Aurizon Network - Review of UT5
Operating Expenditure
Queensland Competition Authority
24-Aug-2018

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AECOM Supplementary Report

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Client: Queensland Competition Authority

ABN: 43 812 633 965

Prepared by

AECOM Australia Pty Ltd
Level 8, 540 Wickham Street, PO Box 1307, Fortitude Valley QLD 4006, Australia
T +61 7 3553 2000 F +61 7 3553 2050 www.aecom.com
ABN 20 093 846 925

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Reviewed by	Mike Stoke

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Rev	Revision Date	Details	Authorised	
			Name/Position	Signature
0	02-Jul-2018	Draft	Jakob Dillon Project Manager	
Draft Final	20-Jul-2018	Draft Final	Mike Stoke Technical Director - Commercial Advisory	
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1.0 Introduction

Aurizon Network submitted a draft access undertaking (‘2017 DAU’) on 30 November 2016 for the regulatory period from 1 July 2017 to 30 June 2021 (the UT5 period) for consideration by the QCA under Part 5 of the QCA Act. A critical aspect of the 2017 DAU is the maximum allowable revenue (MAR) used to derive reference tariffs for coal-carrying train services, of which operating expenditure is a key component.

In September 2017, AECOM submitted a final version of our Review of UT5 Operating Expenditure report, which was published alongside the QCA’s draft decision on the 2017 DAU in December 2017.

The QCA requested preparation of this supplementary report in response to Aurizon Network’s submission on the draft decision dated 12 March 2018. We have undertaken a desktop review of documents submitted to the QCA, and requested additional information from Aurizon Network where necessary.

This document provides the findings and conclusions of that review, and addresses issues as requested by the QCA, and is arranged following the approach used in our original report. Unless otherwise noted, all costs are presented in 2015-16 dollars.

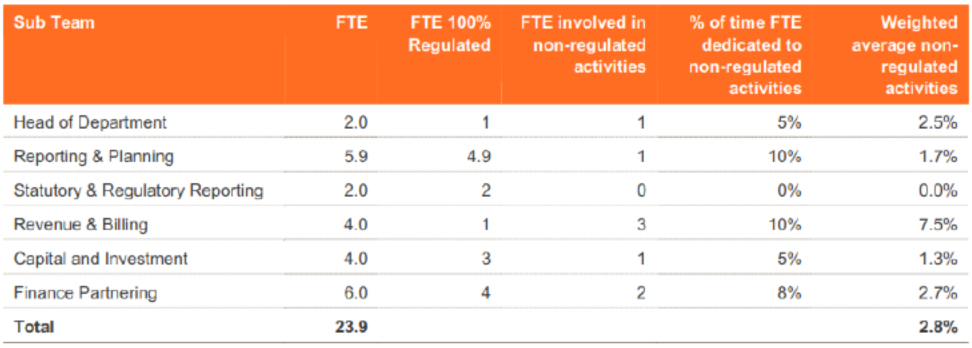
We acknowledge that Aurizon Network has been responsive and helpful throughout this process.

2.0 System Wide and Regional costs

2.1 Allocators

2.1.1 Business Management: Network Finance allocation

Functional Area	Business Management
Name	Network Finance allocation
Description	Network Finance is responsible for billing, budgets, forecasting and preparing financial and statutory reports for Aurizon Network.
Findings in AECOM Final Report	Accept shift to Business Management. Reject 100% allocation. Allocate costs at 90%, which is consistent with other business management function areas.
QCA Draft Decision	*"The QCA agrees with AECOM's assessment and considers that the re-categorisation of these costs from overheads to direct costs is reasonable, given that these functional areas perform activities almost solely for Aurizon Network."* – QCA Draft Decision, p199
Aurizon Network Response to the Draft Decision	*"We note that the QCA did not accept our cost allocation proposal to allocate 100% of Network Finance costs as direct costs to below rail services. While the QCA noted that the Network Finance team would be predominantly involved in matters directly related to the provision of below-rail services, it considered a revised allocation of 90%, consistent with the allocation applied in the UT4 outcome, to be reasonable. The QCA's consultant (AECOM) formed the view that the Network Finance team was responsible for a number of financial functions across the whole Aurizon Network business, and that in the absence of timesheets that record time spent on various activities, it considered it likely that some portion of Aurizon Network's activities would relate to non-regulated activities.* *Aurizon Network's UT5 proposal allocated 100% of Network Finance costs on the basis that the corporate overhead allowance excluded an allocation of costs relating to the Aurizon Group Accounting, Planning & Reporting team regardless of the work undertaken by that team on behalf of Aurizon Network.* *Aurizon Network acknowledges that an allocation of costs from the Group Accounting team would be difficult to quantify however the amount would be significantly more than 10% of the Network Finance team's costs hence why the 0% deduction was proposed by Aurizon Network.* *By applying the 10% deduction to the Network Finance team, the QCA' is implying that 2.4 FTE are 100% dedicated to non-regulated activities, which is an unreasonable inference.* *Aurizon Network also notes that the AECOM statement mentioned by the QCA in the Draft Decision is not a useful point of reference since the Costing Manual was updated and approved in October 2016 to align to the UT4 Final Decision. Therefore it is not the reduction that Aurizon Network contends is representative of the time/cost devoted to non-regulated activities, it is just stating what was imposed by the QCA from the UT4 Final Decision.* *A review of the Network Finance team has been undertaken which identified those individuals involved in non-regulated activities and then apportioned their time spent between regulated and non-regulated activities.* *The outcome of this assessment is presented in the table below.*

<table>
<tr><td></td><td>
<table>
<tr><th>Sub Team</th><th>FTE</th><th>FTE 100% Regulated</th><th>FTE involved in non-regulated activities</th><th>% of time FTE dedicated to non-regulated activities</th><th>Weighted average non-regulated activities</th></tr>
<tr><td>Head of Department</td><td>2.0</td><td>1</td><td>1</td><td>5%</td><td>2.5%</td></tr>
<tr><td>Reporting & Planning</td><td>5.9</td><td>4.9</td><td>1</td><td>10%</td><td>1.7%</td></tr>
<tr><td>Statutory & Regulatory Reporting</td><td>2.0</td><td>2</td><td>0</td><td>0%</td><td>0.0%</td></tr>
<tr><td>Revenue & Billing</td><td>4.0</td><td>1</td><td>3</td><td>10%</td><td>7.5%</td></tr>
<tr><td>Capital and Investment</td><td>4.0</td><td>3</td><td>1</td><td>5%</td><td>1.3%</td></tr>
<tr><td>Finance Partnering</td><td>6.0</td><td>4</td><td>2</td><td>8%</td><td>2.7%</td></tr>
<tr><td>Total</td><td>23.9</td><td></td><td></td><td></td><td>2.8%</td></tr>
</table>
<i>Therefore, the non-regulated deduction proposed by Aurizon Network is 2.8% based on the weighted average of FTE identified as being involved in non-regulated activities”</i> – Aurizon Network Response to QCA Draft Decision, p162-163.</td></tr>
<tr><td></td><td>Aurizon Proposal: Increase cost allocation to 97.2% (with 2.8% allocated to non-regulated activities)</td></tr>
<tr><td>AECOM Recommendation</td><td>Accept
Increase cost allocation to regulated activities to 97.2%</td></tr>
<tr><td>AECOM’s Rationale</td><td>Aurizon Network has proposed an alternative approach to calculating the allocator for Network Finance costs to the regulated service. The proposed methodology is based on the ratio of time spent between regulated and non-regulated activities. We consider that this is a reasonable method of calculating the allocator that reflects a stronger causal driver of costs than the previously proposed revenue allocator.
While we agree with the approach, we note that Aurizon Network has not provided their means of determining the time spent on regulated and non-regulated tasks. Aurizon Network note that ‘<i>a review of the Network Finance team has been undertaken which identified those individuals involved in non-regulated activities and then apportioned their time spent between regulated and non-regulated activities.’</i> The rigour of this review is unclear, and supporting timesheet evidence has not been sighted. However, based on the information that has been made available, we consider the approach to be reasonable and representative of a stronger causal driver of costs than that the allocation method originally proposed. We recommend that the QCA request that stronger evidence to support the allocation is provided in the next (UT6) review.</td></tr>
<tr><td>Documents Reviewed</td><td>• Aurizon Network UT5 Operating Expenditure Submission
• Aurizon Network Financial Reports FY15, FY16, FY17
• Aurizon Group Financial Reports FY15, FY16, FY17
• Aurizon Network Below Rail Financial Reports
• Aurizon Group FY17 Investor Presentation
• Aurizon Network Response to QCA Draft Decision</td></tr>
</table>

2.1.2 Network Control, Safe Working and Operations: Network Train Operations

Functional Area	Network Control, Safe Working and Operations
Name	Network Train Operations
Description	Network Train Operations are responsible for day of operations activities, including execution of scheduled train services and asset activity (yards/maintenance) and coordination of emergency response and recovery efforts where applicable. According to Aurizon Network’s submission, network controllers are also

	responsible for coordinating the movement of non-coal (freight and passenger) services within the CQCN. This is incorporated into the existing workload of network controllers, that is, no dedicated resources are required to facilitate non-coal services, and if they ceased to operate, no cost savings would be realised. Historically, Aurizon Network has allocated a portion of Network Control Centre costs to the non-coal services.
Findings in AECOM Final Report	Reject increase of regulated cost allocation from 91% to 98%; representing a non-coal cost allocation of 2% (previously 9%). Adjust coal allocation to 88% based on train km.
QCA Draft Decision	"*The QCA maintains that a deduction based on the proportion of non-coal train kilometres is more likely to reflect the resources used by Aurizon Network in providing train control services to non-coal train operators, given these costs are a function of scheduling and the time spent on the track.* *The QCA considers a reasonable deduction should consider the most recent information regarding the split between coal and non-coal train kilometres. Based on train kilometres observed in 2015–16, the QCA concludes that a deduction of 12 per cent should apply to Aurizon Network's Network Train Operations costs to reflect non-coal traffic, resulting in the recovery of 88 per cent of these costs from reference tariffs for coal-carrying trains.*" – QCA Draft Decision, p204.
Aurizon Network Response to the Draft Decision	*"We note that the QCA did not accept our proposal for a 2% cost allocation to non-coal carrying services for Network Train Operations and instead proposed an allocation of 12% based on train kilometres.* *Aurizon Network maintains its position as set out in its 2017 DAU submission that there is significantly less effort required in managing non-coal traffic compared to coal traffic. Aurizon Network also notes that the QCA's non-coal carrying train kilometre % allocation was incorrectly calculated. We therefore do not support the QCA's proposal to allocate 12% of below-rail costs to non-coal traffic.* *Aurizon Network subsequently gathered further evidence to calculate the allocation of costs to non-coal traffic based on both scheduling and time spent on track given the QCA deemed train kilometres were a function of scheduling and time spent on the track.* *Aurizon Network is proposing to use the average over a four year period to avoid any bias that would otherwise be inherent in selecting a single year. Aurizon Network notes that the 2016-17 year was significantly impacted by Tropical Cyclone Debbie making it an anomalous year and the only year that hasn't seen a decline in the non-coal service as a percentage of the total services.* *If, however, the QCA is not minded to approve a cost allocation to non-coal traffic of 4.9%, as supported by the data above, then it is prudent in our view that the QCA correctly calculates the deduction based on their train kilometre methodology. Aurizon Network has identified the following issues of concern with the QCA's calculation:* • *non-coal train kilometres used by the QCA referred to non-coal 'billed' kilometres which included other items by default (e.g. maintenance services) for which Aurizon Network earns no revenue but are critical to the operation of the CQCN;* • *non-coal kilometres includes repositioning or transit services for coal trains; and* • *coal train kilometre figures provided to the QCA for cross-system hauls were being reported in both systems and are therefore double counted.* *The outcome of the revised calculations, based on the QCA's preferred methodology, and an average over the four-year period 2013-14 to 2016-17,*

results in a 7.5% non-coal allocation. Aurizon Network again notes that the 2016-17 year was significantly impacted by Tropical Cyclone Debbie making it an anomalous year and the only year that has not seen a decline in the non-coal train kilometres as a percentage of the total train kilometres." – Aurizon Network Response to QCA Draft Decision, p159-161

95.1% using time spent on track approach (4.9% non-coal allocation)

OR

92.5% using train km approach (7.5% non-coal allocation)

AECOM Recommendation

Partially accept

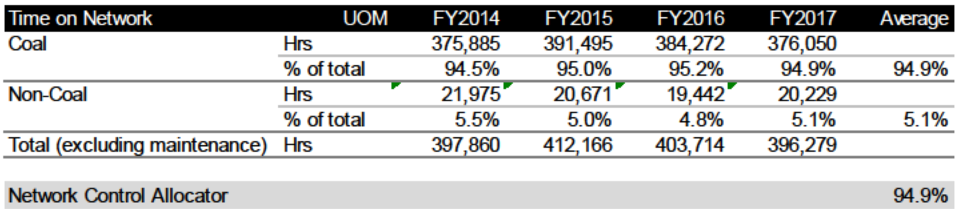
- Accept revised allocator calculation method of 'time spent on track'
- Adjust allocation to 94.9% (5.1% non-coal allocation), excluding maintenance trains

AECOM's Rationale

Following the QCA's comment that '*these costs are a function of scheduling and the time spent on the track,'* Aurizon Network has proposed an alternative approach to calculating the allocation between coal and non-coal services, using time spent on track.

