Office of the Director of
Telecommunications
Regulation

Accounting Separation and Publication of Financial Information for Telecommunications Operators

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Decision Notice 5/99

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Consultation Report and Issues for Further Consideration

Decision No. ODTR 99/35 **May, 1999**

Oifig an Stiúrthóra Rialála Teileachumarsáide
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1. Introduction

In March 1999, the Office of the Director of Telecommunications Regulation ("ODTR") launched a consultation process in relation to accounting separation and publication of financial information for telecommunications operators. The process involved the publication of a consultation document (ODTR 99/10) in March 1999.

The consultation document specifically sought views of interested parties in the following areas: -

- Level of Accounting Separation
- Format of Accounting Separation Statements
- Transfer Charging Principles

In this paper, the ODTR sets out the report on the Consultation process, together with the decisions the Director of Telecommunications Regulation ("the Director") has made to date for the effective implementation of accounting separation in Ireland.

A major issue regarding the treatment of subsidiaries in the context of accounting separation was raised in the consultation. The Director is of the view that this matter requires further consideration and has set out her preferred approach in Annex A. She would wish to have the benefit of views from interested parties before finalising her decision on the matter.

These comments should be submitted in writing before 5.00pm on 18th June 1999 to

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2. Background

There are obligations on the Director of Telecommunications Regulation in both EU and Irish legislation to recognise that, in the interests of developing and sustaining competition in the telecommunications industry, new entrants to the market must have the facility to interconnect to the network of an incumbent operator. Under the legislation, a telecommunications operator providing fixed public telephone networks and designated as having Significant Market Power ("SMP”), is required to publish a Reference Interconnection Offer (“RIO”). The RIO must include a statement of the rates at which other licensed operators may interconnect to the SMP operator’s network. To assist in ensuring that these rates fairly reflect the associated costs, the legislation also requires transparency in and access to the accounts of such organisations. This transparency/access mandate includes "accounting separation".

Furthermore the Director may under Article 9(3) and 9(5) of the Interconnection Directive 97/33/EC obtain and publish any information she sees fit contributes to an open and competitive market, while taking account of considerations of commercial confidentiality.

The purpose of accounting separation is to provide an analysis of information derived from financial records to reflect as closely as possible the performance of parts of a business as if they were operating as separate businesses. The ODTR recognises that it is necessary for competing operators to have confidence that an SMP Operator is not unduly discriminating between itself and competing operators or between one competitor and another when providing similar services.

The aim of accounting separation is to assist in ensuring that charges are cost based, transparent and non-discriminatory. This in turn promotes a competitive environment in a number of ways, including: -

a) the publication of accounts that are transparent allow other operators to understand how the SMP operator's revenues relate to costs

b) the availability of information gives other operators the confidence that the interconnection arrangements are equitable, in that it should demonstrate that there is no over or under recovery of the SMP operator’s network costs

c) the publication of detailed cost statements showing the average cost build of products and services provided by an SMP operator will increase and raise the confidence of competitors that there are no anti-competitive cross subsidisations.

3. Consultative Process & Responses

In March 1999, the ODTR published a consultative document on Accounting Separation and Publication of Financial Information for Telecommunications Operators (ODTR 99/10). This section briefly summarises the responses received from this process and sets out the decisions made by the Director on the points made in the consultative document.

Eight organisations responded to the consultation document and the Director wishes to thank respondents and others that contributed to the process. These comments received have played a major role in informing the decisions contained in this document.

Responses were received from the following parties:-

- The Association of Chartered Certified Accountants (ACCA)
- The Chartered Institute of Management Accountants (CIMA)
- Conduit Enterprises Ltd
- Eircell Ltd
- ESAT Digifone Ltd
- ESAT Telecommunications Ltd
- OCEAN Communications Ltd
- Telecom Éireann

In summary, there was broad agreement on the need to implement an accounting separation framework for the liberalised Irish telecommunications environment that will promote effective competition in the telecommunications market place. There was agreement that this process would involve the separate identification of all elements of cost and revenue related to the various activities of the organisation, so helping to ensure transparency of internal cost transfers and discouraging cross-subsidisation between activities.

The proposals have broadly been seen to be in accordance with Directive 97/33/EC of the European Parliament and Council as transposed into Irish law by Statutory Instrument No. 15 of 1998, the EU Commission Recommendation of 8 April 1998 ("EU Recommendation") and to be consistent with practices evolving in the rest of Europe, the UK and USA.

A summary of the main issues raised by the respondents together with the Director's initial decision on the development of accounting separation are described below. Those issues relating to accounting separation that the Director believes merit further consultation are discussed in Annex A.

3.1. Appropriate Level of Accounting Separation

Most respondents agree in principle with the proposed framework as set out in the consultation paper and believe that those business areas and activities that operate at arms length from the core business should also be separated out within the framework.

It is seen as a key requirement in the disaggregation of activities to ensure that organisations with SMP cannot overcharge competitors or cross-subsidise between business activities in order to prevent or hinder competition in any particular business area. Disaggregated activities listed may need to be reviewed periodically to take account of technological and commercial developments.

In order for non-discrimination to be proved one respondent stated that it must be clear that all operators pay the same for equivalent services, as the SMP operator's retail activities are transfer charged at equivalent rates. This respondent believes that this requirement for transparency can best be met by publishing the maximum amount of information that is consistent with retaining commercial confidentiality. While they agree that the format is relevant, they believe that more detail is needed on the derivation of network costs.

Some respondents believe that in assessing the level of detail required in accounting separation, it should merely be of sufficient detail to establish the existence of cross subsidisation. SMP operators should not be obliged to disclose any additional information that would aid competing operators.

The Director believes that to promote the required level of transparency, accounting separation should apply to Telecom Éireann ("TÉ"[1]) and it's downstream retail activities. Given that other operators compete with TÉ at a retail level, it is in this area that transparency needs to be demonstrated most.

Decision 3.1

Accounting separation is applicable to TE as set out in Section 4 of this document. [2]

[1] In ODTR 99/10, it was indicated that only TE has SMP in the fixed public telephone network and services sector.

