquiry the ACCC will publish final access determinations (**FADs**) for each of these services which will include (among other things) revised service prices.

Each of the current FADs contain fixed principles provisions, which must be maintained in any replacement FAD, at least until their nominal expiry date. Among the fixed principles set out in the current FADs is the following in relation to roll forward of the regulatory asset base (**RAB**):

> *The RAB is to be rolled forward each year according to the formula below:*
>
> $RAB_{t+1} = RAB_t + capex_t - depreciation_t - asset\ disposals_t$
>
> *where*
>
> RAB_{t+1} *= opening RAB for the next regulatory year*
>
> RAB_t *= opening RAB for the current year*
>
> $capex_t$ *= forecast capital expenditure during the current year*
>
> $depreciation_t$ *= regulatory depreciation during the current year*
>
> $asset\ disposals_t$ *= asset disposals during the current year*

(**FAD Allocation Fixed Principles**).

GILBERT TOBIN LAWYERS

On 11 March 2015, the ACCC published a draft decision on revised service prices for the declared fixed line services (**Draft Decision**).

In the Draft Decision, the ACCC treats three classes of asset as 'asset disposals', for the purposes of rolling forward the RAB:

- assets sold to NBN Co
- assets that are not sold, but which are expected to be decommissioned; and
- certain assets that are expected to be utilised to a lesser extent.

For decommissioned copper cables in non-fibre-to-the-node areas, the Draft Decision treats a proportion of the regulatory value of the copper cables asset class as an asset disposal in each year of the forthcoming regulatory period.

To account for an expected under-utilisation of local switching equipment over the next regulatory period, the Draft Decision treats a proportion of the regulatory value of local switching equipment as an asset disposal in each year.

Scope of work

We would like you to review the Draft Decision, and prepare a report setting out your expert opinion on the following matter:

> *Is the ACCC's approach to asset disposals in the context of a Building Block Model approach to determining required revenue consistent with Accounting Standards?*

Guidelines for preparing your report

The Guidelines for Expert Witness in the Federal Court of Australia are attached to this letter. Telstra is seeking a rigorously prepared independent view which may be used in the context of regulatory decision making and in any subsequent review of the ACCC's final decision. Therefore you are requested to follow the Guidelines to the extent reasonably possible.

In particular, as part of any report please:

(a) identify your relevant area of expertise and provide a curriculum vitae setting out the details of that expertise;

(b) only address matters that are within your expertise;

(c) where you have used factual or data inputs please identify those inputs and the sources;

(d) if you make assumptions, please identify them as such and confirm that they are in your opinion reasonable assumptions to make;

(e) if you undertake empirical work, please identify and explain the methods used by you in a manner that is accessible to a person not expert in your field;

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(f) confirm that you have made all the inquiries that you believe are desirable and appropriate and that no matters of significance that you regard as relevant have, to your knowledge, been withheld from your report; and

(g) please do not provide legal advocacy or argument and please do not use an argumentative tone.

Timing

We require a final report by 30 April 2015.

If you have any questions, please do not hesitate to contact us.

Yours sincerely

Gilbert + Tobin

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Attachment: Federal Court guidelines for expert witnesses

Practice Note CM 7: Expert witnesses in proceedings in the Federal Court of Australia

Guidelines

1. General Duty to the Court[1]

1.1 An expert witness has an overriding duty to assist the Court on matters relevant to the expert's area of expertise.

1.2 An expert witness is not an advocate for a party even when giving testimony that is necessarily evaluative rather than inferential.

1.3 An expert witness's paramount duty is to the Court and not to the person retaining the expert.

2. The Form of the Expert's Report[2]

2.1 An expert's written report must comply with Rule 23.13 and therefore must

(a) be signed by the expert who prepared the report; and

(b) contain an acknowledgement at the beginning of the report that the expert has read, understood and complied with the Practice Note; and

(c) contain particulars of the training, study or experience by which the expert has acquired specialised knowledge; and

(d) identify the questions that the expert was asked to address; and

(e) set out separately each of the factual findings or assumptions on which the expert's opinion is based; and

(f) set out separately from the factual findings or assumptions each of the expert's opinions; and

(g) set out the reasons for each of the expert's opinions; and

(ga) contain an acknowledgment that the expert's opinions are based wholly or substantially on the specialised knowledge mentioned in paragraph (c) above[3]; and

(h) comply with the Practice Note.