We appreciate that Aurizon Network has attempted to deliver an allocation method that directly addresses the QCA's comment, and consider that time spent on track is a reasonable metric for determining this allocation. Aurizon Network has provided additional information in their submission regarding the calculation of time spent on track for the past four financial years, and proposes to use an average of these four years. As there do not appear to be any significant outliers, we consider this approach to be reasonable. We note that Aurizon Network has provided additional information regarding the calculation of time spent on track attributed to both coal and non-coal services. We agree with Aurizon Network that maintenance trains are critical to the operation of the CQCN and should not be considered 'non-coal' services only. However, Aurizon Network has proposed to include maintenance trains in the denominator of the new allocator calculation, which has reduced the non-coal allocation. We contend that maintenance trains are necessary for the operation of the whole network and that maintenance activities apply to both coal and non-coal services.

We therefore propose a small change in the calculation whereby the maintenance trains are removed from the denominator. This results in a small change in the time spent on track allocator from 95.1% to 94.9%.



Time on Network	UOM	FY2014	FY2015	FY2016	FY2017	Average
Coal	Hrs	375,885	391,495	384,272	376,050	
	% of total	94.5%	95.0%	95.2%	94.9%	94.9%
Non-Coal	Hrs	21,975	20,671	19,442	20,229	
	% of total	5.5%	5.0%	4.8%	5.1%	5.1%
Total (excluding maintenance)	Hrs	397,860	412,166	403,714	396,279	
Network Control Allocator						94.9%

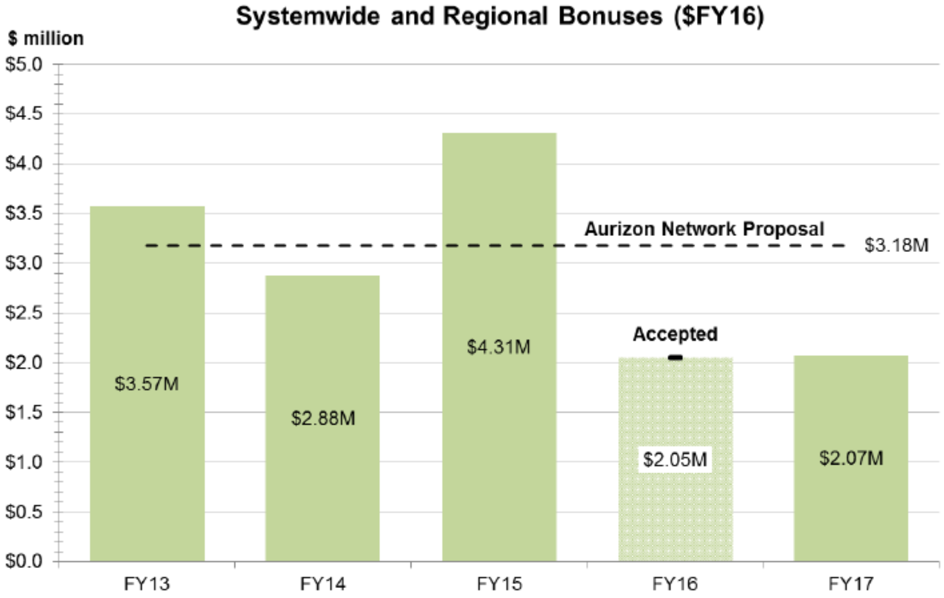
Reviewed

- Historical metrics FY12 to FY16 by OD (with TKM)
- Copy of Historical metrics non coal FY12-16 (with TKM split)
- Aurizon Network Response to QCA Draft Decision
- Hunter Valley Coal Network Access Undertaking Costing Manual July 2016

2.2 Base Year Adjustments

2.2.1 Bonuses

Name	Bonus Adjustment – System-wide and Regional Costs
Findings in AECOM Final Report	FY16 bonuses used.
QCA Draft Decision	*"…we do not accept Aurizon Network's proposal to adjust the 2015–16 base year cost to include 2014–15 cash bonus costs. A review of Aurizon Network's recent bonus expenses reveals that costs incurred in 2014–15 were around 60 per cent higher than those incurred in 2013–14, and around 110 per cent higher than those in 2015–16. In our view, cash bonus costs incurred in 2014–15 were anomalous. The QCA is not convinced that 2014–15 cash bonus costs are a better estimate of a reasonable level of these costs over the UT5 period. As such, we have excluded Aurizon Network's proposed adjustment and retained cash bonus amounts at the level revealed in the 2015–16 base year costs."* – QCA Draft Decision, p195
Aurizon Network Response to the Draft Decision	*"Aurizon Network prepared its UT5 proposal using 2014-15 actual costs as the base year and provided the 2015-16 information as it became available during the QCA's assessment. When providing the 2015-16 information, Aurizon Network made an adjustment of $2.4m for employee cash bonuses to reflect bonuses paid in 2014-15. The QCA did not accept the proposed adjustment stating that 'a review of the Aurizon Network's recent bonus expenses reveals that cost incurred in 2014-15 were around 60 per cent higher than those incurred in 2013-14, and around 110 per cent higher than those in 2015-16.' Aurizon Network acknowledges that moving to a revised position is warranted given the QCA acknowledged that bonuses in 2015-16 were unusually low.* *Whilst Aurizon Network is willing to agree that the bonuses paid in 2014-15 were high (compared to prior years), it is clear from our and the QCA's own analysis that the 2015-16 bonuses were anomalous and should not be considered an appropriate base line for future expense. Aurizon Network also notes that the 2015-16 cash bonuses were heavily impacted by one-off significant adjustments totalling $528m made at an Aurizon Holdings group level including the write off of strategic projects and asset impairments, the majority of which do not relate to the Aurizon Network business.* *Aurizon Network has reviewed the cash bonus expense for 2012-13 to 2015-16 and determined the average expense over the four year period. We consider that this average expense should be included in the 2015-16 base year as it minimises the impact of significant one-off adjustments. The resulting revised adjustment to the 2015-16 base year is estimated at $1.1m across the system wide and regional cost centres."* – Aurizon Network Response to QCA Draft Decision, p159-161
	$1.1 million increase
AECOM Recommendation	**Do not accept**
AECOM's Rationale	Aurizon Network prepared its submission using 2014/15 as the base year, and therefore included 2014/15 bonus costs in that base year. AECOM's analysis used 2015/16 as the base year and considered that 2015/16 bonuses were reflective of efficient costs. Aurizon Network has accepted that the 2014/15 year was an anomalous year, with relatively high bonuses, and has proposed to revise the base year bonus costs to reflect a four year average of bonuses paid between 2012/13 and

	2015/16, and contend that this will '*minimise the impact of one-off adjustments.*' We note that calculating an average over a small sample period (four years) will not effectively minimise the impact of the 2014/15 outlier. In addition, the 2015/16 bonuses were very similar to the 2016/17 bonuses, and we consider, in line with our Final Report, that the 2015/16 base year costs should not be adjusted upwards to reflect past bonuses. 
Reviewed	- Aurizon Network Response to QCA Draft Decision

2.3 Incremental Assessment

2.3.1 Step Change: Network Control School

<table>
<tr><td>Name</td><td>Network Control School</td></tr>
<tr><td>Description</td><td>Aurizon Network's Proposal seeks an additional allowance for the annual 'Network Control School' training program for network controllers. This course is a six month program which follows a recruitment and selection process of approximately 10 applicants per year. The course includes:
Enterprise induction
Safe work standards training
Addition training
Rotation through planning and PMO roles
Control board mentoring.</td></tr>
<tr><td>Findings in AECOM Final Report</td><td>Accept – The actual cost of Network Control School in FY16 was $0.65M. This amount is therefore already accounted for in the FY16 base year. As such, the proportion of costs exceeding $0.65M is accepted (If FY15 was used as the base year, the full step-change would be relevant).</td></tr>
<tr><td>QCA Draft Decision</td><td><i>"Based on AECOM's analysis of Aurizon Network's expenditure models, $0.65 million of the total proposed step change of $0.75 million is already incorporated into 2015–16 base year costs. Accordingly, a step change of approximately $0.10 million per year has been included from 2017-18 onwards for additional network train control school costs. As network control school costs are incurred within the Network Train Operations function, the step change incorporates a deduction of 12 per cent for non-coal traffic, as discussed in section 7.5.3."</i> – QCA Draft Decision, p211</td></tr>
<tr><td>Aurizon Network Response to the Draft Decision</td><td><i>"The QCA reviewed the business case and considered the costs associated with the network control school to be reasonably justified due to the expected critical FTE shortage over the UT5 period. We noted however that the QCA's assessment incorrectly assumed that $0.65m was incorporated into the base year and therefore only approved $0.1m per year (being the incremental costs between $0.65m and $0.75m).</i>
<i>Due to the 2015-16 network control school being delivered across financial years, Aurizon Network removed all costs associated with the school from the base year and then included the full cost of the school as a step change. This was also reflected in the AECOM operating cost model which removed the school costs from the base year. Therefore we seek to include the full cost of the school as per our UT5 proposal"</i> – Aurizon Network Response to QCA Draft Decision, p161-162.</td></tr>
<tr><td></td><td>In FY$16: $0.74M p.a.
In Nominal terms:<table><tr><th>FY18</th><th>FY19</th><th>FY20</th><th>FY21</th></tr><tr><td>0.75</td><td>0.77</td><td>0.80</td><td>0.83</td></tr></table></td></tr>
<tr><td>AECOM Recommendation</td><td>Accept with revised escalation rates</td></tr>
<tr><td>AECOM's Rationale</td><td>In our Final Report, we agreed with Aurizon Network that these costs should be approved. As we were using FY15/16 as a base year, we contended that some of these costs were already captured within the base year, and the step change should comprise the difference between the proposed step change and the costs already captured within the base year.
We accept Aurizon Network's modelling methodology of fully removing the base year costs and reintroducing the full cost as a step change.</td></tr>
</table>

Reviewed	• Trainee Network Controller School – Business Case – FINAL • Aurizon Network RFI responses • Aurizon Network cost models • Aurizon Network Response to QCA Draft Decision (p161)