[2] Article 8(2) of the Interconnection Directive states that Member States shall require organisations operating public telecommunications networks and/or publicly available telecommunications services as set out in Part 1 (fixed public telephone network)s and Part 2 (leased line services) of Annex 1 and notified by the NRA as organisations having SMP which provide public telecommunications network and/or telecommunication services and interconnection services to other organisations, to keep separate accounts for their interconnection activities

3.2. Definitions of Main Business Areas

There was general agreement with the definitions of the four main business areas as set out in the EU Recommendation.

However, one respondent was concerned about providing a split in the local access network between business and residential. Such a split was seen as not being possible, as well as being arbitrary and meaningless given that there is no cost difference between providing a single business or a single residential line.

One respondent found it surprising that the consultation omitted to identify Eircell as having being designated as holding SMP in the mobile telephony market in Ireland. They believed that disaggregation of all activities relating to Eircell's mobile services should be defined separately. This respondent believed that if accounting separation of Eircell's activities is not a requirement, then there should at least be clear accounting separation between the activities of TÉ and its subsidiary.

Another respondent found it unclear from the description of "other activities" where the activity of Eircell and TE's other subsidiaries would be included in the framework.

One respondent believed that engineering services related to the development and maintenance of core and private networks could be considered as a business area to be separated out from the core business (i.e. the sale of interconnection services to the retail businesses and to other operators) for reporting purposes.

The Director has considered the above points. The difficulty of distinguishing between business and residential traffic is accepted, although this point may be revisited in the future. The point about subsidiaries is well taken and a new section discussing this issue is included in Annex A. The level of detail involved in reporting engineering services is considered to be too detailed with the costs of its implementation outweighing the benefits.

The Director agrees with the EU Recommendation on the definitions of the main businesses to be reported under accounting separation.

Decision 3.2

The Definitions of the Main Business Areas are as set out in Appendix I.
In summary they include Core, Local Access, Retail and Other Activities.

3.3. Definitions of Disaggregated Activities

Most respondents agreed in general with the definitions of the disaggregated activities.

There is one area where one respondent believes that the level of disaggregation requires further definition. This is in the area of Supplemental Services. This respondent noted that there are a number of enhanced and value added services which use the TE network but are not conventional PSTN services or are not currently in the TE RIO. Examples of such services are high and low speed data products such as Frame Relay, Callminder, Electronic Yellow Pages, Video and Audio-conferencing and a range of internet and multi-media products.

These supplemental services should buy or sell the underlying services – that is, receive or pay an internal transfer charge – equal to the equivalent retail price of the underlying basic telephony service. For example, the Frame Relay service would buy its leased lines at retail tariffs when it constructs its virtual private circuits. Where there is no equivalent retail price, services should be transfer charged at fully allocated costs plus a commercial return. This would ensure that there is no cross subsidisation of enhanced and advanced services or other anti-competitive pricing.

In Section 3.11 of this document, the Director has set out her approach to transfer charging, which she believes will provide the necessary transparency for all intra TE activities.

One respondent considered the principle that, non-network businesses should buy at retail tariffs, should apply to any non-telephony business, not just Supplemental Services. Failure to do so may result in little or no competition developing for such activities.

The Director believes the disaggregated activities should cover the main retail downstream activities of TÉ. She is of the view that to enable competition to flourish, there must be transparency at the retail level of TÉ's business. She therefore, considers it appropriate to include those major activities where TÉ competes in niche areas with new entrants as part of the disaggregated activities. She reserves the right to review the level of disaggregated activities as set out in this paper in light of relevant market growth or changes in product offerings by TÉ.

Decision 3.3

The Definitions of the Disaggregated Activities to be reported on in the separated accounts are set out in Appendix II.

3.4. Guiding Principles for Separated Accounts

There was general agreement with the guiding principles for separated accounts.

TÉ stated that it would make further refinements to its allocation methodologies for the 98/99 regulatory accounts and that it would not be in a position to restate the 97/98 accounts to reflect any changes in calculation or methodologies. The Director notes that a key purpose of accounting separation is to demonstrate that interconnection charges are appropriately fixed. These charges are fixed in accordance with EU and Irish law and may need adjustment for certain costs e.g. (once off costs, efficiency gains, over capacities etc.) However, in order to provide for the reconciliation of accounts, the Director agrees that the separated accounts should include all costs incurred by TÉ in the provision of the services.

The Director believes where changes in the cost allocation system results in material differences (> £1m), the prior years accounts will need to be restated to ensure a proper basis for comparative analysis. The Director agrees that the accounts should include all costs incurred by Telecom Éireann in the provision of the service. However she notes that the basis established in this way for accounting separation purposes may not be applicable to the setting of rates such as interconnection. For these she reserves the right to adjust for certain costs as appropriate e.g. (once off costs, efficiency gains, over capacities etc).

Decision 3.4

The Guiding Principles for Separated Accounts decided by the Director are set out in Section 5 of this document.

3.5. Appropriate Regulatory Accounting Principles

There was broad consensus on the principles of Cost Causality, Objectivity, Consistency and Transparency as being appropriate when preparing separated accounts. These principles are stated in Appendix III of this document.

The Director maintains the Principles as set out in ODTR 99/10.

Decision 3.5

These principles are restated in Appendix III of this document.

3.6. Format of Separated Accounts

Most respondents were in agreement with the EU Recommendation formats as presented in the consultation paper. While the formats were seen to be relevant some respondents believed that they did not contain sufficient detail.

The EU Recommendation formats split turnover for the core network business between turnover “from retail” and “other operators”. As a result, a concern was raised that any payments from Eircell to the Core Network business (e.g. for call termination on the fixed network and for the lease of any assets shared with the core network) would be bundled in with payments from all other operators. In addition the formats do not disaggregate operating costs, therefore any payments by the Core Network business to Eircell would not be disclosed.

Some respondents believed that the pro-forma statements in Appendix IV of the consultation paper should not include current cost accounting adjustments. They believe that this is not appropriate as statutory, management and regulatory accounts are not prepared on this basis. They further stated that the major accountancy bodies abandoned this concept many years ago as being neither appropriate nor meaningful to the interpretation of financial statements.

Other respondents believed that developing CCA accounts and calculating interconnection charges from them would be a valuable interim measure while LRIC costs are developed.