2.2 At the end of the report the expert should declare that "[the expert] has made all the inquiries that [the expert] believes are desirable and appropriate and that no matters of significance that [the expert] regards as relevant have, to [the expert's] knowledge, been withheld from the Court."

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[1] The "*Ikarian Reefer*" (1993) 20 FSR 563 at 565-566.
[2] Rule 23.13.
[3] See also *Dasreef Pty Limited v Nawaf Hawchar* [2011] HCA 21.

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2.3 There should be included in or attached to the report the documents and other materials that the expert has been instructed to consider.

2.4 If, after exchange of reports or at any other stage, an expert witness changes the expert's opinion, having read another expert's report or for any other reason, the change should be communicated as soon as practicable (through the party's lawyers) to each party to whom the expert witness's report has been provided and, when appropriate, to the Court[4].

2.5 If an expert's opinion is not fully researched because the expert considers that insufficient data are available, or for any other reason, this must be stated with an indication that the opinion is no more than a provisional one. Where an expert witness who has prepared a report believes that it may be incomplete or inaccurate without some qualification, that qualification must be stated in the report.

2.6 The expert should make it clear if a particular question or issue falls outside the relevant field of expertise.

2.7 Where an expert's report refers to photographs, plans, calculations, analyses, measurements, survey reports or other extrinsic matter, these must be provided to the opposite party at the same time as the exchange of reports[5].

3. Experts' Conference

3.1 If experts retained by the parties meet at the direction of the Court, it would be improper for an expert to be given, or to accept, instructions not to reach agreement. If, at a meeting directed by the Court, the experts cannot reach agreement about matters of expert opinion, they should specify their reasons for being unable to do so.

J L B ALLSOP
Chief Justice
4 June 2013

[4] The *"Ikarian Reefer"* [1993] 20 FSR 563 at 565

[5] The *"Ikarian Reefer"* [1993] 20 FSR 563 at 565-566. See also Ormrod *"Scientific Evidence in Court"* [1968] Crim LR 240

Appendix B: Glossary of terms

AASB	Australian Government Accounting Standards Board
ACCC	Australian Competition and Consumer Commission
Accounting Standards	Australian Accounting Standards
BBM	Building Block Model
FLS	Fixed Line Services
FLSM	Fixed Line Services Model
GL	General Ledger
NBN	National Broadband Network
NECM	Network Electricity (or Energy) Consumption Model
RAB	Regulatory Asset Base
RAF	The ACCC's Telecommunications Industry Regulatory Accounting Framework
RKR	The ACCC's Telecommunications Industry Regulatory Accounting Framework (record-keeping rules)

Appendix C: References

AASB, Framework for the preparation and presentation of financial statements, July 2004

AASB116, Property, Plant and Equipment, August 2014

AASB 117, Leases, September 2012

AASB118, Revenue, July 2014

ACCC, Airport prices monitoring and financial reporting guideline, June 2009

ACCC Fixed Line Services Model version 2.0 (Draft) – Public Version.xlsx

ACCC, Final – Fixed Line Services Model version 1.2 – User Manual, 2013

ACCC, Regulatory reporting guidelines for gas pipeline service providers, May 2004

ACCC, Telecommunications Industry Regulatory Accounting Framework (Record-keeping rules), October 2003

ACCC, Public inquiry into final access determinations for fixed line services- primary price terms, Draft decision, March 2015

Australian Energy Regulator, Final Category Analysis Regulatory Information Notice for transmission network service providers, March 2014

Office of the Regulator-General, Victoria, Electricity Industry Guideline No 3, Regulatory Accounting Information Requirements, Issue 1, 1995

Office of the Tasmanian Economic Regulator, Water and Sewerage Accounting Ring Fencing Guideline, Version 1.0, 2013

Telstra media release, 'Telstra signs NBN Definitive Agreements', 23 June 2011.

Telstra media release, 'Telstra signs revised NBN Definitive Agreements', 14 December 2014.