2.3.2 Step Change: APEX System Costs

Name	APEX System Costs
Description	Aurizon Network's Advanced Planning and Execution (APEX) tool is a software solution to support faster and more responsive planning and scheduling of trains. Improvements are being rolled out over multiple phases: Phase 1 (12 months) – Advanced Planning and Scheduling (APS): Phase 2 (18 months) – Movement Planner (Foundation) Phase 3 (36 months) – APS+ Movement Planner (Optimisation*)* In 2013 the program delivery schedule was re-sequenced to bring forward Phase 2, followed by Phase 1 and Phase 3. Integration with APS will occur in conjunction with Phase 1. The capital costs of Phase 2 have been accepted by the QCA as part of Aurizon Network's 2015/16 and 2016/17 capital claim reviews.
Findings in AECOM Final Report	**Partially Accept** Implementation of the program is delayed from the original Investment Approval Request milestone dates, and Aurizon Network advises that only Phase 2 had been delivered as at the end of the FY15/16 financial year. The completion of the program is now forecast to be FY19/20. Accordingly, the support and maintenance costs schedule is now different to the original UT5 submission. [redacted] [redacted] [redacted] [redacted] [redacted] [redacted] [redacted] [redacted] [redacted] [redacted] [redacted] [redacted] The APEX tool is a major capital project. Costs proposed include operating expenditure for ongoing support from the consultant. The capital and operating expenditure was the result of a competitive tender and are therefore considered to be reasonable.
QCA Draft Decision	*In its review of this expenditure item, AECOM noted that implementation of the APEX system has been delayed. The support and maintenance costs schedule is now different to that proposed in Aurizon Network's submission and costs will not be incurred until FY18/19. Based on the latest implementation timeline, we have included step changes as set out in Table 53. As these costs are incurred within the Network Control function, these step changes incorporate a deduction of 12 per cent for non-coal traffic, as discussed in section 7.5.3"* – Aurizon Network Response to QCA Draft Decision, p161-162, Page 211
Aurizon Network Response to the Draft Decision	*Aurizon Network's UT5 proposal included a step change reflecting the operating expenditure for ongoing maintenance & support costs associated with the APEX solution. The QCA considered it reasonable that the expenditure be included in the forecast operating cost allowance however proposed a revised estimate based on information received from Aurizon Network during their investigation. This information was provided by Aurizon Network using the vendor estimates available then and based on the capital delivery implementation timeline anticipated at that time.* *Since the time of Aurizon Network's UT5 proposal, Aurizon Network has substantially progressed discussions with the vendors to implement a 'decoupled' delivery approach to mitigate project and through-life support risks,*

<table>
<tr><td></td><td>and to deliver features (and customer benefits) into production at the earliest possible time through a staged release schedule. This revised approach brings forward components of the APEX solution earlier than planned, and while there are costs that arise earlier than anticipated, the roll-out will deliver benefits for customers. The uplift in APEX operating costs reflects the new 'decoupled' contractual framework – Aurizon Network Response to QCA Draft Decision, p162.</td></tr>
<tr><td>Value Proposed</td><td>Nominal:
<table>
<tr><th>FY18</th><th>FY19</th><th>FY20</th><th>FY21</th></tr>
<tr><td>[redacted]</td><td>[redacted]</td><td>[redacted]</td><td>[redacted]</td></tr>
</table></td></tr>
<tr><td>AECOM Recommendation</td><td>Partially Accept – Costs updated following RFI process (#110)
<table>
<tr><th>FY18</th><th>FY19</th><th>FY20</th><th>FY21</th></tr>
<tr><td>[redacted]</td><td>[redacted]</td><td>[redacted]</td><td>[redacted]</td></tr>
</table></td></tr>
<tr><td>AECOM's Rationale</td><td>As indicated in our previous report, the cost capitalisation practices of Aurizon Network state that 'all project costs incurred in post-commissioning are to be expensed', therefore these costs are to be considered operating expenditure. Cost efficiency was indicated through the use of competitive tender process.

Aurizon Network have provided evidence to support the revised annual step changes which include:
<table>
<tr><td>1. Support for phase 2 - Day of Operations (during phases 1 & 3 implementation)
[redacted]</td><td>Invoice dated 25 June 2018 sighted.
Included and accepted as part of the draft decision.</td><td>Accept</td></tr>
<tr><td>2. Support for phases 1 & 2 - Planning & Scheduling / Day of Operations (during phase 3 implementation)
[redacted]</td><td>Invoice dated 25 June 2018 sighted.
Included and accepted as part of the draft decision.</td><td>Accept</td></tr>
<tr><td>3. Support Services during Implementation charges of [redacted] will continue until Acceptance of Movement Planner
[redacted]</td><td>Part-month invoice sighted.
Contract sighted. Cost superseded by item 4 in FY20</td><td>Accept</td></tr>
<tr><td>4. Movement Planner post-implementation annual support costs (platinum-level support)
[redacted]</td><td>Aurizon Network's original submission proposed an annual cost of [redacted]. Through the course of the original review, this cost was delayed</td><td>Accept</td></tr>
</table></td></tr>
</table>

	[redacted]	until FY21, which was then accepted as part of the draft decision. Aurizon Network has indicated that the support will now commence in FY20, with an increased cost of [redacted]. A revised contract referencing a different Movement Planner “version”. Given that the program has been significantly delayed and then brought forward, we expect that the scope of work for GE will have changed. After accounting for two years of inflation, we consider this cost reasonable. We note that the revised contract includes 10 years of platinum level support, while the original contract included three years of platinum support before being downgraded to gold-service support.		
	5. Topology updates [redacted]	The basis for this cost is for six topology updates per year. We consider this cost appropriate as topology updates form part of the Planning and Scheduling system requirements, detailed in the Amended Agreement Contract (ISD970). The GE contract outlines that the *“Topology Data Analyst is responsible for modification to the data models within the software to maintain consistency of the data model to the physical infrastructure”.*	Accept	
	6. APS Support & Maintenance [redacted] Note: Costs revised to align with RFI#110	Under the new arrangement, the annual support and maintenance ongoing costs for APS will be [redacted] from May 2019 with uplift for CPI (2% per annum). APS support costs were included and accepted as part of the draft decision. The revised cost has been brought forward one year from FY20 to FY19.	Accept	

		As a redacted contract has been sighted, we consider this cost as reasonable.	
	7. APS Defect Fix (Time and Materials) [redacted]	A small allowance has been included to cater for defect fixes. Aurizon Network has indicated that the estimate was developed by the "vendor based on clients worldwide using this product who are of a similar size and use a product of similar complexity". We consider this cost reasonable.	Accept
Reviewed	• Aurizon Network correspondence • Aurizon Network UT5 Operating Expenditure Submission • Aurizon Network RFI responses • Aurizon Network cost models • Project Pluto Funding Request • Contracts / Schedules of Rates • Invoices		

2.3.3 Step Change: Additional FTE Requirements for Reporting

Name	Planning and Development - Additional FTE Requirements for Reporting
Description	Aurizon Network has proposed an increase in planning and development costs to account for the additional obligations imposed by the QCA in the UT4 undertaking, for example, baseline capacity assessments, strategic train plan, system operating parameters and the network development plan. This increase has included the addition of three FTEs in order to meet these obligations.
Findings in AECOM Final Report	**Accept** – included in FY16 Base Year We note that there are some additional reporting requirements for the UT4 Undertaking, and as such, it is anticipated that regulatory reporting requirements will be similar over the UT5 period. We note three additional FTEs were introduced in FY16. By adopting the 2016 year as the efficient cost base year, the additional resources are considered made available already and therefore no further step-change is required.
QCA Draft Decision	*"Information provided by Aurizon Network indicates that 3.8 FTEs were added to the Planning and Development function during 2015–16 in response to additional workload arising from UT4 Undertaking obligations. On this basis, the cost of these resources will be reflected in the 2015–16 base year cost, and no further step change is required."* – QCA Draft Decision, p209
Aurizon Network Response to the Draft Decision	*"We note that the QCA has made no step change to the 2015-16 base year costs to reflect the additional 3.8 FTE employed by Aurizon Network to manage the additional workload arising from UT4. The QCA noted that the 3.8 FTE were employed during 2015-16 and therefore the costs will be reflected in the 2015-16 base year. Aurizon Network notes however that the FTE were employed between April 2016 and June 2016 therefore the full costs of the FTEs have not been included in the 2015-16 base year. Aurizon Network has included a step change to reflect the costs associated with these FTE had they been employed for the full financial year"* – Aurizon Network Response to QCA Draft Decision, p165.
Value Proposed	$0.47M p.a.
Recommendation	**Accept** – add step change to fully reflect cost of additional employees
Rationale	We accept Aurizon Network's modelling methodology of introducing a step change to reflect the costs of these FTEs not fully captured in the base year.
Reviewed	• 2016 Access Undertaking • 2010 Access Undertaking • Aurizon Network UT5 Operating Expenditure Submission and models • Aurizon Network RFI responses

2.3.4 New Step Change: Planning and Engagement

Name	Planning and Engagement
Description	Introducing eight FTEs across the Network Performance, Network Planning & Network Customer Service teams to meet operational requirements and ensure the teams were positioned to support the broader Network Operations business.
Findings in AECOM Final Report	N/A – Not assessed
QCA Draft Decision	*"These changes were not identified in Aurizon Network's November 2017 proposal and have not been substantiated in terms of need, scope or cost. As the proposed step changes occur from 2017–18 onward, and are incremental to base year costs, it is not clear why these were not also identified in Aurizon Network's original forecasts derived from the 2014–15 base year.* *Moreover, in the absence of any material and uncontrollable change in circumstances driving these proposed changes, the QCA considers these costs are incremental business-as-usual expenses. We do not consider step changes are a mechanism to allow the pass-through of incremental costs associated with normal operations. Therefore, we would expect Aurizon Network to meet these costs within its overall operating cost allowance provided for the UT5 period.* *To the extent that these incremental costs are efficient, we would expect them to be revealed in the assessment of efficient base year expenditures for subsequent regulatory periods."* – QCA Draft Decision, p212
Aurizon Network Response to the Draft Decision	*"The planning & engagement step change included eight FTEs across the Network Performance, Network Planning & Network Customer Service teams to meet operational requirements and ensure the teams were positioned to support the broader Network Operations business. The changes are intended to provide opportunities to achieve standardisation and to consolidate capabilities across the Network Operations CQCN function to more effectively leverage expertise and more clearly articulate areas of accountability and delivery.* *The planning & engagement step change included eight FTEs across the Network Performance, Network Planning & Network Customer Service teams to meet operational requirements and ensure the teams were positioned to support the broader Network Operations business. The changes are intended to provide opportunities to achieve standardisation and to consolidate capabilities across the Network Operations CQCN function to more effectively leverage expertise and more clearly articulate areas of accountability and delivery.* *The key objects include:* • *developing a planning framework that optimises track access to meet volumes throughput;* • *flexibly managing market demand and Network aging asset requirements;* • *delivering a single long-range year on year plan to identify current and future access requirements across the four systems in the CQCN;* • *delivering a single plan that integrates all work activities (renewals and maintenance) every time the track is taken; and* • *providing clear responsibilities for the Principal Contractor Work Health and Safety and Rail Safety Management during all Integrated Possession works.* *Aurizon Network has included the costs associated with the planning and engagement step change as per the 2015-16 operational expenditure model."* – Aurizon Network Response to QCA Draft Decision, p165.
Value Proposed	$0.99M per year.
AECOM	Accept addition of FTEs but with the expectation that cost savings will result