As indicated in ODTR 99/17, the Director is minded to follow the EU Recommendation, which recommends that interconnection charges should be calculated on the basis of forward looking long run average incremental costs (‘LRAIC’). The use of LRAIC[3] implies a cost accounting system using activity-based allocation of current costs rather than historic costs. The transition to LRIC[4] from fully allocated historical costs as the basis for determining interconnection charges would require assets to be valued at their market value (or current cost), and hence depreciation and capital employed would be on a current cost basis.

The use of current cost information is therefore a key aspect in helping to determine appropriate interconnection charges. The use of current cost information as the basis for setting interconnection charges may indeed form an interim step in the transition to LRIC.

Current Cost Accounting (“CCA”) is a methodology originally devised for financial reporting in times of rapidly changing prices where traditional Historical Cost Accounting (“HCA”) was considered inadequate. Telecommunications is an industry that experiences a rapid rate of technological change. The new technologies are usually far superior to the old technologies in terms of functionality and efficiency and may have different cost structures.

[3] Long Run Average Interconnection Costs (LRAIC): The term used by the European Commission to describe LRIC with the increment defined as the total service.

[4] Long Run Incremental Costs (LRIC): The incremental costs that would arise in the long run with a defined increment to demand.

The ODTR paper on Costing Methodologies for use in Accounting Separation (ODTR 99/26[5]) asked questions regarding the appropriateness and extent of CCA for use in the preparation of accounting separation statements.

While the overall timeframe for the development of a full CCA system may be long, as stated in ODTR 99/26, the Director is of the view that it would be possible to develop a CCA approach in a number of interim stages while taking into account any likely linkages between these stages. However, she believes that the real benefit of CCA lies in it's use for key decision making purposes eg interconnect pricing rather than for purely reporting purposes. She therefore proposes that the 1998/99 regulatory accounts do not require adjustment for CCA. For 1999/2000 onwards the Director notes that CCA values will be available from Telecom Éireann's work on it's Top Down LRIC model, and therefore requires CCA adjustments together with any adjustments in operating costs resulting from TE’s top down model to be shown where appropriate in the regulatory accounts. This does not preclude her from adjusting for LRIC when approving interconnection charges.

Decision 3.6

The separated accounts should be prepared in the format as set out in Appendix IV, which is consistent with the EU Recommendation. LRIC adjustments will be required to be shown from 1999/2000 onwards.

3.7. Publication of Other Information Prepared as part of Accounting Separation

Some respondents agreed that the additional information as set out in ODTR 99/10 should form part of the separated accounts.

Another respondent suggested that the level of detail should be such that the reporting and account separation process will not unduly disclose commercially sensitive information. In addition transfer charges in a matrix should be on the basis of total fully allocated costs.

One respondent sees the current absence of both the cost data for interconnection services and the information on how it has been derived as one of the principal factors leading to uncertainty in the transparency of interconnection charges. They felt this means that the need to publish should override the need for commercial confidentiality.

Another respondent would like to see publication of the full details of operating, capital and unit costs of network components and how the costs of interconnection services are derived from them and in addition, a detailed description of the cost allocation methodology. The publication of the methodology would increase the confidence of the industry that costs of interconnection services are being calculated in an appropriate way.

In the light of developments in self regulation and Corporate Governance, one respondent believes that an audited compliance statement, disclosing whether the accounts had been

[5] Costing Methodologies for use in Accounting Separation, Consultation Paper

prepared in accordance with recommended practice in relation to costing and transfer charges, would be more appropriate and useful to the users of accounts than if the information referred to in Section 6.1 of the consultation document were to be published by itself. They believe this would take into consideration the need for operators to demonstrate openness and transparency balanced against regulators acknowledging the commercial confidentiality of the proposed information to be produced.

The Director is of the view that the separated accounts on their own is at too consolidated a level to satisfy the requirements of transparency and aid competition. She believes additional detailed information on the costs incurred by TÉ and it's relationship with it's own retail arm is essential to deliver the required transparency for effective competition. The additional information to be published will include:

a) a statement of the accounting policies used in the preparation of the accounts.
b) a matrix summarising the total transfer charges between the different Accounts
c) a statement describing the basis on which unattributable costs have been allocated between different accounts.
d) information about the cost allocation methodologies employed in order to prepare separate accounts. This should be at a level of detail that makes clear the relationship between costs and interconnection charges.
e) a statement showing the average cost of network components.

The EU Recommendation does not detail the information to be disclosed in the statement of the average cost of network components. This is considered further below.

Decision 3.7

Telecom Éireann will publish additional information items as set out above, alongside its separated accounts.

3.8. Statement of Average Cost of Network Components

A range of views were expressed in response to the proposals made. Most respondents favoured at least the level of disclosure proposed in the consultation paper.

Concern was raised by two respondents that the proposed information for publication for the average cost of network components does not distinguish between competitive and non-competitive services. They noted that the objective of accounting separation is to provide an analysis of costs and revenues of separate businesses and publication of this information in order to promote a competitive environment. They believe that where the market is already competitive such as directory enquiries, international services and other value added services the publication of additional average cost of network components goes beyond what is required to ensure no cross-subsidisation and puts TÉ at a competitive disadvantage in these markets.

One respondent maintained that the average costs of network components should be published only for services where an operator has SMP and where the market would not be considered to be fully competitive.

One respondent agrees in principle to such a statement being published as long as such information is comparable and standard at an international level (EU) so that an entity is not competitively disadvantaged as a result.

Another respondent disagrees and believes the statement should contain information on operating and capital costs, allowed return and component volumes. They believe that separated accounts would fail to meet the need for transparency and non-discrimination unless the published statements contain sufficient detail on the unit costs of network, and how these costs make up both interconnection services and internal transfer charges.
This respondent agrees with the proposed breakdown of information in the statement of average network costs as proposed in Section 6.1 of the consultation document. However they believe that 3 schedules are needed, to show:-

(1) the derivation of the average cost of network components,
(2) the use of these components by standard interconnection services, and
(3) the use of these components by TE's retail activities.