Appendix D: Curriculum Vitae

Keith Lockey
Director
KPMG
147 Collins Street
Melbourne VIC 3000

Certifications & Professional Memberships

- BSc (Hons) (Environmental Sciences), University of Lancaster
- Institute of Chartered Accountants in England and Wales

Profile/Overview

Keith has 32 years' experience as a chartered accountant and co-leads KPMG's infrastructure, pricing and economic regulation team. He specialises in advising governments, utilities and other economically regulated industries on matters of industry reform, economic regulation and pricing and funding arrangements. Keith has expertise in undertaking financial analyses and costing to inform the determination of regulated prices and revenues. He has worked almost exclusively in this area since 1995. Prior to then, Keith provided audit and accounting services to a wide range of KPMG clients.

Experience – examples

Legal advisors to ATCO Gas Australia – Expert report on efficient costs – Keith wrote an expert report that used benchmarking to examine the efficiency of corporate support costs and inter-company charges forecast in an access arrangement revision for the MWSW Gas Distribution System and compared forecast costs to historic levels of expenditure.

Electricity Distribution Network Service provider (DNSP) – Cost Allocation Method (CAM) – Keith assisted a DNSP to draft and gain regulatory approval of a revised CAM prior to the submission of its regulatory proposal and the publication by the Australian Regulator of a framework and approach to the DNSP's revenue determination.

Legal advisors to Telstra Corporation – Key principles underlying regulatory cost allocations. Keith drafted an expert report on the principles and precedents that underpin cost allocation approaches for regulatory purposes in Australia.

Legal advisors to Telstra Corporation – Review of Telstra's cost allocation methodology. Keith provided expert opinions on the consistency of Telstra's models for allocating costs to declared fixed line services with generally accepted regulatory and cost allocation principles.

Legal advisors to Telstra Corporation - Fixed Line Services pricing Model (FLSM). Keith was the joint author of an expert report on the operation integrity and fitness for purpose of the ACCC's FLSM.

Major Australian telecommunications service provider: Regulatory imputation test – Keith carried out a regulatory imputation test to assess whether charges for third party mobile network access were sufficient to facilitate retail competition. This involved examining cost reports prepared in accordance with regulatory accounting separation requirements, to determine and report on, the relevant costs of service.

Australian Energy Regulator – Review of Cost Allocation Methods (CAMs). Keith assisted the AER to review the CAMS of a number of businesses for compliance with the requirements of the National Electricity Rules and the AER's guidance, and to advise the AER on possible future directions for its accounting separation requirements in the electricity sector.

Energy Networks Association - Economic benchmarking RIN- Keith assisted the ENA draft and explain to the AER, its submission on the AER's draft economic benchmarking RIN, highlighting and making recommendations to address, a range of practical and conceptual difficulties in the AER's draft.

Office of the Tasmanian Economic Regulator. Keith advised the regulator on the development of a regulatory accounting guideline and reporting templates for the water industry.

Australian Energy Regulator –Accounting for provisions Keith advised on the generally accepted principles and Accounting Standards requirements for accounting for provisions

Queensland Competition Authority – Water business price monitoring. Keith led a team that developed templates to collect financial information to assist the QCA with monitoring price and a financial model for analysing that information in accordance with building block principles.

Office of the Tasmanian Energy Regulator: Redesign and simplification of regulatory accounting requirements - Regulatory developments and modifications to the templates led to the need to review Tasmania's regulatory accounting requirements for the electricity distribution industry.

Allgas: Assistance with compliance with regulatory accounting requirements - Keith helped this gas network operator to develop reporting procedures to help demonstrate compliance with regulatory accounting requirements.

Electricity Transmission Network Owners Forum (ETNOF): Transmission cost allocation guidelines 2007 - Keith carried out an engagement for ETNOF (which represents all the principal Australian Electricity Transmission Businesses) to review draft Cost Allocation Guidelines published by the Australian Energy Regulator.

Transend Networks Ltd: AER Cost Allocation Methodology Manual (2007 and 2008) - Keith led a KPMG team that drafted a "Cost Allocation Methodology" required by the Australian Energy Regulator, to demonstrate the allocation of costs between different transmission services in accordance with the National Electricity Rules. KPMG also drafted an accompanying cost allocation and regulatory reporting procedures and process manual to assist Transend.

Transend Networks Ltd: Allocation of shared costs to unregulated business activities – Keith advised on the consistency of an allocation approach developed by Transend with good business practice and regulatory requirements.

Queensland electricity network businesses: Electricity industry regulatory accounting guidelines - Keith was engaged by industry to assess the Queensland Competition Authority's Guidelines published as part of the 2005 Price Determination. .