Recommendation	from this inclusion.
AECOM's Rationale	Aurizon Network has proposed the introduction of eight FTEs with the purpose of providing *'opportunities to achieve standardisation and to consolidate capabilities across the Network Operations CQCN to more effectively leverage expertise and more clearly articulate areas of accountability and delivery.'* We support Aurizon Network's endeavour to create efficiencies and therefore accept the addition of these FTEs. However, it is our view that Aurizon Network should realise cost savings as a result of the introduction of these FTEs. We consider that the inclusion of these FTEs is an investment that should be expected to achieve a positive outcome for Aurizon Network. A business case for this additional capability would be expected to indicate savings for Aurizon Network that would at least cover the costs of the investment, and we consider it reasonable to expect that these savings would be deliverable within one regulatory period. Therefore, while we accept the inclusion of the FTEs, we propose a neutral cost impact over the period (in $FY16) implying that the savings achievable should at least recover the cost involved.
Reviewed	• Aurizon Network Response to QCA Draft Decision

2.3.5 New Step Change: Electrical Specialist

Name	Electrical Specialist
Description	Creation of a specialist role to engage in regulatory and policy processes regarding electricity wholesale and network issues.
Findings in AECOM Final Report	N/A – Not assessed
QCA Draft Decision	*"These changes were not identified in Aurizon Network's November 2017 proposal and have not been substantiated in terms of need, scope or cost. As the proposed step changes occur from 2017–18 onward, and are incremental to base year costs, it is not clear why these were not also identified in Aurizon Network's original forecasts derived from the 2014–15 base year.* *Moreover, in the absence of any material and uncontrollable change in circumstances driving these proposed changes, the QCA considers these costs are incremental business-as-usual expenses. We do not consider step changes are a mechanism to allow the pass-through of incremental costs associated with normal operations. Therefore, we would expect Aurizon Network to meet these costs within its overall operating cost allowance provided for the UT5 period.* *To the extent that these incremental costs are efficient, we would expect them to be revealed in the assessment of efficient base year expenditures for subsequent regulatory periods."* – QCA Draft Decision, p212
Aurizon Network Response to the Draft Decision	*"The electrical specialist step change included costs associated with one FTE in the Commercial team. Given the large sunk investment in electric traction and the complexity of the energy system's regulatory regime, Aurizon Network identified the potential for cost optimisation and stranding of the electric assets as a key business risk. It is imperative that Aurizon Network has adequate resourcing, internal expertise and capability to understand and influence energy regulation and markets.* *UT5 (Clause 3.4(c)(viii)) states that the supply of Below Rail Services includes providing the use of electric transmission infrastructure on electrified sections of the Rail Infrastructure. Providing this will enable Access Holders or Train operators to run electric train services within the CQCN. Subject to clause 2.6 of the undertaking, the sale or supply of electric energy for traction, includes managing electric energy supply from other parties to Access Holders or Train Operators where requested to provide that electric energy.* *In addition to managing policy and energy regulation, there are a number of opportunities to reduce Aurizon Network's energy costs which have been identified including:* • *assessment of connection points to develop the most cost efficient network by eliminating connection points where electric service can be maintained more effectively through upgrade or improved management of other connection points;* • *connecting other entities (such as solar farms) to Aurizon Network connection points to reduce costs;* • *working with energy providers and the AER to secure lowest possible connection charges; and* • *more efficiently managing energy procurement, through progressive purchasing and pricing.* *These savings will result in a direct pass-through to CQCN customers, as well as assisting to manage Aurizon Network's asset stranding risk. Aurizon Network requires this resource to provide expert advice and bring knowledge of energy markets and regulation to the business. Aurizon Network has not been able to identify an external consultant with this mix of expertise and capability, and we*

	see an ongoing need for this position to manage one of the business's key risks." – Aurizon Network Response to QCA Draft Decision, p165.
Value Proposed	[redacted] per year
AECOM Recommendation	Accept addition of FTE but with the expectation that costs savings will result from this inclusion.
AECOM's Rationale	Aurizon Network has proposed the addition of an electrical specialist. They have contended that the addition of this FTE will provide opportunities to reduce Aurizon Network's energy costs through a number of avenues. We agree with Aurizon Network that the incorporation of this FTE may help to achieve cost savings. We consider that the inclusion of this FTE is an investment that should be expected to achieve a positive outcome for Aurizon Network. A business case for this additional capability would be expected to indicate savings for Aurizon Network that would at least cover the costs of the investment, and we consider it reasonable to expect that these savings would be deliverable within one regulatory period. Therefore, while we accept the inclusion of the FTE, we propose a neutral cost impact over the period (in $FY16) implying that the savings achievable should at least recover the cost involved.
Reviewed	• Aurizon Network Response to QCA Draft Decision

2.3.6 New Step Change: Permanent way development training

<table>
<tr><td>Name</td><td>Step Change: Permanent way development training</td></tr>
<tr><td>Description</td><td>In FY17, Aurizon Network's training and development function under the Manager – Permanent Way was centralised. These costs had previously been incurred within Aurizon Network's maintenance teams, and recovered through labour rates onto the maintenance activities. The training provided includes:
• mandatory enterprise
• generic enterprise
• certificates & higher education
• licences
• safe working & plant & equipment
• operator & post trade competencies.</td></tr>
<tr><td>Aurizon Network Response to the Draft Decision</td><td><i>Beginning 2016-17, Aurizon Network centralised the training and development function under the Manager Permanent Way position reporting to the Head of Network Operations. Previously these costs were incurred in the various maintenance teams and recovered through labour rates onto the maintenance activities.</i>
<i>Consistent with UT4, Aurizon Network pursued recovery of these costs as part of the maintenance allowance as they were inherently built into the base year used for the calculation of the proposed maintenance allowance. Given the Draft Decision adopts 2016-17 as the base year for maintenance, these costs are no longer included in the maintenance allowance and therefore Aurizon Network seeks to recover these costs through the OPEX allowance.</i>
<i>The costs are separately identifiable and incurred in the permanent way development cost centre from 2016-17. Aurizon Network has included costs of $1.7m related to this training as an adjustment to the 2015-16 base year.</i>
<i>In addition, the QCA Draft Decision applies a reduction to corporate costs to take account of transformational savings to be achieved post the 2015-16 base year. One of these initiatives related to reducing external safety training costs, which was in Evaluation stage when the information was presented to the QCA consultants. The initial cost savings estimated for this initiative was $2m per year for Aurizon Network. Aurizon Network in total spent $1m on Conferences, Seminars and Courses (i.e. external training) during 2015-16. It would therefore be impossible to achieve savings of $2m on safety related training alone. Benefit realisation for the initiative continues to be refined and it is currently estimated we will make savings of 2% for 2017-18, increasing to 8% by 2020-2021.</i>
<i>At a broader level, while we support this change in order to reduce the areas of disagreement, we are concerned with the QCA's approach that refuses to accept 'step ups' but imposes 'step downs' because, both types of changes are an inherent part of effective business management. Any requirement on Aurizon Network to reflect productivity improvements should relate to 'net' rather than 'gross' productivity gains. Furthermore, the QCA's approach of 'banking' productivity gains under assessment is not generally regarded as consistent with incentive regulation which is designed to encourage business to seek efficiencies on the basis that it will retain some of that benefit during the regulatory period.</i></td></tr>
<tr><td>Value Proposed</td><td><table>
<tr><th></th><th>FY18</th><th>FY19</th><th>FY20</th><th>FY21</th></tr>
<tr><td>Training Step Change</td><td>1.73</td><td>1.73</td><td>1.73</td><td>1.73</td></tr>
<tr><td>Transformation Savings</td><td>-0.02</td><td>-0.05</td><td>-0.07</td><td>-0.10</td></tr>
<tr><td>Proposal</td><td>1.71</td><td>1.69</td><td>1.66</td><td>1.64</td></tr>
</table></td></tr>
<tr><td>AECOM Recommendation</td><td>Accept – Permanent Way Development Training less transformation savings.</td></tr>
</table>

AECOM's Rationale

We recommend that these costs be accepted as they were previously included in the maintenance profit centres. Aurizon Network training has reduced considerably over the UT4 period from $2.9 million FY14 to $1.9 million in FY17 (the orange bars in Figure 1). Aurizon Network have also indicated that further savings are expected (dotted grey bars), which has been considered in Aurizon Network's proposed step change.

Our review of the profit centres suggests that there is no double counting.

	2014	2015	2016	2017*
Maintenance Profit Centres				
Conferences/Seminars	1,094,772	931,364	712,579	47,345
Labour	1,860,875	1,754,820	1,399,372	14,688
Total	2,955,648	2,686,184	2,111,951	62,033
Opex Profit Centres				
Consumables			31,093	697,078
Labour			131,473	1,138,013
Total	0	0	162,566	1,835,091
Total Training Costs	2,955,648	2,686,184	2,274,518	1,897,125

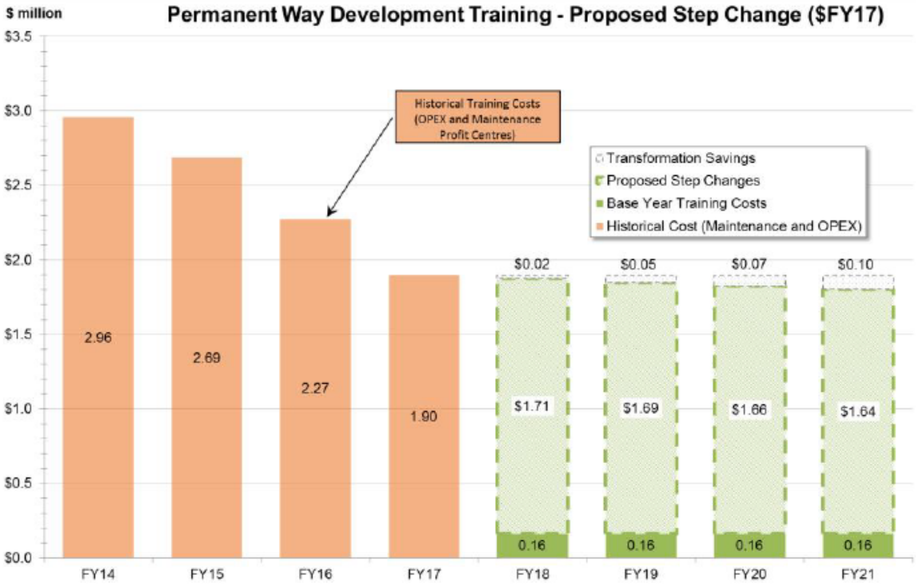


Figure 1 Permanent Way Development Training

Reviewed

- System wide and Regional Cost Model
- RFI responses
- Aurizon Network Response to QCA Draft Decision

2.3.7 New Step Change: Regulatory compliance professional services

Name	Step Change: Regulatory compliance professional services
Description	Anticipated expenditure associated with Aurizon Network's compliance with upcoming regulatory processes that will be incurred during the UT5 term.
Aurizon Network Response to the Draft Decision	*"Aurizon Network proposes a minor uplift of expenditure of $0.75m to recognise anticipated expenditure associated with Aurizon Network's compliance with upcoming regulatory processes that will be incurred during the UT5 term. This expenditure was not included in Aurizon Network's UT5 expenditure proposals, and was therefore not considered in the QCA's Draft Decision and therefore requires an additional adjustment. This relates to:* • *QCA reviews (declaration and certification) – Aurizon Network is expected to incur professional services costs for legal and economic advice in preparing submissions to QCA regulatory processes for re-declaration of Aurizon Network's below-rail assets under the QCA Act and certification of the rail access regime ($ 0.5m FY20);* • *UT6 development – We anticipate additional consultancy expenditure will be required to assist Aurizon Network prepare its proposal and respond to QCA assessments, particularly where there is uncertainty in QCA review methodology ($0.25m FY20)."* – Aurizon Network Response to QCA Draft Decision, p165.
Value Proposed	$0.75M
AECOM Recommendation	**Do not accept** additional cost allowance in FY20 for Declaration Review **Do not accept** the additional cost allowance for UT6
AECOM's Rationale	Aurizon Network has proposed an increase in costs in FY19/20 for external consultants to assist with the regulatory process. These costs specifically relate to the process of re-declaring the below rail network under the QCA Act, which is due for declaration review in 2020. We note that declaration reviews occur every 10 years in accordance with the Act, however Aurizon Network is not obligated to participate in a declaration review. Based on this, we believe that this activity is no different to Aurizon Network's participation in any other consultation process that happens with irregular frequency, such as AER reviews or ACCC reviews, and as a result this should be considered business as usual. The overall allowance derived from the base year should, over the regulatory period, be sufficient to cover these costs, and we do not accept that a step change should be granted for this process. Aurizon Network has also proposed a step change for additional consultancy expenditure for the UT6 proposal development. This proposal, while mandatory, is a part of the regulatory process which is already in place. It is our view that the change should be treated as business as usual, and that sufficient regulatory costs associated with this process are included in the base year given that Aurizon Network was negotiating UT4 in FY15/16. We therefore recommend that this step change is not accepted.
Reviewed	Aurizon Network Response to QCA Draft Decision QCA Act, Part 5

2.4 Impact of Changes to System Wide and Regional Costs

A summary of the updated recommended system wide and regional costs (in $FY16), taking into account the changes in this section, is provided at Table 1. This represents a total of [redacted] over the UT5 period, in $FY16.