In addition the point was made that circuits are a major cost to other operators, and it is important that these charges are seen to be cost based. The variety of different ways in which interconnection circuits may be provided and the range of equipment needed to supply them may prevent a meaningful calculation of average unit costs, as would be expected for conveyance network components. However the costs (and therefore prices) for interconnection circuits are derived from the same accounting system, and the same basket of costs. The separated accounts should therefore contain an audited statement of the total costs of the main types of interconnection circuit.

Respondents generally felt the rate of return on capital employed used to calculate interconnection charges should not be confidential, as it is a very important part of interconnection charges. One respondent believes there should be a public debate on this issue. This issue is being considered in detail in the ODTR's consultation on the Reference Interconnect Offer- ODTR 99/16.

The Director is of the view that a detailed statement of the costs of all network components is an essential element of ensuring transparency and promoting competition.

She believes this statement should be sufficiently detailed to show that Telecom Éireann's own downstream arm is not treated more or less favourably than other operators. She further believes that this is particularly important at the current stage of the market development. The level of traffic Telecom Éireann generates is required by the ODTR for interconnect negotiations, but will not be required to be published for reasons of commercial confidentiality.

Decision 3.8

TÉ shall publish a statement of network component costs, as part of accounting separation information and this will contain the following information:

- **average per minute cost of each conveyance network component (inclusive of WACC)**
- **average per minute cost of each non-conveyance network component**
- **routing factors for traffic**
- **Time of Day Gradients**
- **Final Charges**
- **Reconciliation (if different to Telecom Éireann internal transfer charges)**

Pro forma schedules are set out in Appendix V (Network Statement of Costs) and Appendix VI (Statement of Costs of Network Services – Transfer to Retail and Other Activities). A further schedule on volume information will be provided for ODTR use only.

For confidentiality reasons, the Director believes that the "volume" information prepared as part of the statement of network costs is commercially sensitive to Telecom Éireann and will remain confidential to the ODTR. If however, the Director feels that publication would aid the development of competition, she may do so.

3.9. Additional Explanatory Information

In general respondents were in agreement with the publication of additional explanatory information as outlined in ODTR 99/10 and in the decision notice 3.9. Two respondents maintained that the additional explanatory information as set out in ODTR 99/10 should assist in the understanding of the accounts and should not oblige operators to reveal commercially sensitive information.
Another respondent believes that the additional explanatory information set out in the consultation paper together with a compliance statement in relation to the production of the separated accounts for audit purposes should be sufficient to give interested parties reassurance of the credibility of the information contained in the separated accounts.

The Director has considered these points carefully and remains in agreement with position as outlined in ODTR 99/10. She believes this information will help operators gain a good understanding of the separated accounts and the principles followed in their completion.

Decision 3.9

The additional explanatory information to be published should consist of the following:

i) a statement of the regulatory accounting principles followed when preparing the Accounts
ii) complete definitions of the main business areas and their disaggregated activities
iii) a description of the transfer charging system that is operated for accounting separation
iv) details of significant changes which impact on the financial statements and on comparative figures

3.10. Proposed Timeframe for Publication of Separated Accounts and Financial Information

A range of views were expressed by respondents on this subject.

One respondent believes that the timeframe to produce separate accounting information "within two months after the annual statutory financial statements and within four months after the period to which they relate" is too long and that a shorter timeframe should be set if such information is to be useful to users of the financial statements, and suggested publication:-

- within the time scale of the annual statutory accounts, and
- within two months of the period to which it relates

Another respondent agrees with the timetable, but wishes to see clarification on how the issue of retrospection will be handled. They noted that an important feature of basing interconnection charges on actual cost is the issue of retrospection. The question of retrospection affects the actual interconnect rate and this matter is dealt with in a separate paper (ODTR 99/16) on the Reference Interconnect Offer. In relation to publication, the most up to date information will be used in the published accounts. As indicated in Section 3.4, where there is a change of <£1m, the accounts will be restated.

TE noted that for the 98/99 financial year there is a 6-month timeframe for production and publication of accounts. While this is a very challenging timeframe the company expects, with the assistance of external consultants, to be able to adhere to this timeframe. For the 1999/2000 accounts the consultation paper recommends either two months after publication of statutory or four months after the financial year-end for publication of regulatory accounts. TE sees the timeframe for 1999/2000 as unachievable for the following reasons:-

- The regulatory accounts depend on finalisation of the statutory accounts before data can be loaded into the accounting separation models. Two months is not sufficient to complete the statutory accounts and audit.

- For 1999/2000 regulatory accounts a new financial system will be put in place to replace the existing stand-alone system. The financial system will be in process of implementation during the production of the accounts. While it is difficult in 1998/99 to produce accounts in six months it will be even more difficult in 1999/2000. In following years with new systems in place and experience build up it should be possible to shorten the timeframe.

TE considers that a six month timeframe from the end of the financial year is a more practicable timeframe to produce robust separate accounts.

The Director is of the view that for accounting separation to be effective, the information published should be timely. Unnecessary delay in the publication of the accounts and the additional financial information would reduce the positive effects of accounting separation. She accepts that for the first year's operation, six months, though long, is an acceptable timeframe for publication.

She is of the view that for subsequent years, the introduction of new financial systems in TE should improve the timeliness rather than, as TE state, further delay production of separated accounts. She recommends that Telecom Éireann take steps in the implementation of their new financial systems to ensure the production of separated accounts is catered for in the time scale set out below.

Decision 3.10

For the first year operation (1998/1999), accounting separation information is to be published within six months after the end of the period to which it relates. Thereafter (1999/2000 and future years) accounting separation information is to be published within two months after the date on which the SMP operator's annual statutory financial statements are published and, in any event within four months after the end of the period to which they relate.

3.11. Principles for a Transfer Charging System

Most respondents endorse the principles laid down in Section 7 of the consultation paper in relation to a transfer charging system for accounting separation purposes.

One respondent believes that it should be extended to ensure that all business other than TE's defined retail business activities should be transfer charged for network services at retail tariff or an equivalent. This principle should in fact apply to any internal sale for any product or service between separated businesses, with the exception of network services to TE's retail. This is necessary to ensure that TE is not unfairly cross-subsidising any of its businesses.

The Director is of the view that to ensure no preferential treatment is given to businesses within the Telecom Éireann group, charges for internal use for any product/service should be equivalent to the charge that would be levied if the product or service were sold externally rather than internally.