Australian Competition and Consumer Commission: Record Keeping Rules - Keith reviewed draft accounting separation and cost allocation rules (regulatory accounting requirements) for the postal industry drafted by the ACCC and provided a range of suggestions and advice to improve their workability.

Australian Competition and Consumer Commission: Accounting Ring Fencing Guidelines for Gas Transmission Businesses - The Commission engaged Keith to review a jurisdictional regulator's guideline as a basis for accounting ring fencing for gas transmission pipeline service providers, under the Gas Code. Keith was then engaged to draft a guideline. This was designed to allow service providers to meet the Commission's objective of demonstrating compliance with the National Gas Code, while following generally accepted accounting principles and seeking to minimise the regulatory burden for both service providers and the Commission.

Major New Zealand gas distribution and transmission business: Advice on regulatory accounting requirements - Keith assisted a major gas network business to comply with the New Zealand Commerce Commission's Avoided Cost Accounting Method ("ACAM") for regulatory financial reporting.

Department of Infrastructure, Victoria: Development of accounting information reporting requirements for public transport franchisees - Keith was engaged by the Victorian government throughout 2002 and 2003 to identify financial and performance reporting requirements for monitoring and assessing the profit levels of Victoria's public transport franchisees. The outputs of this work included developing and consulting with franchisees on an information requirements guideline.

Transgrid – Negotiated Services Pricing – Keith led a team that developed a model that enabled prices to be calculated on the basis of both standalone and incremental allocations of cost, in accordance with the National Electricity Rules.

Northern Territory Power and Water Corporation: Development of an industry based cost ring fencing guideline - Keith developed a "self-regulating" cost ring fencing guideline n.

Office of the Tasmanian Electricity Regulator: Electricity Industry Regulatory Accounting Guidelines - In consultation with regulatees and with regard to the ACCC's proposals for transmission pricing, Keith developed the regulator's original regulatory accounting guidelines for distribution and transmission businesses.

Electricity network businesses throughout Australia: Review of regulatory accounting submission - Keith has been engaged by different electricity networks to review regulatory accounts for compliance with regulatory requirements, prior to submission.

Australian Competition and Consumer Commission: Review of Electricity Transmission Business Co Regulatory Information Guidelines - Keith reviewed and provided constructive advice to the ACCC on proposed regulatory information guidelines to help it achieve its objectives in a practical, workable way aiming to minimise the information burden on business. Subsequently a small team led by Keith drafted revised Guidelines.

Office of Regulator-General, Victoria ("ORG"): Regulatory management secondment - Shortly after its establishment, Keith was seconded to the ORG for 15 months to: manage and implement the process of acquiring and analyzing regulatory accounts from electricity distribution businesses. This included drafting Issues 1 and 2 of the regulator's cost allocation and regulatory accounting guideline.

Australian Competition and Consumer Commission - Keith organised and participated as a key speaker at a one-day workshop held with the ACCC on regulatory accounting, that explored both issues of principle and practice.

Legal advisors to MurrayLink - benchmarking of efficient forecast business costs - Keith has provided independent expert advice on issues of cost efficiency and allocation key to cost recovery.

CitiPower and Powercor – Independent expert reports on the efficiency of shared costs. Keith authored reports that assessed whether the costs of shared network operating services attributed to each network were prudent and efficient.

Assessment of potential for cross-subsidies in a vertically integrated energy utility - Keith undertook a study that reviewed the potential for economic cross- subsidies both within the utility and with other parties to assist with planning disaggregation options.

Power and Water Authority: Assessment of cost allocations and the bases of CSO payments for electricity supply - Keith advised on appropriate responses to government guidelines on and a regulator's review of, these issues.

Legal advisors the Goldfields Gas Pipeline and the Victorian Gas Transmission System - benchmarking of efficient forecast business costs - Keith provided independent expert advice on issues of cost efficiency and allocation key to access arrangement revisions.

National Transport Commission – Forward Looking Cost Base Discussion Paper – Keith wrote and presented a paper that examined the potential characteristics of how a forward looking cost base could be applied to determine charges for the use of the roads network by heavy vehicles.

Water Utility – Cost allocation and capitalisation. Keith led a small team that developed options for QUU to refine and redevelop its cost allocation and capitalization policies to better meet a range of regulatory, financial reporting and operational objectives.

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