Table 1 Summary of System Wide and Regional Costs - Updated

$FY16, Million		UT5				
Cost Category	Total	FY18	FY19	FY20	FY21	Total
AECOM Accepted Base Year	**$57.50**	**$57.50**	**$57.50**	**$57.50**	**$57.50**	**$230.01**
Step Changes						
Condition based assessment*		$0.00	$0.00	$0.42	$0.00	
Train-Control school		$0.68	$0.68	$0.68	$0.68	
APEX system costs		[redacted]	[redacted]	[redacted]	[redacted]	
Additional requirement for FTE Reporting		$0.47	$0.47	$0.47	$0.47	
Permanent way development training		$1.68	$1.66	$1.64	$1.62	
Step Changes (No Cost Impact)						
FY20 for Declaration Review		$0.00	$0.00	$0.00	$0.00	
Planning and Engagement		$0.00	$0.00	$0.00	$0.00	
Electrical Specialist		$0.00	$0.00	$0.00	$0.00	
UT6 Development		$0.00	$0.00	$0.00	$0.00	
Total Step Changes		[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total Efficient Systemwide and Regional Costs		[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

* step change previously accepted

3.0 Corporate Overheads

3.1 Allocators

3.1.1 Corporate Cost allocation for IT Costs

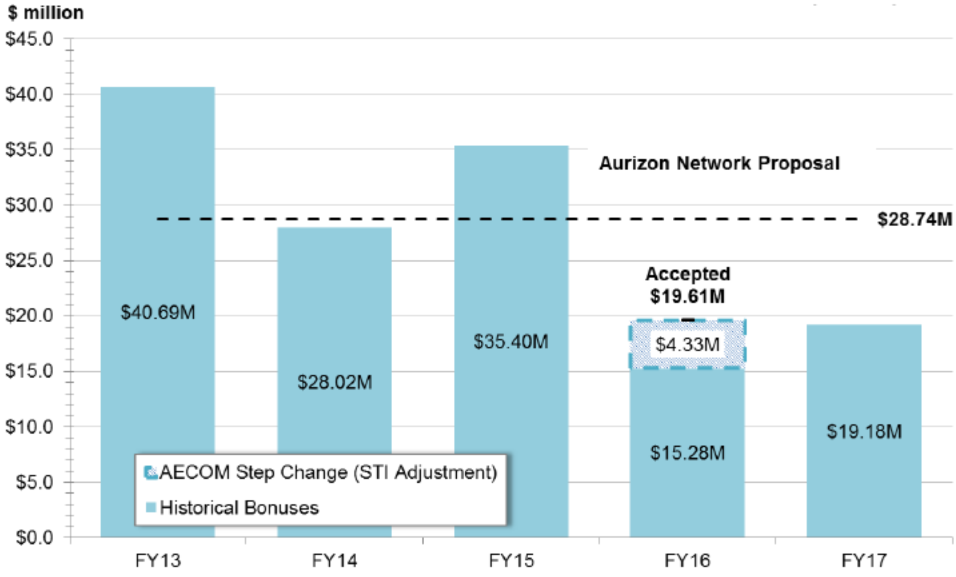
Name	Change in IT allocation
Findings in AECOM Final Report	The costs of the IT group of functions are assigned to Aurizon Network using a 'costs' allocator. We note that enterprise IT systems generally attract a cost in the form of a licence or per seat charge, which is therefore a headcount-based calculation. We recommend that the relative number of licences be used for cost allocation of IT services. In lieu of this information, it is our view that FTE count is a reasonable proxy, however a more accurate assessment could be made if detailed licence information was available.
QCA Draft Decision	*"The QCA sought additional information from Aurizon Network on the relative number of software licenses; however, the level of information available was not sufficient to derive an appropriate allocator. Given this, AECOM recommended that FTE count be applied as a proxy allocator.* *The QCA accepts AECOM's recommendation and considers that, in the absence of an allocator based on software license numbers, IT costs should be allocated by FTE count rather than direct costs."* – QCA Draft Decision, p223.
Aurizon Network Response to the Draft Decision	*In the Draft Decision, the QCA has changed the allocation methodology for corporate Information Technology costs from direct costs, as approved in UT4, to an FTE allocator. A benchmarking report from ITNewcom, commissioned by Aurizon Network during the UT4 process and included as part of the UT5 submission, found that IT costs for a stand-alone business like Aurizon Network would amount to $18m per year. The proposed allowance from the Draft Decision of $46m for the UT5 period falls well short of the benchmarking. The QCA has acknowledged the report in the Draft Decision, however it has not made any comment on its assessment of the findings from that report, or noted any deficiencies in the benchmarking report to support an allowance significantly short of the amounts ITNewcom had proposed. It should be noted that the cost estimate from ITNewcom is annual run cost based on 2013-14 and hence does not include the software maintenance and support services costs for the Advanced Planning and Execution System (APEX) or Network Asset Management Systems (NAMS) software systems. It was also prepared using the Aurizon Network structure at that time and hence does not allow for IT costs relating to the employees restructured into Network on 1 July 2017.* *An allocator based on FTEs is inappropriate for IT costs as IT services are not consumed equally amongst employees. Some office based FTEs will utilise multiple devices, while train drivers and some maintenance workers will not have any IT devices allocated to them and may utilise a common computer device for administrative purposes from time to time. AECOM also did not propose that FTE was the most appropriate allocator for IT costs. The QCA noted in their Draft Decision that the change to the FTE allocator was made on the recommendation of AECOM that a more appropriate allocator for IT costs would software licence numbers, but in the absence of an allocator based on software licence numbers, IT costs should be allocated by FTE count rather than direct costs (page 223).* *In accordance with Aurizon Network's costing methodology, the general direct cost and FTE allocators are only applied when specific costs attributed to Network cannot be identified or causal allocators cannot be determined. Subsequent to the lodgement of the 2017 DAU and in line with the Aurizon Holding Group's move from a functional organisational structure to business units on 1 July 2017, significant work has been undertaken to identify costs of*

<table>
<tr><td></td><td>software applications and to attribute these to the respective business units, and to identify devices used by each business unit. We consider an allocation based on directly identified application costs and end user computer costs (allocated by number of devices) is more reflective of the costs that would be incurred by Network as a stand-alone company than using an FTE allocator or licence numbers. The costs have been resubmitted on the basis of the attribution work done by the Group for application costs. The budgeted IT costs for 2017-18 were grouped into the categories shown below. The actual IT costs for 2015-16 have been grouped into these same categories in the same proportions." – Aurizon Network Response to QCA Draft Decision, page 171.</td></tr>
<tr><td>Value Proposed</td><td>
<table>
<tr><td>Direct Costs (based on the licence costs and devices):</td><td>$7.8 million</td></tr>
<tr><td>Allocation of Shared Costs using the direct cost allocator ($45.3m x 30.7%):</td><td>$13.9 million</td></tr>
<tr><td>Total</td><td>$21.7 million</td></tr>
</table>
</td></tr>
<tr><td>AECOM Recommendation</td><td>Partially Accept
• Accept $7.8 million of direct costs
• Apply the FTE allocator for shared costs</td></tr>
<tr><td>AECOM's Rationale</td><td>Aurizon Network has identified $7.8 million of IT costs directly related to Network and $16.0 million that directly relate to other parts of the business. We accept Aurizon Network's proposal of allocating all of the $7.8 million to Aurizon Network.
Aurizon Network has then proposed to use the corporate cost allocator for the remaining $45.3 million of shared costs, with the position that "IT services are not consumed equally amongst employees which makes an allocator based on FTEs inappropriate."
In the absence of any further information, we consider that an FTE allocator (19.8%) continues to be a more appropriate allocator than a cost allocator. We also note that Aurizon Network's response to the QCA (p. 172) outlines that 21% of licence costs (Table 73) and 20% of devices (Table 74) are applicable to Aurizon Network – proportions similar to the FTE allocator.</td></tr>
<tr><td>Accepted Value</td><td>
<table>
<tr><td>Direct Costs (based on the licence costs and devices):</td><td>$7.8 million</td></tr>
<tr><td>Allocation of Shared Costs using the FTE allocator ($45.3m x 19.8%):</td><td>$9.0 million</td></tr>
<tr><td>Total</td><td>$16.8 million</td></tr>
</table>
</td></tr>
<tr><td>Reviewed</td><td>• Aurizon Network Response to QCA Draft Decision
• Aurizon Network - IT Services Market Price, ITNewcom, Dec 2014</td></tr>
</table>

3.2 Base Year Adjustments

3.2.1 Bonus Adjustment – Corporate Overheads

Name	Bonus Adjustment – Corporate Overheads
Findings in AECOM Final Report	Based on the gross bonuses awarded in recent years, it is our view that FY15 year was an anomalous year due to long term bonuses maturing, and that bonuses in FY16 are likely to be a reasonable indication of future bonus amounts. As we are using actual FY16 costs for their base year, the proposed inclusion of FY15 bonuses into the base year has not been considered, and actual FY16 bonus costs have been used. However in FY16, as noted in the Annual Report 2016, despite the 'credible' performance of the Key Management Personnel (KMP) against their Short Term Incentive (STI) key performance indicators, the Board exercised its discretion and determined not to award any STI to the Managing Director and CEO, or to his direct reports. In FY15, STI awards to the KMP equated to $4.32M in total. It is reasonable to expect that STIs, which include both monetary and share-based payments, will be awarded in subsequent years and throughout the UT5 period, as these are a mechanism through which Aurizon attracts and retains its KMP. This is in accordance with the ASX Corporate Governance Council's Principles and Recommendations, which state that 'a listed entity should design its executive remuneration to attract, retain and motivate high quality senior executives.' In addition, as the Principles and Recommendations indicate, equity incentives are used by listed companies to remove a principal-agent problem and 'to align their (management) interests with the creation of value for security holders.' They are a common element of remuneration packages for key management personnel across similar businesses, including ARTC and Pacific National. To adjust for future awards, we have added the allocated value of the FY15 KMP STI awards, escalated to $FY16 ($0.60M).
QCA Draft Decision	The QCA does not consider that Aurizon Network has made a compelling case to adjust the base year to reflect total bonus costs incurred in 2014–15. We agree with AECOM and consider that actual bonus costs incurred in 2015–16 are likely to offer a more realistic estimate of future recurrent costs than those incurred in 2014–15. Nonetheless, the QCA accepts AECOM's recommendation to include a partial adjustment for key management personnel short-term incentives, which were not included in the 2015–16 base year cost. We are of the view that an efficient organisation would offer short-term attraction and retention incentives for key senior executives, and that it is reasonable for the corporate overhead allowance to include some allocation of these costs.
Aurizon Network Response to the Draft Decision	*"Employee bonus expense in 2015-16 was significantly lower than the previous years due to the Aurizon Group Board not awarding short-term incentives to the CEO or his direct reports (the key management personnel). Cash bonuses paid to staff below this level were also lower than in previous years, as mentioned in section 7.2.3 above. As a result of adopting 2015-16 as the base year, an adjustment is necessary to normalise that year's bonuses. The QCA has accepted their consultants' recommendation to adjust the base year by $0.6m to reflect the allocated value of short-term incentives awarded to key management personnel in 2014-15. Aurizon Network supports this adjustment being made, but contends that the adjustment should be increased to $1.6m per year, incorporating an adjustment for both key management personnel and other staff. Our proposed adjustment has been calculated using average bonus expenses for the four years 2012-2013 to 2015-16 for each corporate cost centre included*