Proposed details of internal transfers to be prepared along with the separated accounts as set out in Appendix VIII and IX.

The Transfer Charging Principles to be followed are set out below:-

- Transfer charges (revenues and costs) shall be attributed to cost components, services and main business areas or disaggregated businesses in accordance with the activities, which cause the revenues to be earned, or costs to be incurred.

- The attribution shall be objective and not intended to benefit any business or disaggregated business.

- There shall be consistency of treatment of transfer charges from year to year.

- The transfer charging methods used should be transparent. There should be a clear rationale for the transfer charges used and each charge should be supportable.

- The transfer charges for internal usage should be determined as the product of usage and unit charges.

- The charge for internal usage should be equivalent to the charge that would be levied if the product or service were sold externally rather than internally. For accounting separation purposes, it should be assumed that the retail business pays the same interconnection charge for the same service as set out in the RIO, if different this charge must be appropriately justified.

- The separated accounts shall disclose the transfer charges between businesses and disaggregated businesses.

Decision 3.11

The Transfer Charging Principles decided by the Director are as set out above

4. Level of Accounting Separation

This section sets out the level of disaggregation that is required for the published separated accounts ("Accounts") of applicable organisations**.** The ODTR believes that the publication of sufficiently detailed financial information will increase transparency and clearly show that there is no cross subsidisation between the activities of an SMP operator. Balanced against the requirement to promote increased transparency and a competitive environment is the need to consider concerns over the commercial confidentiality of the information.

Consideration of the applicable National and EU legislation, the Recommendation and comments from interested parties, has resulted in the decision by the Director to require applicable organisations to publish separate accounting information for the following main business areas:-

a) Core Network

b) Local Access Network

c) Retail

d) Other Activities

A definition for each of the above business areas is set out in Appendix I[6]. The Accounts of the main business areas should be consolidated into a summarised set of Accounts.

The Recommendation suggests that the publication of Accounts for the disaggregated activities of the above main business areas would further increase transparency and assure other operators that there is no discrimination in the provision of services to the SMP Operator's own retail arm and other operators. The Recommendation also suggests that reconciliations between the Accounts and the Statutory accounts.

In the light of this Recommendation and responses received from interested parties, it is the Director's view that a framework for the disaggregation of activities will take the following format:

1) Consolidated Accounts

a) Core Network

b) Local Access Network

c) Retail

    i) Retail – Local Calls
    ii) Retail – National Calls

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[6] These definitions are as set out in the EU Commission Recommendation of 8th April 1998 on interconnection in a liberalised telecommunications market Part 2 – Accounting separation and cost accounting.

iii) Retail – International Calls
iv) Retail – Directory Enquiry
v) Retail – Public Payphones
vi) Retail – Lease Lines
vii) Retail – Calls To Mobile
viii) Retail – Internet
ix) Retail – Supplemental Services Business
x) Retail – Remaining activities

d) Other Activities

i) Other – Apparatus Supply
ii) Other – Remaining Activities

Set out in Appendix II are definitions for the above disaggregated activities of Retail and Other.

It will be necessary to publish reconciliation statements in conjunction with the Accounts. These reconciliations will be:-

a) between the Statutory accounts of the organisation and the Consolidated Accounts of the main business areas.
b) between the Consolidated Accounts of the main business areas and the Accounts of the main business areas (e.g. Retail).
c) between the Accounts of the main business areas (e.g. Retail) and their disaggregated activities (e.g. Local Calls, National Calls).

5. Format of Accounting Separation Statements

The preparation of the Accounts should follow the set of guiding principles set out below:-

a) The separated accounts shall be based on a transparent cost apportionment methodology.

b) The separated accounts shall include transfer charges between the main business areas and the disaggregated activities for services the organisation provides to itself. They shall also disclose the equivalent transactions with competing operators.

c) The separated accounts shall be prepared in accordance with accepted accounting standards insofar as they are relevant.

d) The separated accounts shall be prepared in accordance with the Regulatory Accounting Principles, which set out the general rules by which the financial statements are prepared. These principles are set out in Appendix III.

e) Details of significant changes that impact on the financial statements and prior year restatements shall be given.

f) Separated accounts shall be published annually and contain comparative information. Where there are material changes to Regulatory Accounting Principles, Cost Allocation Methodology, Attribution Methods, or to Accounting Policies that have a material effect on the information reported in the separated accounts of a main business area or a disaggregated activity, the parts of the previous year’s separated accounts affected by the changes shall be restated.

g) The separated accounts shall make explicit, any differences between costs allocated to different activities by the operator and the costs that the ODTR allowed for the purpose of determining charges.

h) The separated accounts shall be subject to an audit, in accordance with the relevant rules of Irish legislation.

The Profit and Loss formats disclose Turnover (split between internal and external provision of services for the Network businesses, and connection fees, rentals and call charges for the Retail businesses), Operating Costs and Transfer Charges. Access Deficit and Universal Service contributions are also shown. The return (profit / loss) is calculated on the same basis as the cost of capital i.e. if a pre-tax and pre-interest WACC is used, the return in the accounts would be before interest and tax.

The Balance Sheet format includes a breakdown of Fixed and Current assets, as well as totals for Creditors and Provision for Liabilities and Charges. The Balance Sheet figures are the average values for the period to which the Balance Sheet relates. This average should ideally be a weighted average value, although a simple average value of opening and closing balances could initially be used.

5.1. Publication of Confidential Financial Information

The Director may request detailed financial information at any time from an operator designated as having SMP status. This information may be published, if she considers it would contribute to an open and competitive market subject to the consideration of its commercial confidentiality.

The process of determining an appropriate balance between contributing to an open and competitive market and the commercial confidentiality of the information is not a straightforward matter. The information to be provided on foot of this decision will open up for the first time, a great deal of detailed information on the main businesses within TE and the relationships between them. The Director believes that the right balance has been struck between the provision of information and the commercial interests of TÉ. A further decision will follow on the question of subsidiaries outlined in Annex A.

5.2. Duration

This Decision will be subject to review and amendment from time to time. In particular, it is the Director's intention to carry out a brief review after a year of operation, with a rather more extensive review after 3 years.

5.3. Related Issues

This paper is one of a series of linked papers that the ODTR is issuing during 1999. The issues raised in these papers are closely related and the outcome of each consultation will impact on others.

Interested parties are referred to the following consultation documents:

The Development of Long Run Incremental Costs for Interconnection (ODTR 99/17[7]): Consultation paper published in March 1999, comments requested by 30th April 1999, proposed report on consultation in May 1999

A key issue that has been the subject of much discussion throughout Europe is the basis on which interconnection costs are calculated. In line with best practice throughout Europe and in particular Part 1 of the European Commission Recommendation on Interconnection (98/195/EC), the Director considers LRIC based costing to be the most appropriate basis to be used.

This consultation is seeking views on the different methods of implementing LRIC and how they may be best applied in Ireland's liberalised environment.

Costing Methodologies for use in Accounting Separation (ODTR 99/26): Consultation paper published in April 1999, comments requested by 28th May 1999, proposed report on consultation in June 1999

This paper considers the recommendations set out in Part 2 of the Commission Recommendation on Interconnection (98/322/EC), and addresses the appropriate methodology to be applied in establishing appropriate cost drivers and allocation methods to be used primarily for accounting separation purposes.

[7] The Development of Long Run Incremental Costing for Interconnection, Consultation Paper

Appendix I – Definitions of Business Areas

Core Network
The Core Network business provides a range of interconnection services internally and externally in order to allow the customer of one operator to communicate with customers of the same or another operator, or to access services provided by another operator. These services include the switching and conveyance of calls. In addition, the Core Network business may provide other services to operators e.g. such as engineering services related to the development and maintenance of private networks.
The accounts for the Core Network business will include the costs, revenues and capital employed associated with the provision of these services. The revenues of the Core Network business will derive principally from the sale of interconnection services to the Retail business and to other operators.

Local Access Network
The Local Access Network provides connections to the Core Network. The accounts for the Local Access Network business will include the costs and capital employed associated with providing and maintaining these connections. For accounting separation, the Local Access Network business will include all the customer-dedicated components of the network including, for example, the line cards and ports located at concentrators and/or exchanges. The Core Network business will include all other network components. Customer line rental will be a service provided by the Retail business. The revenue from line rental provided to end users will therefore be recorded in the Retail accounts. The cost of providing customer lines will be recorded against the Local Access Network business and there will be a transfer charge of costs to the Retail business in order to match revenues with their associated costs. The costs transferred to Retail should be net of any possible local access revenue.

Retail
The Retail business includes all those activities involving the selling of telephony services to end-users, including line rental, leased lines, calls, payphones and the provision of directory information.
The accounts for the Retail business will include the costs, revenues and capital employed associated with the provision of these services to end-users. The costs allocated to Retail will include transfer charges related to the use of network resources or services provided by Local Access Network and the Core Network businesses, and the marketing and billing costs associated with the provision of end user services.

Other Activities
Operators typically provide a wide range of other services including the rental, repair and maintenance of customer equipment. In addition, they may have interests in non-telecommunications activities. For the purposes of accounting separation, the costs, revenues and capital employed associated with these activities will be separately identified. The Director has included in the "Other " category, subsidiary activities of Telecom Éireann in line with para. 1.4 of the EC Recommendation of 8/4/98 on accounting separation.

Appendix II – Definitions of Disaggregated Activities

Retail – Local Calls

Local dialled calls originating from ordinary, ISDN and private payphone telephone exchange lines.

Retail – National Calls

Dialled calls charged at regional and national tariff rates originating from ordinary, ISDN and private payphone telephone exchange lines.

Retail – International Calls

Continental, Intercontinental calls and Northern Ireland calls originating from ordinary, ISDN and private payphone telephone exchange lines. This also includes receipts from overseas telecommunications operators and cashless calling.

Retail – Directory Enquiry

Inland and international calls placed with the operator to obtain information about Irish and overseas telephone numbers, whether made from business or residential telephone exchange lines or from public payphones and includes calls made to the Directory Enquiry database.

Retail – Public Payphones

Local, national and international dialled calls, originating from public payphones, using cash, phone cards or credit cards.

Retail – Leased Lines

Business of rental, maintenance, connection and change of inland and international lease lines beyond customers' premises and which have access to the public switched network (PSTN).

Retail – Calls To Mobile

Dialled calls originating on ordinary and private payphone lines that terminate on a mobile, not fixed, network. This also includes revenue from calls originating from public payphones.

Retail – Internet

Calls to the internet originating from ordinary and ISDN telephone exchange lines.

Retail – Supplemental Services Business

The Business relating to the supply of certain data and value added services.

Examples of these services are data networks, messaging services, mobile messaging communications, fax network services, electronic information services, broadcast and visual services, internet multimedia services, managed answering services and telemarketing.

Retail – Remaining Activities

All other telecommunications services that are within the Retail Business.

Other – Apparatus Supply

The Business relating to the rental and sale of customer premises equipment in the Republic of Ireland.

Other – Remaining Activities

All other remaining activities .

Appendix III – Regulatory Accounting Principles

The following Regulatory Accounting Principles should be applied when preparing the Separate Accounts.

- Priority: within the Regulatory Accounting Principles, insofar as there is conflict between the requirements of any or all of these Principles, the Principles are to be applied in the same order of priority in which they appear in this document.

- Definitions: Any word or expression used in the Accounting Documents shall, unless the context otherwise requires, have the same meaning as it has in the Licence.

- Cost Causality: Revenue (including transfer charges), costs (including transfer charges), assets and liabilities shall be attributed to cost components, services and businesses or disaggregated businesses in accordance with the activities which cause the revenues to be earned or costs to be incurred or the assets to be acquired or liabilities to be incurred.

- Objectivity: The attribution shall be objective and not intended to benefit the SMP operator or any other Operator, product, service, component, Business or disaggregated business.

- Consistency of treatment: There shall be consistency of treatment from year to year. Where there are material changes to the Regulatory Accounting Principles, the Attribution Methods, or the Accounting Policies that have a material effect on the information reported in the Financial Statements of the Businesses, the parts of the previous year's Financial Statements affected by the changes shall be restated.