<table>
<tr><td></td><td>in the allocation to Aurizon Network, multiplied by the allocator (FTEs or direct costs) applying to each cost centre. Four years is representative of an Access Undertaking period and using the past 4 years average bonus is the same approach as has been taken for the calculation of system wide and regional costs.” – Aurizon Network Response to QCA Draft Decision, page 169-170</td></tr>
<tr><td>Value Proposed</td><td>$1.6 million increase per annum</td></tr>
<tr><td>AECOM Recommendation</td><td>Do not accept</td></tr>
<tr><td>AECOM’s Rationale</td><td>
<p>AECOM’s analysis used 2015/16 as the base year and considered that 2015/16 bonuses were reflective of efficient costs.</p>
<p>Aurizon Network has accepted that the 2014/15 year was anomalous, with relatively high bonuses. They have agreed in principle with the adjustment AECOM has recommended – to include an allowance for foregone KMP STIs in 2015/16. However, Aurizon Network has suggested that this principle should also apply to non-KMP. Aurizon Network has proposed to revise the base year bonus costs to reflect a four year (allocated) average of bonuses paid between 2012/13 and 2015/16.</p>
<p>We do not consider this to be an effective approach. Similar to the System Wide bonuses, we consider that calculating an average over a small sample period (four years) will not effectively minimise the impact of the 2014/15 outlier. In addition, short term incentives are an incentive-based feature of remuneration for Key Management Personnel only, and Aurizon Network reported a decision not to award these in FY15/16. We have noted in our Final Report that STIs are a mechanism through which Aurizon attracts and retains its KMP, and we believe that the adjustment made for this was appropriate.</p>
<p>To further support this, the adjusted FY15/16 base year bonus costs suggested are very similar to those incurred in FY16/17 (once adjusted for inflation). We recommend that our original proposal of $19.61M (before allocation) is accepted as part of the UT5 allowance.</p>


<p>Figure 2 Corporate Overhead Bonuses – Before Allocation ($FY16)</p>
</td></tr>
<tr><td>Reviewed</td><td>
Annual Reports
Aurizon Network Response to QCA Draft Decision
</td></tr>
</table>

3.3 Incremental Assessment

3.3.1 Change: Corporate Office Consolidation

Name	Corporate Sites (commercial office tenancy)
Description	Aurizon Group has announced that it will be consolidating its Brisbane premises, 175 Eagle St and 192 Ann St, to a new head office at 900 Ann St from September 2018. The Aurizon Network corporate cost proposal includes rent and other tenancy costs, such as utility charges, outgoings, compliance reporting, land tax, repairs and maintenance for 900 Ann St in place of 192 Ann St from that date.
Findings in AECOM Final Report	AECOM did not accept this step-change. Aurizon Group has committed to consolidation of offices to a new location at 900 Ann St. This move delivers a substantial reduction in property costs for the Group as a whole, although per head occupancy costs for the 200 Network staff involved are projected to increase (using per head rates). In our view, any cost reduction available to the Aurizon Group should be passed on proportionally to Aurizon Network, so we do not accept the increase included in the submission. We note that rental costs at 192 Ann St are likely to have otherwise continued to increase at the contracted 3.5% per annum, and consider that a reasonable alternative, while noting that it would be preferable for Aurizon Network to receive a reduction in occupancy costs in line with that being gained by the Aurizon Group. Consumables are expected to increase in line with CPI.
QCA Draft Decision	*"AECOM reviewed the proposed costs and formed the view that any cost reduction available to the Aurizon Group should be passed on proportionally to Aurizon Network. AECOM concluded that rental costs at 192 Ann St would otherwise have continued to increase at a contracted rate of 3.5 per cent per annum. AECOM considered this to be a reasonable alternative estimate, while noting that it would be preferable for Aurizon Network to receive a reduction in occupancy costs in line with that being gained by the Aurizon Group.* *The QCA considers that Aurizon Network has not justified the inclusion of this proposed increase in accommodation costs. While consolidation of its corporate headquarters may be a prudent commercial decision for the Aurizon Group, it is a discretionary strategic decision; the resulting costs of which we do not consider would reasonably be included in Aurizon Network's efficient cost base if it were a standalone entity"* – QCA Draft Decision, p229.
Aurizon Network Response to the Draft Decision	*"The QCA has disallowed the additional costs that will be incurred from June 2018 due to the consolidation of two corporate offices (192 Ann Street and 175 Eagle Street) at 900 Ann Street and the QCA does not consider the cost would be reasonably included in Aurizon Network's efficient cost base if it were a stand-alone entity.* *This type of forensic examination of costs on an individual cost centre basis and requirement for detailed justification for changes in these costs is more consistent with cost-based regulation than incentive-based regulation. As long as Aurizon Network continues to operate within its overall spending allocation and is incentivised to manage its costs and deliver efficiencies, then these costs should be considered reasonable.* *Notwithstanding our high level concerns, Aurizon Network has assessed the Draft Decision and contends that the A-grade office at 900 Ann Street is an efficient cost whereby the rent for 900 Ann Street is within the range for gross face rents in the CBD fringe for large ASX listed companies.* *Rent for city fringe properties is generally lower than CBD. However, rent for 900 Ann Street is higher than current rent at 192 Ann Street which is due to the style and grading of the buildings. The building at 900 Ann Street has been built to A-*

<table>
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grade specification and the condition expected for an ASX listed company. It is assumed that Aurizon Network as a stand-alone entity would also be a listed company, consistent with assumptions made in the assessment of WACC.

The report prepared by KPMG which was provided to the consultants during the review of the 2017 DAU has been updated to include recent evidence of market rent in both Brisbane CBD and city fringe, based on leases executed in the last year. While it has not been included in the report as the lease was not executed in the last year, it is also noted that net face rent for 145 Ann Street from November 2018 will be in excess of $900psm. The report highlights that Aurizon's lease of 900 Ann Street is comparable to other large tenants in the city fringe, particularly when the cost of the building specification is considered. An example of a recent lease contract for an ASX listed company is the lease of 180 Ann Street with a gross face rent of $700-$750 psm, compared to [redacted] *for 900 Ann Street.*

The costs submitted in the UT5 proposal included lease of 192 Ann Street until the end of September 2018 when the lease expires, and then increased lease costs for the new building thereafter. The timelines relating to the relocation have further developed since the 2017 DAU was made and it is expected the new building will become occupied in June 2018. Accordingly, the costings have been revised to include 3 additional months of rent for 900 Ann Street.

Aurizon will continue to incur lease costs for 192 Ann Street until the lease expiry in September 2018 as it is very unlikely that a tenant to sub-lease for a short space of time would be found. It is not considered unreasonable for there to be up to a three month overlap in the lease payments for both properties to allow for unexpected delays and to ensure successful relocation. An additional $0.7m has been included in the resubmitted costs in relation to the earlier relocation to 900 Ann Street in FY19." – Aurizon Network Response to QCA Draft Decision, p173.

</td></tr>
<tr><td>Value Proposed</td><td>

Corporate Premises cost increase ($FY16):

<table>
<tr><th>FY18</th><th>FY19</th><th>FY20</th><th>FY21</th></tr>
<tr><td>$0.06M</td><td>$0.45M</td><td>$0.56M</td><td>$0.60M</td></tr>
</table>

Three month lease overlap: $0.7M in FY19

</td></tr>
<tr><td>AECOM Recommendation</td><td>Do not accept the rate increase</td></tr>
<tr><td>AECOM's Rationale</td><td>

Our original finding concluded that any cost reduction available to Aurizon Group should be passed on proportionally to Aurizon Network. We note that Aurizon Network's response does not address this topic. It is clear that Aurizon Group will benefit from this proposal, but the proposal would apparently increase costs attributable to Aurizon Network, which we continue to view as unreasonable.

Aurizon Network clarified how the 900 Ann Street actual rental costs ([redacted] and [redacted] attributed to rent and outgoings respectively) compare with the $645psm cost in the KPMG report, with. We note corporate contracts, such as internal cleaning and security, are additional to this cost. Costs for 192 Ann Street can similarly be calculated with [redacted] and [redacted] attributed to rent and outgoings, yielding a gross-face rental of [redacted].

In our view, we consider an increase of 3.5% per annum as an appropriate alternative as:

- it would be preferable for Aurizon Network to receive a reduction in occupancy costs in line with that being gained by the Aurizon Group
- the KPMG benchmarking report notes that another tenant is contracted with a gross-face rental of $585psm.

</td></tr>
</table>

Table 2 192 Ann Street Costs

192 Ann Street Costs	$FY18	$m2
Rent	[redacted]	[redacted]
Outgoings	[redacted]	[redacted]
Electricity	[redacted]	[redacted]
Total	[redacted]	[redacted]
Total with Corporate Contracts	[redacted]	[redacted]

Source: Aurizon Network Model, AECOM calculations

Source: Aurizon Network Model

We therefore do not accept the proposed rental increase, but instead consider an annual increase of 3.5%, which is consistent with the value in Aurizon Network's original model. It is recommended that other outgoings such as non-rent costs are escalated at CPI.

Aurizon Network has also requested an allowance for a three month rental overlap. AECOM's recommended corporate office costs are reflective of a continuation of the current tenancy costs at 192 Ann Street, effectively assuming from a cost perspective that a relocation of Aurizon Network does not take place. We therefore do not consider a three month overlap of rental costs to be reasonable or efficient.

Reviewed

- Aurizon Network RFI responses
- KPMG Benchmarking Report

3.3.2 Change: Transformation Program Efficiencies

Name

Transformation Program Efficiencies

Description

Our detailed review of Aurizon Network's cost models identified areas where savings are available over the UT5 period but have not been included in Aurizon Network's submission.

Findings in AECOM Final Report

FY18	FY19	FY20	FY21
-$2.3M	-$2.5M	-$2.6M	-$2.7M

QCA Draft Decision

"The QCA considers that some of the anticipated savings from ongoing transformational activities should be reflected in the UT5 corporate overhead allowance. We agree that the projected savings identified as 'cash-flowing', 'locked in', and 'implementing' should be fully included in the negative step change.

With regard to initiatives still under evaluation, the QCA accepts that not all of these measures will come to fruition and deliver savings. The QCA agrees with AECOM and considers it appropriate to include 50 per cent of these savings in the negative step change, in recognition of this.

Aurizon has incentives to implement its transformation initiatives and realise efficiency gains. We consider incorporating this step change reinforces those incentives, while appropriately balancing the legitimate business interests of Aurizon Network, the interests of access seekers, access holders and the public interest, in accordance with s. 138(2) of the QCA Act. While AECOM has recommended that an ex-post true up of these savings occur at the end of the regulatory period, we do not consider this is necessary. To the extent that Aurizon Network is able to achieve costs savings greater than the negative step change applied, these should be reflected in the base year expenditure for the UT6 undertaking period. Likewise, if actual savings fall short of the negative step change, base year expenditures should also capture this.