- Transparency: The Attribution Methods used should be transparent. Costs and revenues, which are allocated to Businesses or activities, shall be separately distinguished from those that are apportioned.

Appendix IV – Office of the Director of Telecommunications Formats

Reporting format for the Core Network Business

PROFIT AND LOSS

			Current Period		Prior Period
Turnover:					
	From Retail		X		X
	Other operators		X		X
Total Turnover			X		X
Operating Costs		X		X	
LRIC Adjustments[8]		X		X	
Total Operating Costs			X		X
Return[9]			X		X

Return on Capital Employed

	Current Period	Prior Period
Return	X	X
Mean Capital Employed	X	X
Return on Mean Capital Employed	X%	X%

[8] LRIC Adjustment. This includes the change to historical costs arising from the revaluation of assets on a current cost basis. In the statements for individual business areas the adjustments comprise the unrealised holding gains or losses arising from changes in asset values, together with the effect on asset values and depreciation of the appropriate allocation of modern equivalent assets between businesses. It also includes any adjustments to operational costs arising from the introduction of LRIC within TE.

[9] The calculation of the return should be consistent with the basis on which the cost of capital is calculated.

Appendix IV (Contd.)

Reporting format for the Core Network Business[10]

BALANCE SHEET as at

	Current As at	Prior As at
Fixed assets		
Tangible fixed assets	X	X
Intangible fixed assets	X	X
Investments	X	X
Total fixed assets	**X**	**X**
Current assets		
Stocks	X	X
Debtors	X	X
Investments	X	X
Cash at bank and in hand	X	X
Total current assets	X	X
Creditors	(X)	(X)
Provisions for liabilities and charges	(X)	(X)
Mean capital employed	X	X

[10] All entries in the "balance sheet" should be average values for the year to which they relate. Where possible and material the average values shown should be weighted averages. If information is not available, a simple average of opening and closing balances may initially be used

Appendix IV (Contd.)

Reporting format for the Local Access Network Business

PROFIT AND LOSS

		Current Period		Prior Period
Turnover:				
Transfer charges to Retail		X		X
From other operators (if any)		X		X
Total Turnover		X		X
Operating Costs	X		X	
Total Operating Costs		X		X
Return (excluding ADCs[11], if any)		X		X
ADCs (if any)				
From other operators		X		X
From Retail		X		X
Total ADCs		X		X
Return (including ADCs, if any)		X		X

Return on Capital Employed

As for Core Network

BALANCE SHEET

As for Core Network

[11] Access Deficit Contributions (ADCs) - Contributions payable by other licensed operators and the Retail Businesses to the Access Business for losses it sustains on the provision of services on the access network.

Appendix IV (Contd.)

Reporting format for the Retail Business[12]

PROFIT AND LOSS

		Current Period	Prior Period
Turnover			
	Connection charges	X	X
	Rental charges	X	X
	Call Charges	X	X
Other turnover		X	X
Total Turnover		X	X
Operating Costs:			
	Operating costs specific to Retail	X	X
	Transfer charges from Core Network	X	X
	Transfer charge from Local Access Network	X	X
	ADCs paid to Local Access Network (if any)	X	X
Total operating costs		X	X
Return (excluding Universal Service Contributions, if any)		X	X
Universal Service Contributions from other operators (if any)[13]		X	X
Return (including Universal Service Contributions, if any)		X	X

Return on Capital Employed

As for Core Network

BALANCE SHEET

As for Core Network

[12] The same format would apply to separate regulated activities within Retail, if applicable.
[13] Universal Service Contributions applied internally would net off to zero and are therefore not shown in the profit and loss for Retail.

Appendix IV (Contd.)

Reporting format for the Other Activities

PROFIT AND LOSS

		Current Period	Prior Period
Turnover		X	X
Operating Costs:			
	Operating costs specific to Retail	X	X
	Transfer charges from Core Network	X	X
	Transfer charge from Local Access Network	X	X
	ADCs paid to Local Access Network (if any)	X	X
Total operating costs		X	X
Return		X	X

Return on Capital Employed

As for Core Network

BALANCE SHEET

As for Core Network

Appendix V – Network Statement of Costs

	Operating Costs IR£	Capital Employed IR£	Rate of Return %	Capital Costs IR£	Total Operating and Capital Costs IR£	Total Volume Minutes	Average Cost Pence/Minute
Traffic Sensitive							
Subscriber Unit	X	X	X	X	X	X	**X**
Primary Switch	X	X	X	X	X	X	**X**
Secondary Switch	X	X	X	X	X	X	**X**
Tertiary Switch	X	X	X	X	X	X	**X**
Transmission - Non-Length Dependent							
RSU to Primary/Secondary Link	X	X	X	X	X	X	**X**
Primary to Primary Link	X	X	X	X	X	X	**X**
Primary to Secondary Link	X	X	X	X	X	X	**X**
Secondary to Secondary Link	X	X	X	X	X	X	**X**
Secondary to Tertiary Link	X	X	X	X	X	X	**X**
Tertiary to Tertiary Link	X	X	X	X	X	X	**X**
Transmission - Length Dependent *(Split as above)*							
International Transmission	X	X	X	X	X	X	**X**
Directory Enquiry	X	X	X	X	X	X	**X**
International Directory enquiry	X	X	X	X	X	X	**X**
Private Circuits\Leased Lines	X	X	X	X	X		
Interconnect connections and rentals	X	X	X	X	X		
Other categories will be included as appropriate	X	X	X	X	X	X	**X**
Total Conveyance	X	X	X	X	X	X	**X**

Appendix VI – Statement of Costs of Network Services

	Traffic Sensitive	Subscriber Unit	Primary Switch	Secondary Switch	Tertiary Switch	***Non-Length Dependent***	RSU to Primary/Secondary	Primary to Primary Link	Primary to Secondary Link	Secondary to Secondary Link	Secondary to Tertiary Link	Tertiary to Tertiary Link	***Length Dependent***	(Split as above)	International Transmission	Directory Enquiry	International Directory enquiry	Private Circuits\Leased Lines	Interconnect connections and rentals	Other cost categories will be included as required
Average Cost Pence/Minute[14]		**X**	**X**	**X**	**X**		**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**			
Total Costs[15]															**X**	**X**	**X**	**X**	**X**	**X**
Usage Factors (Routing or Percentage)																				
Retail Services																				
Local Calls	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
National Calls	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
International Calls	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
(Other retail services as appropriate)																				
Other Activities Services																				
Apparatus Supply	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
(Other services as appropriate)																				
RIO Services																				
Call Termination																				
Primary	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Tandem	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
(Other RIO services as appropriate)																				

[14] From Statement of Network Costs Schedule
[15] Ibid

Appendix VI (Contd.) – Statement of Costs of Network Services

	Traffic Sensitive	Subscriber Unit	Primary Switch	Secondary Switch	Tertiary Switch	***Non-Length Dependent***	RSU to Primary/Secondary Link	Primary to Primary Link	Primary to Secondary Link	Secondary to Secondary Link	Secondary to Tertiary Link	Tertiary to Tertiary Link	***Length Dependent***	(Split as above)	International Transmission	Directory Enquiry	International Directory enquiry	Other cost categories will be included as appropriate		Gradient	**Call Conveyance Cost**
Average Cost Per Minute																					
Retail Services[16]																					
Local Calls		X	X	X	X		X	X	X	X	X	X		X	X	X	X	X	Peak	**X**	**X**
																			Off - peak	**X**	**X**
																			Weekend	**X**	**X**
National Calls		X	X	X	X		X	X	X	X	X	X		X	X	X	X	X	Peak	**X**	**X**
(Other retail services as appropriate)																			Off - peak	**X**	**X**
																			Weekend	**X**	**X**
Other Activities Services																					
Apparatus Supply		X	X	X	X		X	X	X	X	X	X		X	X	X	X	X	Peak	**X**	**X**
(Other services as appropriate)																			Off - peak	**X**	**X**
																			Weekend	**X**	**X**
RIO Services																					
Call Termination																					
Primary		X	X	X	X		X	X	X	X	X	X		X	X	X	X	X	Peak	**X**	**X**
																			Off - peak	**X**	**X**
																			Weekend	**X**	**X**
Tandem		X	X	X	X		X	X	X	X	X	X		X	X	X	X	X	Peak	**X**	**X**
(Other RIO services as appropriate)																			Off - peak	**X**	**X**
																			Weekend	**X**	**X**

[16] Those costs are obtained from multiplying the average cost per minute by the usage factors, both of which are shown on page 34. These costs reflect the conveyance element of the service only.

Appendix VII – Transfer Charge Statement

Costs/Services	***Retail Services***	Local Calls	National Calls	International Calls	Directory Enquiry Services	Public Payphones	Lease Lines	Calls to Mobile	Internet	Supplemental Services Business	Remaining	***Other Activities Services***	Apparatus Supply	Remaining Activities
Network Cost	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Local Access Costs	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Other Operating Costs	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Total Transfer Charges	X	X	X	X	X	X	X	X	X	X	X	X	X	X

Appendix VIII – Inter Business Costs Summary

From /To	Access IR£	Network IR£	Retail Systems IR£	Other Activities IR£	Total IR£
Access		X	X	X	**X**
Network	X		X	X	**X**
Retail	X	X		X	**X**
Other	X	X	X		**X**
Total	**X**	**X**	**X**	**X**	**X**

Annex A – Issues for Further Consultation

A) Definitions of Main Business Areas

There was general agreement for the definitions of the four business areas set out in the EU Recommendation for publication of accounts.

As noted in the main report the question of accounting separation in respect of subsidiaries was raised by respondents.

The Director agrees with the Commission Recommendation of 8th April 1998 on the definitions of the main business to be reported under accounting separation. She further believes it is important that transparency is demonstrated in these areas and therefore that the subsidiary activities of Telecom Éireann should be part of the "Other Activities " category.[17]

Q A.1 Do you agree that the separated accounts should include the main subsidiary activities of Telecom Éireann within the "Other Activities" category.

If you disagree, please give reasons why.

B) Definitions of Disaggregated Activities

Concern was also expressed that all subsidiary or "downstream" activities of firms with SMP should be disaggregated, including publication of telephone, classified and other directories, paging services, internet services, mobile activities, burglar alarm services, and other services, which compete in niche areas with non-SMP firms.

Given the very strong response on this issue, the Director believes that to promote the required level of transparency, accounting separation should apply to Telecom Éireann and it's downstream retail activities, including those operating through subsidiaries. Given that other operators compete with Telecom Éireann at this retail level, it is in this area that transparency needs to be demonstrated most.

The Director proposes that the "Other Activities" category should be further disaggregated to show separately the main subsidiary activities of Telecom Éireann. Initially, her view is the Eircell and Indigo should be disaggregated within this category.

Q B.1 Do you agree that both Eircell and Indigo be shown separately in the separated accounts.

If you disagree, please give reasons why.

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[17] Commission Recommendation of 8/4/98 on interconnection in a liberalised telecommunications market Part 2 - Accounting separation and cost accounting S (2)

Q B.2 Are there any other subsidiary activities which should be disaggregated?

C) Statement of Average Cost of Network Components

In view of the above and the disaggregation of the subsidiary activities, the Director's view is that it is appropriate to include the subsidiary activities as part of the Statement of Average Cost of Network Components.

Q C.2 Do you agree that the diaggregated subsidiary activities should form part of the statement of Average Network Component Costs.

If you disagree, please give reasons why?

D) Principles for a Transfer Charging System - Subsidiaries

Many respondents felt that publication of information in this area would be of most benefit to them in assessing the transparency and non-discrimination relationship between themselves and Telecom Éireann and between TE and it's own subsidiary activities. The Director has set out in Section 3.11 her principles of transfer charging including that it is applicable to all products and services purchased internally in Telecom Éireann.

However, she believes that disaggregated information on internal operational costs and activities are confidential to Telecom Éireann. To ensure the principles of transparency and non discrimination are adhered to, she has set out detailed statements of the internal operational costs and relationships between TE and it's subsidiaries, which are to be provided to the ODTR only, as apart of the separated accounts.

Q D.1 Do you agree with this approach?

If so, please set out your reasons, and any intermediate position that you consider may be appropriate in the absence of full publication.