Accordingly, the QCA has applied negative step changes of $10 million in aggregate over the UT5 period (nominal, after allocation)." – QCA Draft

<table>
<tr><td></td><td>Decision, p230</td></tr>
<tr><td>Aurizon Network Response to the Draft Decision</td><td><i>“Approximately half of the transformation savings included in the corporate cost allowance in the Draft Decision relates to an initiative to reduce external safety training costs. This initiative was still under evaluation at the time the register was provided to the QCA consultants, but had estimated potential savings of $2m per year for Aurizon Network. The benefits from the initiative continue to be refined but the cost savings will be far less than was originally entered into the initiatives register. Whatever cost savings are achieved will result in cost reductions in Aurizon Network directly and would not flow through to Aurizon Network as a corporate cost. In the initiatives register, benefits realisation for this initiative has been reassigned from corporate Safety, Health and Environment to the Network business. The costs of the corporate Safety, Health and Environment team will not be impacted as a result of this initiative as costs of external training are incurred within Aurizon Network directly. Accordingly, the transformational savings included in the corporate cost allowance should be reduced by $4.1m for the duration of UT5 ($1m in 2017-18, escalated by CPI each subsequent year). Savings relating to this initiative have been included as a step change to the system wide business management costs – permanent way development training (refer section 7.2.3)”</i> – Aurizon Network Response to QCA Draft Decision, p173.</td></tr>
<tr><td>Value Proposed</td><td><table><tr><th>FY18</th><th>FY19</th><th>FY20</th><th>FY21</th></tr><tr><td>-$1.3M</td><td>-$1.5M</td><td>-$1.6M</td><td>-$1.6M</td></tr></table></td></tr>
<tr><td>AECOM Recommendation</td><td>Accept</td></tr>
<tr><td>AECOM’s Rationale</td><td>Aurizon Network has accepted all transformation savings with the exception of reducing external training costs. Aurizon Network has instead provided revised saving forecasts for this area, which was discussed in Section 2.3.6.
We consider the revision acceptable, as the original estimate of approximately $2 million per year is excessive when FY17 training costs total $1.9 million.
We accept the revised transformation savings, noting a reduction of approximately $1 million per annum as the negative step change relating to training was previously categorised as “evaluating” and incurred a 50% reduction from the estimated saving of $2 million.</td></tr>
<tr><td>Reviewed</td><td>• Aurizon Network RFI responses</td></tr>
</table>

3.4 Infrastructure Engineering and Infrastructure Delivery Restructure

This section addresses the requested changes to the operational expenditure resulting from the corporate restructure whereby the Infrastructure Engineering and Infrastructure Delivery teams shifted from Aurizon Operations to Aurizon Network. We understand that these teams were fully utilised by Aurizon Network.

Previously, when Infrastructure Engineering and Infrastructure Delivery services were part of Aurizon Operations, the cost of these teams to Aurizon Network was inclusive of a 'margin' to account for corporate overheads incurred. We understand that the costs for the Infrastructure Delivery team had previously been fully capitalised, while Infrastructure Engineering costs were partially capitalised, with non-capitalised costs charged to Aurizon Network and recognised as consumables expenses.

Now that the teams have moved to within Aurizon Network, Aurizon Network has contended that, among other changes listed elsewhere, this should result in adjustments to corporate overhead allocators. In other words, it contends that the addition of these teams should attract a higher portion of corporate overhead costs.

We agree with Aurizon Network that additional staff and materials will result in an increased allocation of corporate overheads directly to Aurizon Network. We note that these costs are not new costs, and were previously paid through the 'margin' discussed above, with some expenses capitalised and others included as expenses to Aurizon Network.

For the Infrastructure Engineering costs, we note that a proportion of these were not previously capitalised. We consider that these costs were already incorporated into the pre-restructure base year costs, and capitalised costs were included in the capital indicator. Aurizon Network has advised that the reduction in the capital indicator relates only to Infrastructure Delivery, and so capitalised costs from Infrastructure Engineering remain in the capital indicator. We therefore contend that there should be no changes to the corporate overhead allowance for Infrastructure Engineering. This means that to avoid double counting of costs, direct costs added to the calculation of the corporate cost allocator should be associated with Infrastructure Delivery only, and further the Infrastructure Engineering FTEs should not be included in the updated FTE allocator. These items are discussed in more detail below.

For corporate overhead costs allocated via other means (for example; real estate footprint and direct IT costs), the difference is not expected to be material in this instance.

3.4.1 Increased Corporate Overheads Allocation: Corporate Cost allocation

Functional Area	Increased Corporate Overheads Allocation: Corporate Cost allocation
Aurizon Network Response to the Draft Decision	*"As noted on page 190 of the Draft Decision, a new Aurizon Group organisational structure has come into place effective 1 July 2017. The organisation structure moved from a functional based model to a business unit model designed along the core areas of Aurizon Group's business, including Network, as well as central support and planning functions. Under the restructure, Infrastructure Engineering and Infrastructure Delivery services which had previously been provided by Aurizon Operations moved into Aurizon Network.* *These changes have had an impact on the FTE numbers and costs for Network. While the QCA Draft Decision has assumed that the same structure is in place for UT5 as at the time of the 2017 DAU, Aurizon Network contends it would be appropriate to update the operating cost allowance for these changes. …* *AECOM did not recommend any change to the 'Costs' allocator, as projections for the expected level of business activity for the Aurizon Group were not available and hence the projected 'Costs' allocator for future years could not be calculated. The assumption was made that the Aurizon Group would continue to operate at FY16 levels except for a slight reduction due to the Transformation Program. The 'Costs' allocator for FY17 has subsequently been calculated using the financial statements for Aurizon Network Pty Ltd and Aurizon Holdings Ltd for the year ended 30 June 2017 and was used in the preparation of the 2017 Below Rail Financial Statements. The 'Costs' allocator for FY17 was 25.0%. With the inclusion of the Infrastructure Delivery and Infrastructure Engineering*

	teams, the direct 'Costs' allocator increases to 30.7% as a result of the addition of $89.1m in costs (pre capitalisation) to both the numerator and denominator of the direct 'Costs' ratio. – Aurizon Network Response to QCA Draft Decision, p170-171.
Value Proposed	30.7%
AECOM Recommendation	**Partially Accept**
AECOM Rationale	The direct cost allocator is used to apportion some Corporate Overhead costs to Aurizon Network. Previously, when Infrastructure Engineering and Infrastructure Delivery services were part of Aurizon Operations, the cost of these teams to Aurizon Network was inclusive of a 'margin' to account for corporate overheads incurred. We understand that the costs for the Infrastructure Delivery team had previously been fully capitalised, while Infrastructure Engineering costs were partially capitalised, with non-capitalised costs charged to Aurizon Network and recognised as consumables expenses. Now that the teams have moved to within Aurizon Network, Aurizon Network has contended that, among other changes listed elsewhere, this should result in an adjustment to the direct cost allocator. In other words, that the addition of these teams should attract a higher portion of corporate overhead costs. We agree with Aurizon Network that additional staff and materials will result in an increased allocation of corporate overheads directly to Aurizon Network. We note that these costs are not new costs, and were previously paid through the 'margin' discussed above, with some expenses capitalised and others included as consumables expenses. For the Infrastructure Engineering costs, we note that a proportion of these were not previously capitalised. We consider that these costs were already incorporated into base year costs as consumables, which are included in the calculation of the cost allocator. In addition, we note that the reduction in the capital indicator relates only to Infrastructure Delivery. Therefore no additional costs for Infrastructure Engineering should be included in the cost allocator calculation. For those costs that had previously been capitalised, including them in the direct cost allocator calculation means adding the additional costs to both the numerator and the denominator, and therefore we agree with Aurizon Network's approach to this, to the extent that these costs are offset by a reduction in the capital indicator. However, of the $89.1 million increase in costs, $42.1 million relates to labour costs, so this should not be included in the direct cost allocator calculation (*"Aurizon Network direct costs % is the direct operational costs excluding labour and depreciation) of the below rail network business as a percentage of the total direct operational costs (excluding labour and depreciation) of the Aurizon Group."* – Aurizon Network Cost Allocation Manual*)*. We therefore accept the addition of the proposed value minus the proportion that is labour, as increases in labour are realised through the FTE allocator. We have noted that these costs have previously been capitalised. Aurizon Network has proposed to reduce its capital indicator to account for this and avoid double-recovery. We therefore suggest that the direct cost allocator is increased to 28.1% by adding $47 million to both the numerator and denominator of the calculation.

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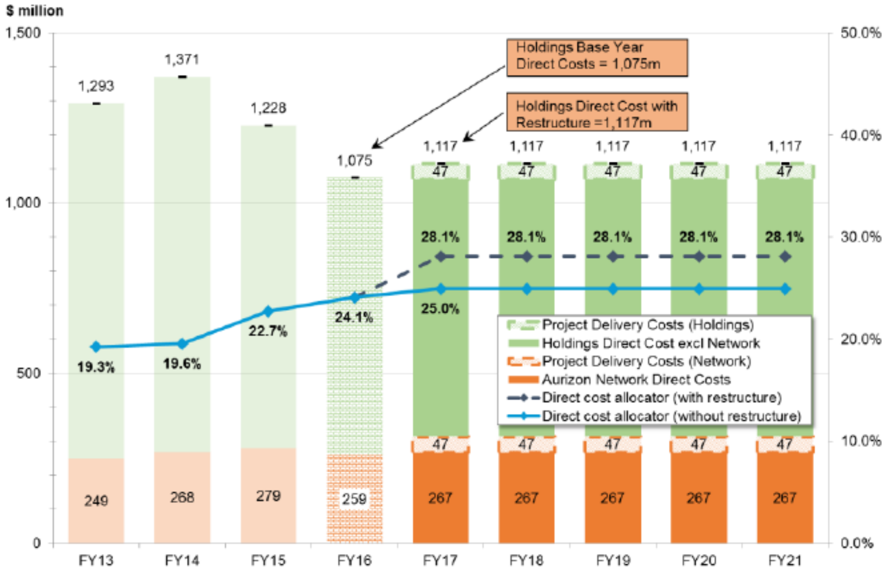
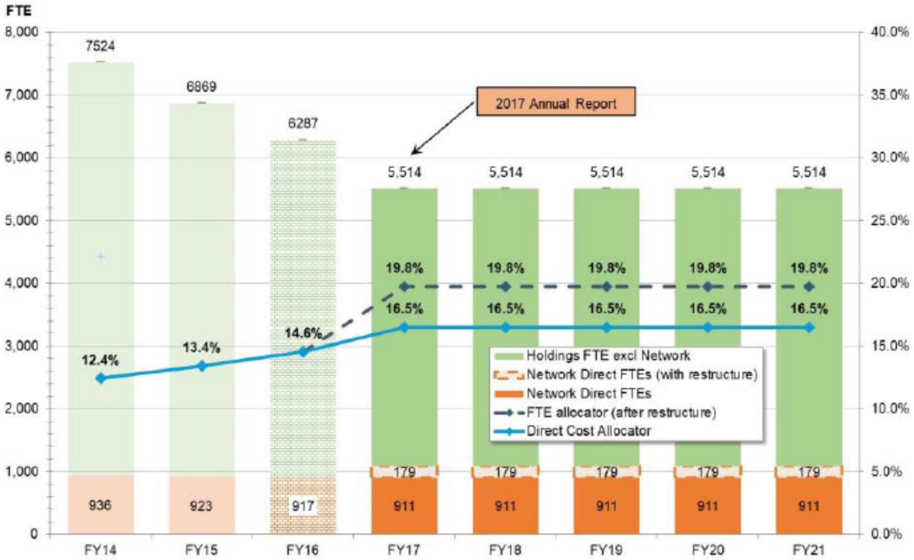


Figure 3 Corporate Overheads direct cost allocator (with restructure)

</td></tr>
<tr><td>Value Accepted</td><td>Cost allocator increased from 24.1 to 28.1%
(increase of $1.1m in FY18)</td></tr>
<tr><td>Reviewed</td><td>- Aurizon Network Response to QCA Draft Decision</td></tr>
</table>

3.4.2 Increased Corporate Overheads Allocation: FTEs and Safety

Name	Increased Corporate Overheads Allocation: FTEs and Safety
Aurizon Network Response to the Draft Decision	*"As noted on page 190 of the Draft Decision, a new Aurizon Group organisational structure has come into place effective 1 July 2017. The organisation structure moved from a functional based model to a business unit model designed along the core areas of Aurizon Group's business, including Network, as well as central support and planning functions. Under the restructure, Infrastructure Engineering and Infrastructure Delivery services which had previously been provided by Aurizon Operations moved into Aurizon Network.* *Aurizon Network notes the QCA's decision to accept the recommendation from AECOM to increase the FTE allocation % to 16.1% was based on December 2016 actuals, the latest available at the time of AECOM's review. Based on FY17 actuals, the allocation percentage increases to 16.2%. The FTE allocator increases to 21.1% with the inclusion of the Infrastructure Delivery and Infrastructure Engineering teams from the restructure discussed above." –* Aurizon Network Response to QCA Draft Decision, p170
Value Proposed	Increase from 16.2% to 21.1%
AECOM Recommendation	**Partially Accept** – exclude FTEs from Infrastructure Engineering team.
AECOM's Rationale	This allocator is used for all personnel-related Aurizon Group costs. For the Infrastructure Engineering costs, we consider that these costs have already been incorporated into the pre-restructure base year costs as the 'margin' to account for corporate overheads incurred. While we accept the principle of the FTE allocator calculation, we assume that this margin is inclusive of those corporate overhead costs that would be allocated via the FTE allocator. As a result, as these costs are already in the base year, including the Infrastructure Engineering FTE numbers in the FTE allocation calculation will result in double counting. Therefore, we consider that increasing the allocator to 19.8% is reasonable for all of the cost categories for which it has been assigned. The impact to the FTE allocator is illustrated in Figure 4.  **Figure 4 Corporate Overheads FTE allocator (with restructure)**
Value Accepted	19.8%

Reviewed	• Aurizon Network Response to QCA Draft Decision • Annual Report • FTE Staff List

3.4.3 Increased Real Estate Footprint (Corporate Premises)

Name	Increased Real Estate Footprint (Corporate Premises)
Aurizon Network Response to the Draft Decision	*"As noted on page 190 of the Draft Decision, a new Aurizon Group organisational structure has come into place effective 1 July 2017. The organisation structure moved from a functional based model to a business unit model designed along the core areas of Aurizon Group's business, including Network, as well as central support and planning functions. Under the restructure, Infrastructure Engineering and Infrastructure Delivery services which had previously been provided by Aurizon Operations moved into Aurizon Network.* *The 2015-16 base year costs increase by $9.0m as a result of the recalculation of the allocators, increase in real estate footprint of $1.4m for operational sites and $0.7m for corporate premises and the change in methodology for IT costs described below. The additional costs for corporate premises have been calculated by increasing the share of 192 Ann Street costs to 40% and 900 Ann Street costs to 21% based on 117 more FTEs being based in Brisbane." –* Aurizon Network Response to QCA Draft Decision, p170
Value Proposed	$0.7M
AECOM Recommendation	**Partially Accept** Accept increased share of costs with the rate accepted in Section 3.3.1
AECOM Rationale	We consider an increased real-estate footprint appropriate to accommodate the additional 117 FTEs that are based in Brisbane. We accept a larger share of the gross-face rental of [redacted], in line with our conclusion in Section 3.3.1.

Table 3 Increased real estate footprint

192 Ann Street	$FY18, million
Original Submission - Network Portion: 25%	$1.26
Revised Submission - Network Portion: 40%	$2.01
Difference	**$0.76**

Value Accepted	$0.76M ($FY18)
Reviewed	• Aurizon RFI Responses

3.4.4 Increased Real Estate Footprint (Operational Sites)

<table>
<tr><td>Name</td><td>Increased Real Estate Footprint (operational sites)</td></tr>
<tr><td>Aurizon Network Response to the Draft Decision</td><td><i>"As noted on page 190 of the Draft Decision, a new Aurizon Group organisational structure has come into place effective 1 July 2017. The organisation structure moved from a functional based model to a business unit model designed along the core areas of Aurizon Group's business, including Network, as well as central support and planning functions. Under the restructure, Infrastructure Engineering and Infrastructure Delivery services which had previously been provided by Aurizon Operations moved into Aurizon Network.</i>

<i>The 2015-16 base year costs increase by $9.0m as a result of the recalculation of the allocators, increase in real estate footprint of $1.4m for operational sites and $0.7m for corporate premises and the change in methodology for IT costs described below. The additional cost for corporate premises has been calculated by increasing the share of 192 Ann Street costs to 40% and 900 Ann Street costs to 21% based on 117 more FTEs being based in Brisbane."</i> – Aurizon Network Response to QCA Draft Decision, p170</td></tr>
<tr><td>Value Proposed</td><td>$1.4M</td></tr>
<tr><td>AECOM Recommendation</td><td>Accept</td></tr>
<tr><td>AECOM's Rationale</td><td>
<table>
<tr><th>Site</th><th>Services</th><th>Assessment and Rationale</th></tr>
<tr><td>1. Blackwater Depot

+$0.04M</td><td>Operational Depot
- Centralised Track Control (CTC) Building
- Track Depot
- Microwave Hut
- Trackside Systems Depot</td><td><i>Accept</i> based on the:
- increase to footprint size (5.6 to 8.0 ha)
- use of one additional building
- increased land tax</td></tr>
<tr><td>2. Emerald Maintenance Depot

+$0.03M</td><td>Maintenance Depot</td><td><i>Accept</i> based on the:
- increase to footprint size (1.5 to 2.8 ha)
- addition of Lot and Plan number 93SP127170
- increased land tax</td></tr>
<tr><td>3. Glenmore (North Rockhampton)

+$0.20M</td><td>Operational Depot</td><td><i>Accept</i> based on the:
- increase to footprint size (4.5 to 4.7 ha)
- addition of two sheds previously attributed to operations
- increased land tax, rates and corporate contracts</td></tr>
<tr><td>4. Gracemere "Overhead" Depot

+$0.05M</td><td>Operational Depot</td><td><i>Accept</i> based on the:
- increase to footprint size (0.5 to 2 ha)
- addition of approximately 30 FTEs
- addition of depot and associated facilities</td></tr>
</table>
</td></tr>
</table>

	5. Jilalan Infrastructure Depot +$0.10M	Operational Depot	*Accept* based on the: - increase to footprint size (7.0 to 10.5 ha) - addition of 8RP741153 - revised licence fees - increased land tax and council rates
	6. Rockhampton "Signal Construction" Depot Hill +$0.50M	Telecommunication	*Accept* based on the: - increase to footprint size (0.14 to 1 ha) with two additional warehouses - increased land tax, corporate contracts, electrical costs and licence costs
	7. Yukan Depot +$0.16M	Operational Depot Multi Use - Overhead Power, Plant Maintenance - Rail construction fitters	*Accept* based on the: - increase to footprint size (0.58 to 4.28 ha) with three additional warehouses - increased land tax, corporate contracts, electrical costs, rates, and licence costs
	8. Paget +$0.16M	Not available	Accept based on: - 50% of office staff now allocated to network (12 of 24 employees) - Includes corporate contracts, electricity costs, rates and land tax
	9. Stuart +$0.13M	Compound	Accept based on: - 29% of staff now allocated to network (16.4 of 56 desks) - Includes corporate contracts, electricity costs, rates and land tax
Value Accepted	$1.38M per year		
Reviewed	• Aurizon RFI Responses		

3.4.5 Summary of Changes to Corporate Overhead Costs

The total recommended adjustments to Aurizon Network's corporate overhead costs base year as a result of the corporate restructure are summarised in Table 4.

Table 4 Corporate Restructure – Accepted Adjustments

Corporate Restructure in FY18	$FY18, million
Increased Corporate Cost Allocator*	$1.12
Increased FTE allocator*	$3.42
Increased Real Estate Footprint (Corporate Premises)	$0.76
Increased Real Estate Footprint (Operational Sites)	$1.38
Total increase	**$6.68**
Aurizon Network's Proposed Increase	$9.00
Difference	**$2.32**

* FTE Allocator used for shared IT costs

In an attempt to make the restructure a relatively cost-neutral change, Aurizon Network explained that the corporate overhead margin of the Infrastructure Delivery team will no longer be capitalised in future capital projects: *"As the majority of the work performed by Infrastructure Delivery is capitalised onto projects, the corporate costs associated with this area have effectively been recovered through a capital claim, resulting in an increase in the RAB, rather than through the corporate cost allowance. That is, the payment for the services performed, including the margin, forms part of Aurizon Network's* *capital costs. The direct costs of the services performed will still be capital costs to Aurizon Network, however, it is proposed to discontinue the charging of the margin, and instead recover the corporate costs attributable to these services through the corporate cost allowance".*

The margin that is expected to be removed in the UT5 period is listed is Table 5.

Table 5 Corporate Overhead – Infrastructure Delivery

Margin to remove from Capital Indicator	FY18	FY19	FY20	FY21
Track Construction	$4.49	$4.58	$4.67	$4.67
Electrical Systems	$1.46	$1.49	$1.52	$1.52
Program Management	$0.14	$0.14	$0.14	$0.14
Total	**$6.09**	**$6.21**	**$6.33**	**$6.33**

3.5 Impact of changes to Corporate Overheads

A summary of the updated recommended corporate overhead costs (in $FY16), taking into account the changes in this section, is provided at Table 6. This represents a total of $197.33M over the UT5 period, in $FY16.

Table 6 Summary of Corporate Overhead Costs - Updated

$FY16, Million		UT5				
Cost Category	Total	FY18	FY19	FY20	FY21	Total
2016 Actual	**$51.70**	**$51.70**	**$51.70**	**$51.70**	**$51.70**	**$206.79**
AECOM Adjustments						
IT Adjustment - Remove all allocated costs	-$19.47	-$19.47	-$19.47	-$19.47	-$19.47	
IT Adjustment - Add calculated costs	$16.74	$16.74	$16.74	$16.74	$16.74	
Executive STI Bonuses	$0.60	$0.60	$0.60	$0.60	$0.60	
RFM Housing	-$0.28	-$0.28	-$0.28	-$0.28	-$0.28	
Base Year	**$49.28**	**$49.28**	**$49.28**	**$49.28**	**$49.28**	**$197.13**
Step Changes						
Transformation Savings		-$1.28	-$1.42	-$1.47	-$1.48	
Operational Sites - Decomissioned Areas		-$0.13	-$0.13	-$0.13	-$0.13	
Corporate Office Consolidation		$0.08	$0.11	$0.15	$0.19	
Corporate Office - Additional Rent		$0.00	$0.00	$0.00	$0.00	
Corporate Restructure						
Increased Real Estate - Operational Site		$1.38	$1.38	$1.38	$1.38	
Increased Real Estate - Corporate Office		$0.04	$0.07	$0.09	$0.11	
Increased Real Estate - Additional Rent		$0.00	$0.00	$0.00	$0.00	
Total Step Changes		**$0.09**	**$0.02**	**$0.02**	**$0.07**	**$0.20**
Total Efficient Corporate Costs		**$49.38**	**$49.30**	**$49.30**	**$49.36**	**$197.33**